Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Effects of IFRS 16 on the European Public Good

Analysis by Leaseurope

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Introduction

This year the European Union will decide whether to endorse the new lease accounting standard, IFRS 16, for use in Europe by listed companies and other public interest entities that follow international standards. Under Regulation 1606/2002, it must be proven before IFRS 16 can be adopted that it is "conducive to the European public good".[1]

Factors used to consider this test include whether IFRS 16 would endanger financial stability, whether it would hinder EU economic development, the impact of the new standard on the competitiveness of European undertakings, and whether it has 'added value' for the European Union.

The Commission requested endorsement advice from the European Financial Reporting Advisory Group (EFRAG) and EFRAG has carried out an effects analysis. EFRAG's advice on whether IFRS 16 is conducive to the European public good supplements its assessment of IFRS 16 against the technical endorsement criteria in the IAS Regulation.

Leaseurope considers there are potential effects of IFRS 16 relevant to the 'public good' test that are not covered by EFRAG's analysis and advice. Details are set out in this paper. Further work may be needed to confirm these effects.

For completeness, we also set out in Appendix 2 our concerns over the Standard itself and the process by which it has reached this stage of being endorsed for use in Europe.

The abbreviation 'ROU' is used throughout this paper to refer to the 'Right of Use' model that is the key concept behind IFRS 16, by which all leasing creates assets on the balance sheets of lessees.

About Leaseurope

Leaseurope, the European Federation of Leasing Company Associations, represents as an umbrella body both the business equipment leasing and automotive rental industries in Europe, and is composed of 46 Member Associations in 33 countries.

In 2015, the leasing firms represented through Leaseurope's membership helped European businesses invest in assets worth more than 315 billion EUR, reaching 755 billion EUR of outstandings at the end of the year. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 40% of all European SMEs make us of leasing which is more than any other individual form of lending) and is also used by most larger corporates and many public sector organisations.

[1] See 'Non-Paper' on this topic: http://ec.europa.eu/finance/company-reporting/docs/committees/arc/2016-06-27-european-public-good%5Fen.pdf

1. Effects on Small and Medium-Sized Enterprises (SMEs)

The EFRAG Effects Analysis finds that over 99% of European businesses - being mostly SMEs that do not use international accounting standards - will not be significantly affected. This conclusion reflects the scope of the Commission's request to EFRAG for endorsement advice, which excluded effects arising from national legislation.

Leaseurope expects the biggest impacts on SMEs will be through national legislation and regulation, including (but certainly not limited to) national accounting standards.

We consider national accounting standards in this section, as they are specific to SMEs. Other changes to national legislation and regulation arising from IFRS 16 are described in later sections and would also impact SMEs.

Many European national accounting standard setters have a policy of keeping their local SME accounting rules aligned with international standards, including IFRS for SMEs.[2] The ROU lease accounting model is such a different approach to today's arrangements that it would be difficult for a national standards setter that is committed to alignment not to use it.[3]

There has been no cost-benefit analysis of the effects of the ROU model on SMEs. The administrative burdens of the ROU model may be something a large company could cope with, but (even simplified from IFRS 16 rules) are likely to represent a more significant burden for SMEs.

The IASB and EFRAG have suggested that if firms choose not to lease they can use other financing techniques instead. This negates the important benefits of leasing, that are listed in Appendix 1. Even if it might be the case for some of the largest companies it does not apply to many SMEs. Research shows that often leasing is available to SMEs when other finance options are not, and often leasing costs less (because of the security of the assets). Firms that lease are shown to invest more than those that do not, and leasing is particularly important for exporting and growth firms.[4]

Unfortunately, by the time national standard setters consider their options, they will find it difficult not to extend the new rules to maintain consistency with larger company accounting. This approach to developing new regulation of SMEs, where the interests of most European SMEs are not properly considered in the accounting standards setting process until it is likely to be too late, is inconsistent with the 'Think Small First' principle set out in the Small Business Act within the EU framework for SMEs.[5] It also undermines the Seventh Accounting Directive objective of reducing red tape in small company accounting.

