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Your reference :
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Eindhoven, 15 December 2010

Handled by : Roel Vriens
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Subject : Comment letter to Exposure Draft Leases

Dear Sir Tweedie:

Thank you for the opportunity to comment on the joint IASB and FASB Exposure Draft Leases.

Our comments and views expressed in this letter and annex are reflective of the characteristics of the finance industries in which we are active. De Lage Landen is a global provider of leasing business and consumer finance solutions, including vendor finance and factoring with a financed portfolio of € 25 billion, new business volume of about € 14 billion and in excess of one million contracts in 2010. Our asset-based financing programs help our customers grow market share, enhance profitability and achieve their strategic goals. As equipment lessor and financing partner we are also a substantial user of financial statements as we use these to assist in determining the creditworthiness of our customers.

We are a fully-owned subsidiary of the Rabobank Group, the world's most creditworthy privately held bank. With a triple-A rating from Moody's and Standard & Poor's, the Rabobank Group provides a secure, stable foundation for our activities.

If you have any questions regarding this letter, please do not hesitate to contact Roel Vriens or one of the undersigned.

Yours sincerely,

A large, stylized signature in black ink, consisting of several overlapping loops and horizontal strokes.

Bill Stephenson
CCO De Lage Landen International B.V.

A handwritten signature in black ink, appearing to read 'Overdijk' with a long, sweeping underline.

Frans Overdijk
CFO De Lage Landen International B.V.

Response to the IASB/FASB Leases Exposure Draft (ED/2010/9 “Leases”).

Company profile

De Lage Landen has a worldwide network, active in over 35 countries with more than 5,000 FTE's. The leasing business is organized in the following business units: Banking Services, Food & Agriculture, Office Equipment, Technology Finance, Construction & Industrial, Transportation, Healthcare, Clean Technology and Car Leasing. Our core business is leasing of small and mid-sized tickets (principal below € 1 million). Our customers are manufacturers, dealers/resellers and end-users (lessees).

Executive Summary

De Lage Landen supports the proposed recognition of all leases on the Balance Sheet of lessees, however, considers the proposals in the ED Leases as too complex and costly for both lessees and lessors, specifically in the small and mid sized ticket lease environment, which is the large majority of lease contracts in the world. We would like to see guidance that facilitates an easier implementation and maintenance as to how to determine the amounts to be recognized at inception of the lease and subsequently in the financial statements of lessees. De Lage Landen fully supports the comments given by the associations Leaseurope, ELFA and the NVL (Dutch Lease Association) and by the EFRAG in their responses to the ED Leases, addressing both lessee and lessor accounting. With respect to the individual questions in the ED leases, we refer to the response of Leaseurope, as De Lage Landen has actively participated (directly and indirectly through the NVL) in formulating the response of Leaseurope.

Our comments incorporated in this letter are triggered by the expected business impact of the ED Leases on our leasing business, specifically aimed at the following topics:

1. Balancing costs for lessees and lessors with benefits to investors and other stakeholders
2. Simplifying and limiting accounting models for lessees and lessors
3. Opting for committed lease term versus estimated lease term
4. Distinguishing service from lease components in a lease contract.

Moreover we are concerned that the proposals, as described in the ED Leases, may impact the ability to lend which may slow global economic recovery.

We agree with the Boards statement that there are greater deficiencies in the quality of information in relation to lessees than lessors and we also believe that it is important to have consistent accounting for lessees and lessors, but not at all cost. We think that the lessor accounting approaches proposed in the ED Leases have a greater impact on the processes and operations, including IT systems, of lessors than is warranted by the importance of having consistent accounting for lessees and lessors.

De Lage Landen is of the opinion that there is no immediate need to replace the current accounting rules (IAS 17) for lessors by the proposals in the ED Leases, specifically considering that the

proposals are costly to implement and maintain and are rather complex with limited benefits for investors compared to the current accounting rules.

We recommend that the Boards have the final leasing standard simplified along the lines of the Leaseurope proposal “An Alternative: A Simplified Right of Use Model for All Leases”. This “Alternative” does not jeopardize the objectives and goals set in this project by the Boards while reducing complexity and additional workload. Such simplified lessee and lessor accounting model would create a level playing field among the various financing options a lessee has available, where all options are recognized in the balance sheet and create comparable accounting complexity and workload for lessees, and hence decisions are made based on the business economics of the transaction and finance options and not on side effects like off-balance financing or avoidance of an administrative burden.