2. Effects on SMEs accessing capital markets

Firms wishing to access capital markets for the first time, in line with the Capital Markets Union and modernisation of the prospectus rules[6], could have to undertake additional work if they do not have the

[2] IFRS for SMEs is not endorsed for use in Europe but it is open to national standards setters to observe its content and reflect parts of it in their national regulation as they see fit. Many sets of national accounting standards in Europe have much in common with IFRS for SMEs. We note the European Federation for Accountants and Auditors of SMEs forthcoming study on the influence of IFRS on the accounting treatment of SMEs to be launched at event in Brussels on 28 March 2017.
[3] The UK accounting regulator, the FRC, has already proposed doing this, on the stated basis that it is needed to maintain consistency between small and large company accounting. See https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Consultation-Triennial-review-of-UK-and-Ireland-a.aspx
[4] See page 4 of The Use of Leasing Amongst European SMEs, a report prepared by Oxford Economics for Leaseurope, 2015
[5] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52008DC0394
[6] See page 3: http://ec.europa.eu/finance/capital-markets-union/docs/20160913-cmu-accelerating-reform_en.pdf

data and systems needed to prepare their accounts using IFRS 16. This is in addition to the ongoing extra costs these firms will face as users of IFRS 16.

We note that in its December 2016 response to EFRAG's Preliminary Consultation Document regarding the endorsement of IFRS 16 Leases, the Quoted Companies Alliance (QCA) said it believed the adoption of IFRS 16 will have a disproportionate impact on the financial reporting of smaller companies with fewer leases. The 'portfolio effect' that could smooth out such effects for larger companies would not hold true for smaller listed companies. The impact on the Income Statement of a material new lease, or of a lease coming to the end of its life, would be greater and would require a greater explanation to investors the QCA suggested.[7]

Meanwhile brokers, possibly with restricted budgets for reporting smaller businesses following Mifid II, might not have the time to ensure they fully understand reported ROU data, with the risk this could lead to poorer quality research and potential harm to company values.

3. Effects on European banks and insurers

The banking industry has raised concerns over how the assets that banks lease themselves, mainly property, will be treated for prudential purposes. If ROU assets are treated as intangible this could have a major effect on some banks' and insurers' capital ratios. Even if treated as tangible there could be significant impacts for some banks and insurers.

EFRAG reports that the ECB has 'not identified conclusive evidence' to indicate a significant risk to financial stability and that the overall prudential impact is expected to be 'of limited significance'. Leaseurope suggests that more granular analysis is needed before reaching any conclusions on the impact of this effect on the European public good. The use of leasing for property and equipment varies considerably between different banks and between banks in different countries.

4. Effects on the European collaborative economy

The European Commission's 2016 Communication, *A European agenda for the collaborative economy*[8], noted that the collaborative economy creates new opportunities for consumers and entrepreneurs, contributing to jobs, competitiveness and growth. The growth of the collaborative economy could be supported, the Communication said, by reducing the administrative burden on individuals and businesses without discriminating between business models.

PwC's 2016 study on the collaborative economy in Europe for the Commission[9] found Peer-to-Peer (P2P) transportation is the biggest sector of Europe's sharing economy in terms of revenues, turning over some €1.7bn in 2015 - almost half of total revenues across the sectors analysed. P2P schemes involve either sharing of vehicles owned by individuals, or sharing of vehicles operated (often leased) by P2P providers.

Providers of car sharing schemes, such as Zen Car in Brussels, Zipcar in London and DriveNow in many European cities, have so far marketed mainly to individual citizens. This seems set to change, with several offers now targeted at corporates, such as Zen Car's Custom solution[10]. Usage is expected to increase as companies move towards solutions that reduce the overall mobility costs for their staff.