1 Balancing costs for lessees and lessors with benefits to investors and other stakeholders

De Lage Landen is of the opinion that the costs of the new standard for lessees and lessors exceed substantially the benefits for the investors. The PWC Survey and FLA Study (see separate attachments) support this view about lessee accounting and report the following statistics:

- 74% of respondents expect that the costs for preparers exceed the benefits
- Steps or activities to account for a lease from a lessee’s perspective will increase enormously under the ED Leases compared to the current approach (IAS 17). For operating leases it will increase more than 9-fold (from 8 to 77 steps) and for financial leases by a factor more than 3 (from 22 to 77 steps). This will significantly increase costs of leasing transactions, and leasing is put at a disadvantage as we know that the workload of recording the purchase and depreciation of an asset and attracting alternative financing of such asset is substantially less than the 77 steps mentioned. The lessee’s workload and complexity of accounting for a lease under the ED Leases is reducing the attractiveness of leases compared to other financing options available to lessees.
- The same survey and study show that at least 48% of the lessees said they plan to ask their providers of leasing services (lessors) for data required for the implementation and ongoing accounting for leases. Moreover, between 70- 80% of the respondents mention that their IT systems, processes, resources and information/data are mostly not in place to be ready for implementing the proposed lease accounting standard. This additional need for information will likely increase the costs of leases compared to other financing options and again put leasing at a disadvantage.
- Between 70% and 85% of the lessees mention that the implementation and ongoing accounting complexity and costs for renewal options and contingent rentals will be quite or very significant.
- Between 40% and 60% (depending on industry segment) mention that because of the change in accounting rules, they will not continue leasing in the same way as today. This change is not driven by the business economics of lease transactions compared to other financing solutions but by the increased complexity of accounting for leases.

2 Simplifying and limiting accounting models for lessees and lessors

It is the view of De Lage Landen that there should be one accounting model for lessees: the right-of-use model. If the current lessor accounting guidance of IAS17 is to be replaced then there should be one accounting model for lessors, the derecognition model, where lease contracts less than 12 months are treated as executory contracts. Further, accretion of residual values should be

incorporated, among others because the accretion in value is incorporated in the periodic lease payment charged to the lessee and inherent to the business economics of the transaction.

Intangible assets, like application software, should be included in the scope of the final lease standard as in today's office equipment and technology finance markets a substantial part of the total costs relate to application software.

3 Opting for committed lease term versus estimated lease term

De Lage Landen opposes the proposal to replace the current guidance of "contracted and committed term" by "estimated, longest possible term that is more likely than not to occur" as described in the ED Leases.

This proposal puts lessors at a disadvantage compared to manufacturers with a captive. To illustrate this the following lease example. For a 5 year committed (finance) lease with no residual value and an annual payment of € 100 and a longest possible term that is more likely than not of 7 years, the manufacturer with a captive will recognize a sales revenue of:

- € 400, assuming finance charges of € 100, under the current IAS17. The € 400 equals the fair value of the equipment at inception of the lease.
- € 600, assuming about the same finance charges as after 5 years the principal is fully paid down, under the ED Leases. The about € 200 additional revenue is, however, not committed and depends on customer behavior not changing in the coming 7 years.

Would the manufacturer sell the equipment to a third party or a third party lessor, the manufacturer can only recognize € 400 revenue as the third parties will not pay the manufacturer in excess of the fair value of the equipment.

In our opinion, this proposal could inappropriately allow income to be recognized before earned. Similarly, the recording of liabilities associated with estimates will put excessive burden on the accounting. Where customer behavior changes and results in a write-off of the remaining lease receivables, such write-off will produce avoidable volatility in the earnings. This volatility may prevent or hinder the desired earnings transparency in the financial statements most beneficial for users.

4 Distinguishing service from lease components in a lease contract

The guidance to distinguish between lease and service components is not clear and needs more explicit clarification.

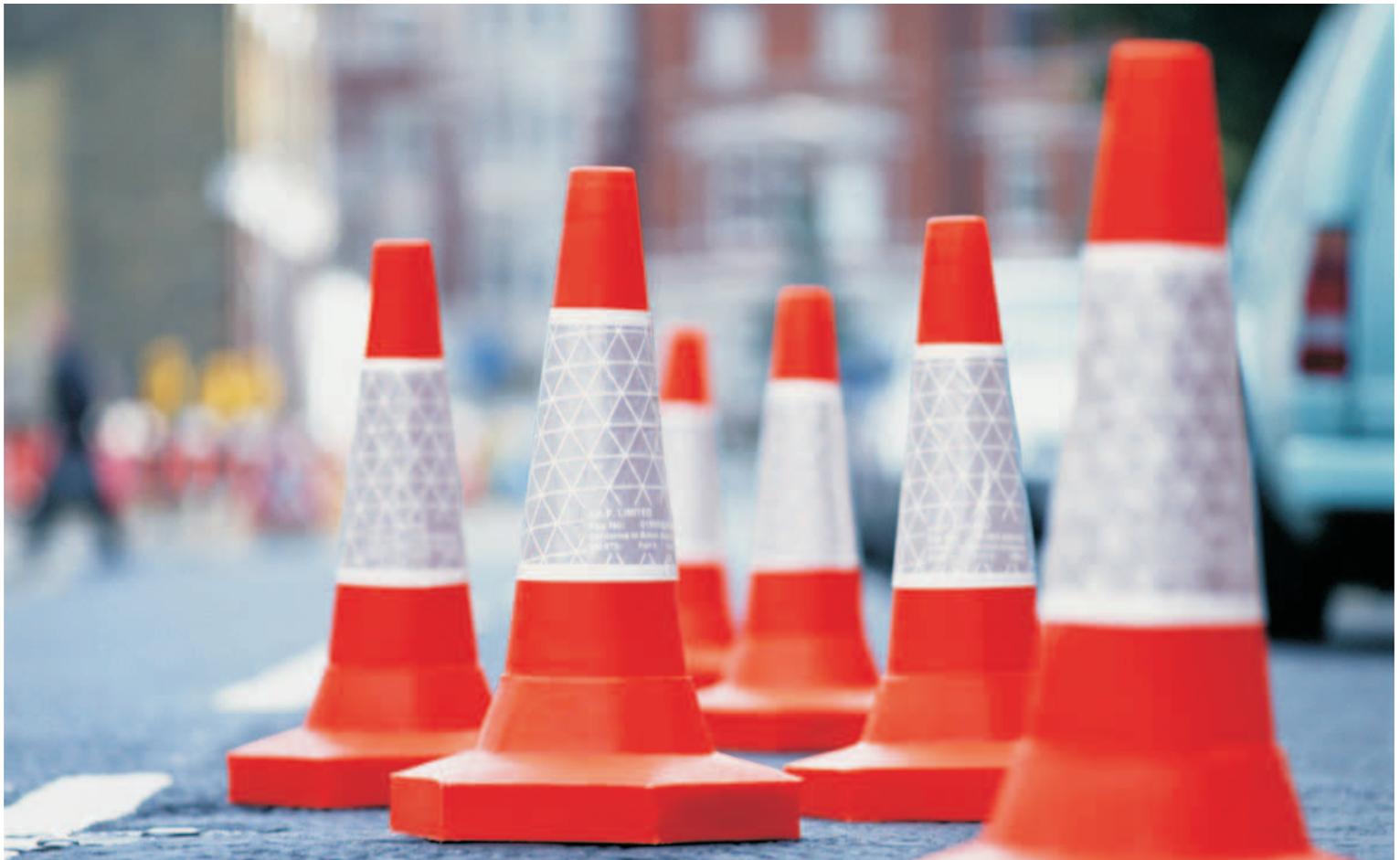
A market trend is noted where companies choose to focus on their core activities and outsource non-core activities. The outsourcing contracts, especially in the IT and office equipment markets, are based upon all kind of different concepts and names like managed print services, facility management, full service contracts. These contracts range from a simple cost-per-copy contract to contracts where the service provider commits to an agreed upon output or performance without any commitment as to which equipment and how many are used in delivering the committed services. The company has no control over the equipment although the equipment may be present at the premises of the company. Are such contracts treated as leases? And if so, how to distinguish between the lease and service components?

Attachments

- Preparers' view on New Lease Accounting: European Impact Survey 2010 by PWC
- FLA – Steps to accounting for a lease under the International Accounting Standards Board's proposals
- An Alternative: A Simplified Right of Use Model for All Leases. (Draft) proposal by Leaseurope

Are you ready for the new lease standard?

Preparers' Views on new Lessee Accounting:
European Impact Survey 2010



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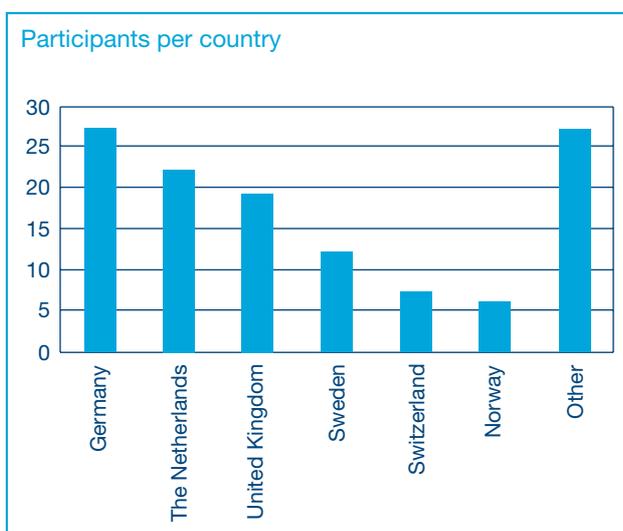
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Key survey results