[7] The Quoted Companies Alliance Financial Reporting Expert Group, which includes representatives of many accounting firms, advise the QCA on its response. The QCA is a founder member of European Issuers, which represents over 9,000 quoted companies in fourteen European countries.
[8] http://ec.europa.eu/DocsRoom/documents/16881
[9] http://www.pwc.co.uk/issues/megatrends/collisions/sharingeconomy/future-of-the-sharing-economy-in-europe-2016.html
[10] https://www.zencar.eu/en/business/

Providing employees with access to car sharing schemes is already forming part of such mobility solutions. Although schemes open to the public may be difficult for companies to use, increasingly cars are being shared by personnel within companies, and between groups of companies (e.g. a group of companies that use the same fleet manager).

Companies need certainty that these arrangements are not leases, as the administrative burdens of accounting for shared cars under IFRS 16 are likely to be unacceptable. The complexity of the IFRS's existing guidance on substitutability in the Standard[11] leaves the accounting treatment unclear.

5. Effects on the European circular economy

The European Commission's Circular Economy (CE) Package is intended to help European businesses and consumers to make the transition to a stronger and more circular economy where resources are used in a more sustainable way.

InnovFin Advisory, the European Investment Bank's Advisory Services arm, carried out a study on the role of finance in the transition to a CE in 2015. InnovFin Advisory's final report[12] considers three main categories of CE business models, including Product to Service models. These typically entail a (partial or total) conversion from manufacturing and selling a product to a service-based model, where the product remains the owner of its products for a number of years, enabling easier return, refurbishment, remanufacturing and reuse. Such arrangements are, typically, operating leases for accounting purposes.

InnovFin Advisory's report notes that operating leases for assets such as machines and cars are well known already, but suggests that in the CE context such arrangements could start to be applied to new asset classes, including cleantech or digital assets.

It is necessary, Innovfin Advisory suggests, to consider the accounting effects of using operating leases, as the business case for companies wanting to transition to this type of model is not easy to make. The fact that leasing or offering a service has a positive societal impact is less likely to be the determinant factor that will convince individuals or businesses to start renting rather than acquiring, the report states.

This analysis does seem to suggest that anything that makes operating leases more difficult to use will constrain the shift towards Product to Service models that is needed to make the European CE a reality.

6. Effects on businesses that rent equipment

The effects of IFRS 16 on the European equipment rental industry have received little attention, as lessees may choose not to apply most of the IFRS 16 rules to 'short-term leases' that last up to 12 months. IFRS 16 could however still impose new administrative burdens on providers and users of rental equipment compared to IAS 17.

The size of the rental business in Europe is estimated at EUR 24.3 billion (in 2015). The number of rental companies in the 15 major rental countries in Europe (representing nearly the full European business) amounts to 15,500 (2013) and the number of employees to 120,900.

Unless immaterial, firms using the exemption for short-term leases will prepare disclosures setting out the fact that the exemption has been used, the expense related to their short-term leases, the value of short-term leases (in certain circumstances), and additional information if needed to meet the disclosure objective set out in the Standard.

[11] IFRS 16, B13-B19, see also Conclusions of this Paper.

[12] http://www.eib.org/attachments/press/innovfin-advisory-report-on-circular-economy-full-report-public.pdf

These disclosures will potentially involve a lot of extra administration for companies to collate details of their expense on a multitude of low-value rentals for items such as cement mixers, vans and printers[13]. The overall effects might be immaterial but it will be difficult to confirm this without first doing the work. If disclosures are made they seem likely to make accounts more cluttered and therefore less useful.

7. Effects on Value Added Tax

The VAT Directive does not give specific guidance regarding the VAT treatment of equipment and vehicle leases. It does, however, make an important distinction between the supply of goods and the supply of services. This distinction is relevant to determine when the chargeable event shall occur and when VAT shall become chargeable as well as to assess whether a tax exemption applies. The 'grey area' for leasing is whether different types of leases are supplies of financials services, or supplies of goods, or a combination of the two.