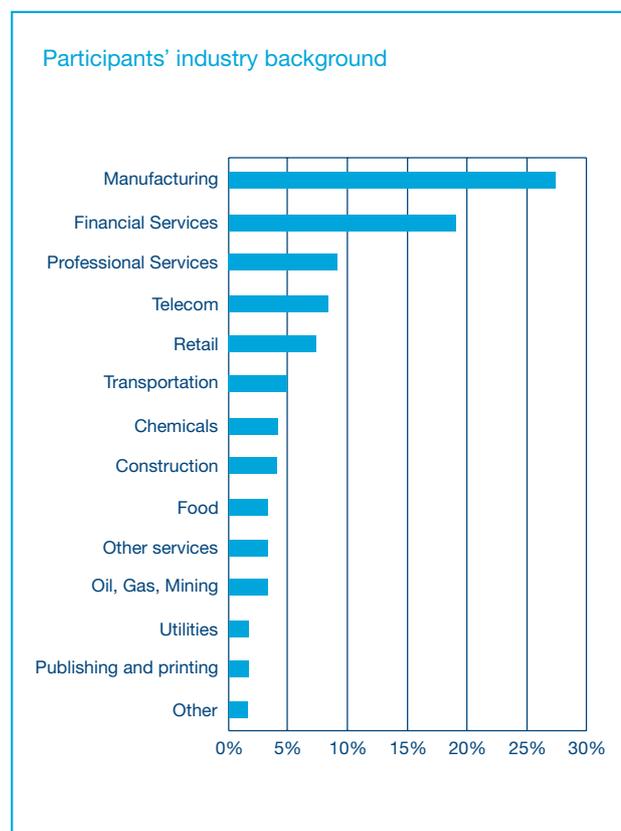
1. About the survey

This survey sets out to understand the reactions and perceptions of European entities with respect to the proposed overhaul of lease accounting. European entities will need to adopt a new lease accounting standard if they are reporting under International Financial Reporting Standard ('IFRS'). The survey was conducted in cooperation with the Rotterdam School of Management, Erasmus University, the Netherlands. We invited approximately 500 European listed companies to participate in this survey. Some 200 European preparers responded that they were willing to participate in this survey. Others did not respond or specifically indicated that leases are immaterial to their financial statements. Interactive Dialogues, a web-based questionnaire, was used to poll CFO's and/or external reporting managers in the period from 20 May 2010 to 17 August 2010. Approximately 125 respondents from 21 European countries and various industries gave their views on the proposed changes which are reflected in this report:



The other territories primarily include participants from France, Belgium, Italy, Austria, Finland, Greece and Poland.

The fieldwork for the survey was completed just before the release of the Exposure Draft 'Leases' on 17 August 2010. This report summarises the views and perspectives of survey participants in respect of lessee accounting. It does not include lessor accounting, as this was excluded in the previously issued Discussion Paper.



2. Keeping up with the pace of standard-setting for leases

The International Accounting Standards Board ('IASB') and its US counterpart, the Financial Accounting Standards Board ('FASB') are sustaining an unprecedented level of standard-setting activity. The amount and complexity of proposed changes in accounting standards is challenging users, preparers and their advisors. The IASB and FASB are under pressure from the European Union, G20 and other stakeholders to converge and improve standards in key areas by 2011. They are therefore committed to this objective and will continue working towards the goal of finalising some 11 joint projects. A number of these projects are expected to be completed by mid-2011 as promised in the Memorandum of Understanding (MoU)¹. This has led some to question whether such a timeframe will allow for a full and robust due process necessary to produce high-quality standards. Not only do the proposals require thoughtful consideration, but the interrelationships of the various proposed changes to standards and the related impact on preparers' reporting, systems and operations need to be evaluated. This survey focused on the lease project, which is one of the projects due to be finalised by mid-2011.

The IASB needs high-quality input from preparers and users to make the forthcoming changes to standards implementable. Many of these accounting changes (for example, to leases, financial instruments, insurance, revenue recognition, consolidation and financial statement presentation) will require changes to IT systems, processes and controls. Given the number and complexity of these projects, preparers will require considerable time to analyse the business and operational implications to be able to provide high-quality input to the IASB.

The majority of respondents do not have the resources to keep up with the pace of the lease project. This appears to reflect preparers' recent concerns about the pace of standard-setting activity. A key challenge for the IASB will therefore be to deliver on its commitment to perform effective outreach.

“The majority (85%) of respondents are aware of upcoming changes in the lease standard but 43% of respondents are not well-informed at this stage. Only 25% of respondents said they currently have the resources available to implement the new lease standard”

¹ The MoU embodies an agreement between the IASB and FASB, published in 2006, to collaborate on eliminating major differences in U.S. Generally Accepted Accounting Principles ('US GAAP') and International Financial Reporting Standards ('IFRS').

3. Understanding the business and operational implications

Understanding the business and operational implications is an important element to allow entities to prepare themselves for the changes, especially when these are pervasive. Also, a comprehensive understanding of the practical implications will help entities provide high-quality input to the IASB.

The front loading of costs from the proposed right-of-use model intensified by the proposed transition rules resulting in lower earnings after transition to this model is not well-known with European entities.

Impact on preparer's net earnings

The proposed right-of-use model for lease accounting – which treats all leases somewhat similar to finance leases today – will result in higher total expenses in the earlier periods of a lease and lower expenses in the later periods compared to the pattern for operating leases today, as illustrated below:



The chart above depicts the impact on expenses recorded in earnings for leases for a basic 10-year lease with an initial annual rent of EUR 2,000, a fixed 2% annual escalation rate and an assumed incremental borrowing rate of 7%.

This front loading of costs under the right-of-use model is further intensified by the proposed transition rules. The currently proposed transition rules put forward a modified retrospective application, which requires that all existing leases will be considered new leases on the date of the new standard's initial application. This will cause a more dramatic effect of the front loading of costs as in effect all leases will be in their early stages in the first years after adoption. In contrast, with a fully retrospective application the effect would have been neutral to some extent as the mix of lease portfolios would generally include some leases in the earlier periods and some in later periods of the lease term, thereby creating an offsetting effect on costs and net earnings.