A series of Court of Justice cases provides guidance although there remain different interpretations and applications of the cases in national rules. An important recent case is Eon Asset[14] in 2012, in which the CJEU set out conditions under which a lease should be classified as a supply of goods rather than services. These conditions were framed around the accounting distinction between operating and finance leases, with direct reference made to IAS 17. [15]

If the CJEU continues to follow the line drawn in Eon Asset, it will be necessary for VAT purposes to continue to consider IAS 17 distinctions.

At one level, this represents a substantial extra administrative burden, as lessees are unlikely to be able to simply rely on the classification choice made by the lessor.

Perhaps of greater significance, it appears that the CJEU made use of the IAS 17 distinctions not as a matter of convenience but rather because this was a distinction that is consistent with the VAT Directive and reflects the economic reality of leases.

As the VAT treatment of financial services is clarified over time, through further case law as well as the long-running proposals for a new Directive and Regulation to modernise and simplify the VAT treatment of financial services, IFRS 16 could mark a significant and perhaps a problematic divergence between accounting and European VAT principles.

8. Effects on corporate tax

In many European countries (including Estonia, Italy, the Netherlands, Poland, Portugal, Spain and the UK) existing lease taxation rules for all companies for leases use the accounting distinctions between operating and finance leases.

The consequences of this distinction disappearing are potentially very significant. In the UK, the tax authority HMRC has issued a paper setting out options for a tax system response to IFRS 16.[16] The steps needed in each country will be different and depend partly on whether the tax rules cross-refer to accounting standards, or whether the distinctions between operating and finance leases are set out within the local tax legislation.

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[14] Case C-118/11 Eon Aset Menidjmunt OOD v Direktor na Direktsia "Obzhalvane I upravlenie na izpalnenieto", 16 February 2012, ECLI:EU:C:2012:97

[15] For a full analysis, see thesis by Igor Kochkodan, Lund University: http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=5435653&fileOId=5435658. Note the conclusions are based on the IASB's 2013 proposals which would have maintained a distinction between two types of leases.

[16] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/544654/Lease_accounting_changes-tax_response-consultation_document.pdf

At a high-level, the choices in each country are likely to replicate those identified in the UK.[17] They are:

I. To continue to use operating and finance leases as a basis of tax law. This avoids changing tax rules unless the tax rules currently cross-refer to accounting standards, in which case the distinctions between operating and finance leases will need to be coded into the tax system. However, it means that for companies using ROU lease accounting, it will be necessary to maintain a second accounting system based on today's accounting rules.

II. To switch to using the ROU model as a basis for taxation. This seems impractical for many years (if ever), as most companies (non-users of IFRS) will not have ROU accounts to use for their tax calculations. Additionally, it is very difficult to see how the ROU model could be used. Would the lessee, lessor, or both parties be eligible for tax investment allowances? The simplest approach might be to only provide tax allowances to the lessee, as they now always have a ROU asset. That would harm business investment if the lessee is unprofitable and therefore unable to benefit from allowances.

III. To maintain different tax rules for users of IFRS compared to local accounting rules, adding complexity to the tax system (and still leaving the issue described above of how to use the ROU model for tax calculations for IFRS users).

IV. Other options involving de-linking tax and accounting rules, perhaps basing the tax treatment on legal ownership of assets.

None of these options is at all simple and the effects could be quite fundamental to how the tax systems in the relevant countries promote business investment. The issue is also inextricably linked to the question of whether the ROU model will be rolled-out to SMEs in local standards, such that any uncertainty over this leaves the relevant tax authorities with a very difficult problem to solve. There is, therefore, a risk that IFRS 16 could lead to more complicated and expensive corporate taxation rules that are less efficient in promoting business investment.

9. Support for business investment

Several important European schemes to support business investment, including those forming key parts of the Investment Plan for Europe, rely on the distinction between operating and finance leases based on IAS 17. In general, schemes work for finance leases and not operating leases. They include:

- European Investment Bank's intermediated loans programme
- European Investment Fund's InnovFin SME Guarantee Facility
- European Bank for Reconstruction and Development's financial instruments
- EIB-supported Green for Growth Fund

The underlying reason for schemes such as these to include finance leases is to recognise that many businesses do not have the free cash to pay for equipment upfront, but still meet the scheme objectives. The ROU model would not provide a useful basis for determining eligibility. It appears it will be necessary for these, and many other national schemes, to maintain their use of the IAS 17 definitions.

10. Other legislation and regulation

The existing operating and finance lease split is deeply embedded throughout a wide range of European law, regulation and policies. This is not by accident, it is because policy makers have found it to be a useful and economically-valid distinction to make, and one that has been maintained in the USA. Examples include:

[17] The UK tax authority HMRC has confirmed it plans to select the first of these options.

- Many areas of Eurostat's rules on government accounting and statistics that use the distinctions, including:
    - The European System of National and Regional Accounts (ESA 2010) Chapter 15
    - Eurostat Manual on Government Deficit and Debt
    - Eurostat guidance on the impact of energy performance contracts on government accounts[18]
- Law in many European countries is based around the current operating lease / finance lease split. In these cases, it is unclear how ROU assets for lessees would be handled. Across Europe, we expect there are many relevant legal or regulatory references to operating leases. Some examples including:
    - In the Netherlands, tax authorities have a legal privilege to seize assets from the premises a tax-payer. The tax authorities have a general ruling, the 'Leaseregeling', to deal with equipment under operating leases, recognising the lessor's interests in the assets.
    - In the UK, schools can by law only use operating leases and not finance lease unless specifically approved by Government.
    - In Portugal, leased cars must be registered in the name of the lessor for an operating lease but also in the name of the lessee for a finance lease.
- The prudential regulation system in Europe, through the Capital Requirements Regulation (CRR) and Directive sets out the regulatory treatment of firms providing financial leasing, and of financial leasing as a product. The term 'financial leasing' is not defined in the prudential law and regulations but a European Banking Authority report on the perimeter of credit institutions in 2014[19] refers to the ESA 2010 Regulation that includes a description of financial leasing as compared to operating leasing.

In these areas, and we expect there are many more, it will be necessary to consider whether there are ways of coping with the shift away from operating and finance leases without excessive expense or harming the competitiveness of European enterprises.

[18] http://ec.europa.eu/eurostat/documents/1015035/6934993/EUROSTAT-Guidance-Note-on-Energy-Performance-Contracts-August-2015.pdf/dc5255f7-a5b8-42e5-bc5d-887dbf9434c9
[19] https://www.eba.europa.eu/documents/10180/534414/2014+11+27+-+EBA+Report+-+Credit+institutions.pdf

Conclusions & recommendations

We have identified a wide range of possible effects of IFRS 16 on the European public good that have not been considered by EFRAG. We recommend further analysis is completed of these effects before the endorsement process proceeds.

Fortunately, many of the biggest effects of IFRS 16 on the European public good may be resolvable without changing the Standard. The following recommendations should help to achieve this:

1) **The Commission should make clear at the time of endorsement that:**

    a. **Whilst no cost-benefit analysis of the effects of extending the ROU model to SMEs through national standards has been carried out at any stage of the development of IFRS 16, any new accounting compliance burdens are likely to have a proportionally higher impact on smaller firms with a lower benefit to users of their accounts.**

    b. **The costs of extending the ROU model to SMEs through national standards may therefore exceed the benefits.**

2) **The Commission should require the IASB to clarify its guidance on parts of the Standard, including:**

    a. **The right to substitute.** The IASB's Application Guidance on substitutability is very unclear on how firms should establish that a right to substitute is substantive. There is guidance on what is excluded but not on what is intended to be included.

    b. **The low value lease exemption.** The IASB's Application Guidance includes some examples of low-value assets, but is unclear on the circumstances in which the most common assets used for operating leases in Europe, i.e. cars and small commercial vehicles, may be treated as low value, as seems entirely logical for many companies.

    c. **The Portfolio application expedient.** This has the potential to significantly reduce compliance costs for many companies with car fleets, but there is considerable confusion over the condition that leases must have 'similar characteristics' and how to assess the materiality of use of this approach.

    d. **Extent of disclosures required.** The disclosures section of the Standard is considerably more extensive than IAS 17 and for many companies this will create the most significant reporting burdens. More clarity is needed on how firms should consider whether the benefits of their disclosures to users of their accounts will exceed their costs.