The majority (74%) of respondents are unaware of the negative impact on net earnings in the first years after transition to the new lease standard.

Only 26% of respondents seemed able to assess the higher costs and deterioration of net earnings after transition. 66% of respondents seemed able to assess the significance of the impact on their operating income (EBIT), EBITDA, operating cash flows and interest coverage. The implications for balance sheet ratios – such as debt to equity (leverage), asset turnover ratios and return on capital employed also generally seemed well understood by preparers.

The currently proposed transition rules, which ironically have been included as a relief to preparers in order to avoid them having to go back and apply the right-of-use model to leases that were entered into a long time ago, may have a significant negative impact on preparers' reported net earnings in the years following transition.

Between 20% and 35% of respondents expect a decline in credit rating or increase in cost of capital as a result of the new lease standard. 16% expects a breach in their covenants.

Entities will need to consider the impact on their financial ratios and performance measures including the effect on net earnings when renegotiating compliance and performance targets in financing arrangements, agreements with suppliers and vendors and employee compensation agreements.

Impact on regulatory capital requirements for banks

Over 70% of bank participants are uncertain whether the new lease standard will affect their required regulatory capital.

European banking representatives may need to start assessing whether changes are needed to capital requirements as a result of the reporting of all leases on balance sheet.

Organisational readiness

The majority of respondents said they do not currently have or only to a limited extent have the necessary information and data (68%), resources (74%), processes (78%) and IT systems (76%) in place to implement the new lease standard.

If preparers have a significant number of longer-term leases, locating, collecting and then reviewing lease agreements that were negotiated decades ago may prove time consuming or even impossible. Collecting and reviewing large numbers (for example tens or hundreds of thousands of lease contracts) of individually insignificant smaller and shorter-term lease contracts used throughout a business for assets such as ICT equipment could prove equally challenging.

European entities are not yet ready to implement the new lease standard when looking at the availability of information and data, resources, processes and their IT systems.

Respondent: “We will not start the implementation or adjust any processes, IT systems, etc. until necessary, i.e. when the current proposals have become an exposure draft or ‘near final’ standard”.

There were no significant differences between lessees and those that also act as a lessor in respondents’ readiness to implement the new lease standard. This may be caused by the fact that some of the participants in the survey that act as a lessor do not consider leasing to be their primary business.

48% of respondents said that they plan to ask their providers of leasing services (lessors) for the data required for the implementation and ongoing accounting for leases. Another 29% do not know yet at this stage whether they will ask their lessors for these data.

In aggregate, 77% of respondents may ask their lessor in the future, while at this stage only 13% of respondents have initiated discussions with their lessors. This may indicate that some preparers are unaware that their current rental/service agreements will be recorded on balance sheet in the future.

Obtaining the required information from lessors could prove to be more challenging than currently expected by lessees. Lessors may need to start thinking about the support they can provide to lessees now and what changes may be needed to their own IT systems. Lessees may consider performing an assessment of the availability of information at an early stage. This assessment would include assessing their potential reliance on multiple lessors for data. Even if lessors will be able to provide lessees with some required data, there are still many other practical challenges to overcome such as uniformity of data provided by multiple lessors. In addition, reliability of the data used for financial reporting is a key element that needs to be addressed by preparers and their auditors.

Lessees and lessors will finally need to overcome the (commercial) challenge of agreeing who will bear the costs. Coming up with solutions for lessees' needs in this respect may provide some lessors with a competitive advantage.

Expected business and operational impact

The upcoming changes in the lease standard will have an impact on preparers' IT systems and operations, processes and performance measurement systems.

Respondent: "Leasing agreements are entered into by all companies and countries in the group. The proposed accounting model is very complex and there is significant education, tools development, follow up and analyses needed to implement the new lease standard".

Nearly half of respondents are unable to assess to what extent changes are needed to business models, business and financial processes, IT systems, reporting and closing processes, internal controls, performance measurement systems and budgeting and tax planning strategies.

Head offices will need to take a coordinating role in preparing for the changes. A key question will be to what extent leases will be managed or monitored centrally in the future. Although managing leases centrally can be difficult as a result of local legislations, having some central monitoring of all leases within the group may provide advantages. While it may seem that the effective date of the new standard is some way off, preparers may want to think through the operational and practical implications now considering the pervasive impact.

4. Engaging stakeholders

Determining a communication strategy to explain changes in financial information to the markets and managing stakeholders' reactions is key for any major change in financial reporting. The challenge for preparers is to avoid 'surprise' changes that can trigger negative market reactions.

Managing market and stakeholder reactions

Respondents have had very limited communications internally and externally with stakeholders about the impacts of the upcoming changes in the lease standard.

To date only 37% of respondents said they had already discussed the changes and the impact with their Board of Directors. Of those respondents, only 5% have had in-depth discussions with their Board of Directors. The remainder said they only briefly discussed the matter.