    More practical and constructive guidance is needed on these topics and others, written in a way that can readily be applied to business equipment and vehicle leasing arrangements in Europe to significantly reduce compliance costs for many users of today's operating leases.

    We further suggest that the Commission considers convening a forum for lessees and accounting firms to identify the areas where further guidance from the IASB could help reduce the reporting burdens for European companies.

3) **Allowing European companies an extra year to implement the Standard**. This additional flexibility will help companies needing to collect data and develop new systems.

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Leaseurope is entered into the European Transparency Register of Interest Representatives with ID n° 16013361508-12

Appendix 1
Benefits and importance of leasing and automotive rental

The benefits of using lease finance include:

- The possibility to finance 100% of the purchase price of an asset without having to offer any supplementary guarantees which would otherwise be an additional burden for the company seeking finance;

- Allowing companies to manage their working capital by spreading payments over the life of the asset;

- Making budgeting exercises easier as lease payments are regular and usually for a fixed amount;

- Giving firms the opportunity to renew their equipment, making sure that they benefit from the latest available technologies;

- Providing other sources of finance, independent from bank loans or credit lines, thereby conveying more freedom to the lessee;

- Ensuring the lessee has a stable and certain source of funds that cannot be withdrawn as long as payments are made;

- The ability for the lessee to use equipment or other assets without having to worry about considerations linked to being an owner such as the disposal of the asset when it is no longer used including the resale value;

- Providing customers will a full package - a lease can also accompanied by an array of services, including the insurance and maintenance of the asset. A wide range of services can be combined with different types of leases;

- Taking advantage of local fiscal treatment which implies that leasing can also be beneficial from a tax point of view;

- Being the only available source of funds. In certain cases, particularly for smaller companies who have high growth potential, leasing may be the only way to finance their development;

- Generally speaking, providing finance in circumstances when traditional bank facilities would not be granted as lessors have greater security due to the ownership of the asset. This also implies that leasing may be offered on better terms than other forms of finance.

Appendix 2: Leaseurope's view on IFRS 16

Leaseurope has major reservations over both the process by which IFRS 16 was developed and the quality of the Standard itself.

Our concerns over process include:

- The need for change to IAS 17 in Europe was never strongly established. New lease accounting rules were always driven by concerns over off-balance sheet assets in the US, with little evidence of any problems in Europe. Academic research also confirms that users of accounts can generally cope with any perceived weaknesses of the current arrangements.[20]

- The IASB's early rejection of the option of improving IAS 17 to deal with perceived weaknesses, and the subsequent ongoing failure to compare the costs of the proposals with the 'next best' alternative in line with normal regulatory practices.

- The lack of an impact assessment that addresses the questions set out in the EC's Guidelines on Impact Assessment.[21]

- The IASB's ability to proceed with a Standard without major changes, despite unprecedented levels of concerns expressed in hundreds of responses to the exposure drafts.

- The process by which EFRAG has been quite critical of the IASB's proposals over the years, yet in its final assessment appears to support the Standard almost unreservedly despite many of the EFRAG's recommendations not having been accepted.[22]

- The IASB (in its Effects Analysis) and EFRAG (in its Endorsement Advice) suggesting that the extra work needed to prepare data for use in IFRS 16 will lead to 'better' decision making on the use of leasing. European companies already have a choice of investing in lease management systems today should they consider that a useful exercise.

We consider IFRS 16 does not add value in Europe compared to IAS 17 for the following reasons:

Less consistency between transactions

- There is a significant new risk of inconsistency between similar transactions, as the key accounting 'dividing line' shifts from operating lease vs. finance lease (which is well understood and generally consistently applied in Europe) to the lease vs. service distinction that was previously of minor importance and is very difficult to define.
- By leaving lessor accounting using the operating lease vs. finance lease distinction, but making lessee accounting focused on the lease vs. service distinction, there is a new inherent and fundamental inconsistency in lease accounting.

Less relevant and less reliable reporting

- Users of accounts will lose visibility of whether lease liabilities are finance-based or are executory (service-based) where the lessee does not bear the risks and rewards associated with the leased asset (at a time when service-like contracts are the fastest growing segment of the leasing market).

[20] For a contemporary overview of a wide range of relevant research, see Leases: A Review of Contemporary Academic Literature Relating to Leases, Angela Wheeler Spencer and Tomas Z. Webb, Accounting Horizons, December 2015.
[21] http://ec.europa.eu/smart-regulation/guidelines/ug_chap3_en.htm
[22] Specific examples are set out in Leaseurope's response to EFRAG's Preliminary Consultation Document at http://www.efrag.org/Activities/269/IFRS-16--Leases

- As the quantity of disclosures is increasing considerably compared to IAS 17, this will make accounts longer and more cluttered. It also provides an indication that few expect the figures in the financial statements themselves to provide relevant and reliable information.
- The ROU model is based on the outdated notion that all businesses operating in a sector work the same way and are directly comparable. One car manufacturer may control production entirely in-house, another might outsource its entire supply-chain logistics. One hotel group may own and operate hotels, another may be a brand manager that owns or leases no properties. It is futile, and harmful to EU economic development, to try to use accounting to attempt to turn the clock back to a simpler world where businesses own or lease all the assets they use to create a good or service that happens to have their name on it. Doing so when American companies will maintain the current split between operating and finance leases in their accounts risks harming the competitiveness of European companies.

Inconsistency with FASB

- The differences between the principles of the IASB and FASB models are quite fundamental and their effects could be significant when comparing similar businesses in Europe and the US. By contrast, the existing accounting standards IAS 17 and FAS 13 are substantially converged.
- European companies will show lower profitability in the earlier years of investments than US companies. The results will only be similar if lessees have stable and mature leasing portfolios, whereas most lessee have more dynamic leasing requirements. IFRS preparers may not be at a competitive advantage to US companies *on average* but that will mean nothing to individual European businesses and it is therefore not a reliable indicator of the real impact on European competitiveness.

Appendix 3: Steps to account for an operating lease

The administrative burden of accounting for today's operating leases will increase under IFRS 16 compared to IAS 17. There are at least 21 main steps and considerations involved in accounting for each lease under IFRS 16 compared to around 7 under IAS 17. The extra steps are likely to require input from operational staff across companies, not only effort within the accounting function.

The work involved to account for today's operating leases under IFRS 16 is far more extensive than under IAS 17, this is a high-level summary of the steps and considerations involved.

IAS 17	IFRS 16
1. Determine there is a lease	1. Determine there is a lease
2. Classify the lease as operating lease	2. Determine whether there are linked leases
3. Calculate total lease payments	3. Determine whether there are separable contracts
4. Expense the payments on a straight-line basis	4. Determine if goods and services are separable
5. Disclose total future minimum lease payments	5. Calculate lease payments due
6. Disclose lease payments recognised as an expense in the period	6. Consider and adjust for possible lease extensions
7. Provide a general description of leasing arrangements	7. Consider and adjust for other variable lease payments
8.	8. Determine initial and end of lease costs
9.	9. Determine interest rate implicit in the lease or incremental borrowing rate
10.	10. Calculate net present value of adjusted lease payments
11.	11. Calculate depreciation and charge to income statement
12.	12. Calculate interest on lease liability
13.	13. Reassess the lease liability as appropriate
14.	14. Charge interest to income statement
15.	15. Present closing liability on balance sheet
16.	16. Disclose carrying amount of ROU assets
17.	17. Disclose depreciation by class of asset
18.	18. Disclose maturity analysis of liabilities
19.	19. Report short-term lease payments
20.	20. Report low-value lease payments
21.	21. Disclose total cash outflow for leases