Only 10% of respondents said they had discussed the changes with their shareholders and investors and 28% had discussed them with their peer companies. Also, the majority of respondents do not expect shareholders and/or investors to request information about the impacts until the exposure draft (11%) or final standard (46%) is issued, or even as late as the date of adoption of the new lease standard (28%). Based on past experiences with new standards, in reality, analysts are likely to ask for information sooner than preparers currently anticipate.

Potential expectation gap

40% of respondents said that the proposed changes in the lease standard will not result in a decline in their credit rating or increase in cost of capital. 50% of respondents do not expect a breach of their covenants

Previous research (refer to PwC's global research²) showed that there will be a significant difference between adjustments made to financial statements by users today and the actual impact of the new lease standard. Different investors use different models to adjust financial statements today and will have different perceptions of the impact of bringing all leases on balance sheets. The actual impact is therefore expected to differ from these perceptions which may result in a potential expectation gap and 'surprise'. This expectation gap, unless managed properly by entities, may result in changing perceptions of entities' financial strength after the transition to the new lease standard.

Respondent: "Informing shareholders/ analysts about the new lease standard will require a lot of time and energy, and it is to be expected that the new lease standard will create a lot of misunderstanding and confusion at the start".

Some respondents have raised concerns about whether their analysts will be able to distinguish between changes as a result of amending their accounting for leases and their genuine changes in financial position and performance. Based on past experiences with new standards, it is likely that analysts will rely on preparers to explain the effects on key financial ratios and performance measures. Entities will need to develop a strategy for communicating with their analysts and the broader stakeholders to inform them about the impacts. This is particularly important in light of any perceived weakening in financial position and performance in the eyes of analysts after adoption of the new lease standard.

2 PwC's global research. A quantitative research of the impact on debt, leverage and EBITDA of approx. 3,000 companies across different countries and industries.

5. Improvements for users of financial information

Some of the key questions are whether the new lease standard will provide more useful information to users of financial information and whether the benefits of the new lease standard will exceed the costs for preparers. The preparers' assessments in this survey are subjective but provide an indication of preparers' perceptions of complexity and costs compared to the benefits for users.

Improvements to financial information

70% of respondents are aware that users routinely adjust financial information for off balance sheet assets and liabilities arising from operating leases.

According to the IASB and the comment letters received with respect to the Discussion Paper investors think positively about the greater transparency, comparability and relevance of financial information that the new lease standard is expected to provide. The need for them to make time-consuming and cumbersome adjustments to entities' financial statements would be eliminated under the new lease standard. However, a key concern of respondents seems to be the extent to which the information provided by the new lease standard will be more useful and comparable for users.

Respondent: "To simplify lease accounting, it should be avoided to have a wide range of choices and extensive use of judgments and estimates. Operating leases today are easy to account for, as the rental cost usually corresponds to invoices and payments but a concept as "most likely lease term" permits different judgments among different entities and even within the same entity over time".

The majority of respondents (62%) said that the proposed changes in the lease standard will result in some degree of improvement to financial reporting and the usefulness of lease information provided to investors. Only 3% of those respondents believe this will be a significant improvement, 25% believe there will be some improvement and 34% believe there will be little improvement to financial information.

Some respondents have said that this is due to the complexity and judgements required in estimating renewal options and contingent rentals including their periodic reassessment. These respondents believe that the proposed new lease standard will result in more subjective assessments and therefore reduce comparability. The proposals go beyond recording contractual lease commitments on balance sheets and include likely renewal periods, contingent rentals and payments for residual value guarantees. Some respondents conceptually disagree and have said that only contractual obligations meet the definition of a liability and that renewal options and contingent rentals should be disclosed in detail to provide investors with information needed to do their own specific modelling as required.

Respondent: “The right-of-use model as proposed is conceptually flawed: this model will result in recognizing assets and liabilities that do not meet the framework definition and, as a consequence, would overstate the assets and the liabilities of the lessee”.

The IASB’s concern in this respect is that assets used to generate revenue as well as liabilities and likely cash outflows would be understated. In addition, the IASB believes this would not avoid structuring opportunities which would undermine one of the objectives of the new lease standard.

Perceptions of costs for versus benefits to users

The majority of respondents said that they expect the implementation and ongoing accounting complexity and costs for (renewal) options (85%) and contingent rentals (71%) would be quite or very significant. The majority of respondents (74%) also said that the costs will exceed the benefits for users of their financial information.

Respondents that believe the implementation and ongoing accounting complexity and costs for preparers will be significant also said that the implementation and compliance costs for preparers will exceed benefits to users. These respondents also said that as a result of the complexity and judgments, especially when looking at periods beyond management’s regular business planning cycle they expect little or no improvement to the usefulness of financial information. Some respondents said that the judgments and estimates in respect of renewal options and contingent rentals will increase discussions with their auditors.

6. Future use of leasing

When asked about the impact of the proposed changes on the future use of leases, respondents considered various alternatives, such as shorter-term leases, moving to more service and executory type contracts and outright purchase of assets.

Respondent: “We generally do not lease for the avoidance of capitalising an asset but to obtain flexibility (possibility to surrender the asset at the end of the lease term) and for tax reasons. Nonetheless the proposed new lease standard may result in increased focus on business drivers for leasing”.

Changes to future lease decisions for real estate

40% of respondents will not continue leasing real estate property in the same way as today. 22% expect to move to shorter leases.

Respondent: “It is of course very difficult to know the future actions taken on leasing but it is reasonable to state that one part of the evaluation will be the accounting effects. Obviously good business deals will continue to be made also with the new lease standard”.

60% of respondents said that given the importance of real estate leases to their businesses (for example retailers) they expect to continue to lease the same way as today. It is difficult at this stage to identify the potential impact of changing real estate tenant behaviour on real estate markets. Nevertheless, a trend towards shorter leases in certain countries is likely and might create

increased uncertainty and volatility in cash flows for real estate investments. This could have potential knock-on effects, for example in respect of valuation models of real estate portfolios, and may affect real estate investment companies' ability to obtain funding. This impact will differ from country to country and would be the highest in countries with longer average lease periods, such as the UK. Investors looking for the traditionally steady and low-risk cash flow profiles of real estate investments may change their future investment decisions.

Changes to future lease decisions for other leases

For other leases between 40% and 60% of respondents will not continue leasing the same way as today.

Favoured alternatives for other leases were shorter-term leases and service and executory contracts. For ICT and plant and equipment, more than 10% said that they would consider moving to service contracts. This indicates that some respondents may be unaware that certain service agreements will have to be recorded on balance sheet. Many rental, outsourcing, supply or service agreements include both a service and lease element. The lease element will have to be recorded on balance sheet. If preparers are unable to distinguish between these elements, they will have to record the full likely payments for the combined service and lease elements as lease liabilities on their balance sheet. Therefore, preparers should look carefully at their current rental and service agreements and assess to what extent these fall within the scope of the new lease standard. This distinction between service and lease elements for current operating leases will become more relevant in the future when leases will be recorded on balance sheet. Preparers should also act cautiously when entering into new service contracts today hoping to reduce their lease liabilities going forward – they may not achieve their objective.

7. Looking ahead

Thinking through the operational and practical implications

The majority of respondents are not yet ready to implement the new lease standard. There was limited difference in readiness between respondents that were well-informed and those that were not, nor between those that act as lessee and lessor and those that only act as lessee. This indicates that most respondents have not yet started their impact assessments and implementation activities. Some preparers will see a pervasive impact on their business and operations, including their relationships with business partners, suppliers, banks, vendors, shareholders, investors and tax authorities. In addition, they will need to implement this amid other significant changes in accounting standards which all may have similar significant impacts. Preparers could be negatively surprised by the limited available time for an effective implementation of the new lease standard when these impacts are pervasive. Preparers should start thinking through the likely lease accounting change and anticipate how this will impact their businesses to effectively prepare for the changes.

Responding to the Exposure Draft on leases

52% of respondents will not respond to the Exposure Draft on leases.

48% of the respondents have indicated that they will respond to the Exposure Draft, of which the majority will do so through a representative (industry) association. Lessees indicated more often that they will respond directly, while lessors more often indicated they will respond through their industry representative associations.

As mentioned previously, the IASB and FASB are under pressure to maintain their pace of change. They have a clear commitment to finalise their convergence projects in due course. The IASB has committed itself to reach out to preparers, which is a step in the right direction.

However, it will not be sufficient if preparers forego this opportunity to contribute high-quality input and views to the IASB.

The comment period for the Exposure Draft for leases will close on 15 December 2010. Lessees might not be able to research all implications before that time unless they start assessing the implications today. This will enable preparers to attain insights into how practical and operational the proposed changes are for their specific industry and to contribute their views to the IASB.

Transition to the new lease standard

The IASB plans to seek separate feedback from preparers and users on effective dates and transition. Staggered implementation of all new standards would allow companies more time to get ready, but a 'big bang' approach to the adoption, combined with early adoption as an alternative, might be more (cost) efficient. The majority of the upcoming changes besides leases (for example financial instruments, insurance, revenue recognition) are likely to require other changes to IT systems, processes and controls, which could be combined in one implementation effort. This would reduce the need to revisit earlier decisions in respect of operational changes.

Ongoing engagement and communication with stakeholders

Although analysts already routinely adjust financial statements for off balance sheet assets and liabilities arising from operating leases, we believe the actual impact from the new lease standard may differ significantly from existing adjustments made by different users. Preparers should keep their stakeholders informed throughout this process to reduce the expectation gap and potential risks of financial weakening in the eyes of their stakeholders.

Closing remarks

The IASB has brought forward valid arguments for proposing changes to the existing lease standard: one of them is that under current lease accounting rules approximately USD 1.25 trillion in assets are kept off balance sheets in the US alone. The majority of respondents have acknowledged that a new lease standard will bring some improvements to the financial information provided to users. However, the improvements are now considered small in the perception of preparers. Respondents have said that the IASB should find ways to further reduce complexity and costs of implementation and ongoing accounting for leases. Some respondents have specifically requested to reduce complexity in the areas of renewal options, contingent rentals and short-term leases. Some respondents have said that the IASB's concerns of creating new structuring opportunities could also be addressed by high-quality disclosures. Balancing the need to reduce complexity and costs for preparers with the need to eliminate structuring is a challenging task for the IASB. Based on past experience, new standards turn out to be of high quality once they ultimately achieve acceptance by both users and preparers worldwide.

The appendices contain further illustrations of matters discussed in chapters 1 through 7.

Appendices

1. Unprecedented pace in standard-setting activity

The International Accounting Standards Board ('IASB') and its US counterpart, the Financial Accounting Standards Board ('FASB') are sustaining an unprecedented level of standard-setting activity. The following table summarises the IASB's current agenda of standard-setting activities³:

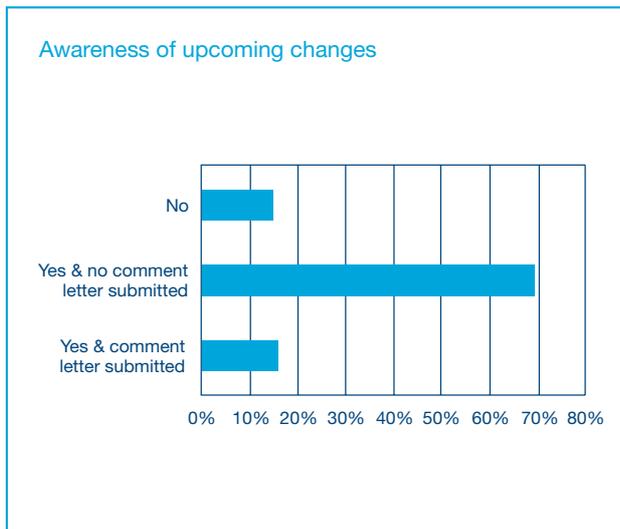
Project name	Estimated publication date				
	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 H2+
Financial crisis-related projects:					
Consolidation:					
Replacement of IAS 27		IFRS			
Disclosures about unconsolidated SPEs/structured entities		IFRS			
Investment companies		ED		IFRS	
orzevenDerecognition – Disclosures	IFRS				
Fair value measurement guidance			IFRS		
Financial instruments (IAS 39 replacement):					
Classification and measurement – financial liabilities				IFRS	
Impairment				IFRS	
Hedge accounting	ED			IFRS	
Asset and liability offsetting		ED		IFRS	
Memorandum of Understanding projects:					
Financial statement presentation:					
haDiscontinued operations			ED		IFRS
Presentation of items of other comprehensive income		IFRS			
Replacement of IAS 1 and IAS 7			ED		IFRS
Financial instruments with characteristics of equity			ED		IFRS
Income taxes	ED		IFRS		
Joint ventures	IFRS				
Leases	ED			IFRS	
Post-employment benefits (incl. pensions):					
Defined benefit plans			IFRS		
Termination benefits	IFRS				
Revenue recognition				IFRS	
Other projects:					
Annual improvements 2009-2011		ED		IFRS	
Emissions trading schemes					ED
Extractive activities		AD	AD		
Insurance contracts	ED			IFRS	
Liabilities (IAS 37 amendments)			IFRS		
Rate-regulated activities			IFRS		
Conceptual framework (measurement)					ED

³ The table includes the following abbreviations: IFRS: final standard; ED: Exposure Draft; AD: agenda decision.

2. Keeping up with this pace for leases

Awareness of upcoming changes to the lease standard

This survey finds that the vast majority of European preparers are aware of the proposed changes in the lease standard:

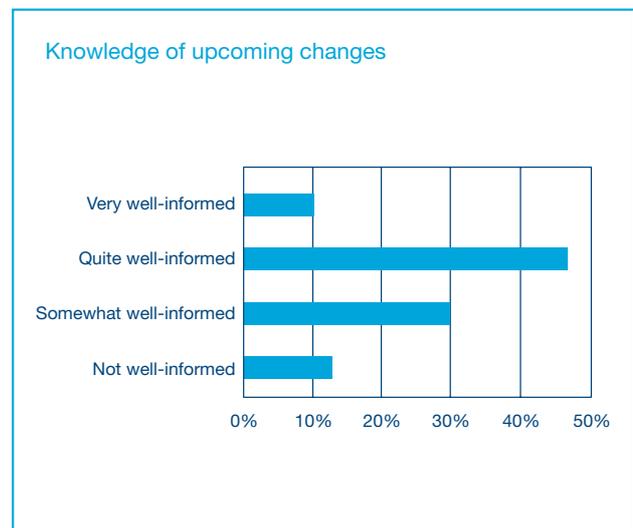


Less than 20% of respondents indicated that they also submitted a comment letter, or contributed to a comment letter on the Discussion Paper by an advising or governing body (e.g. industry associations). If individual companies do not have the resource bandwidth to respond to the proposed changes in the lease standard, involving an industry association to respond on behalf of the industry might prove to be effective.

However, while lessors' industry associations are generally very active, at this stage, industry associations on the lessee side are not very active when it comes to financial reporting issues. A key challenge for certain highly impacted industries, such as retail, is to organise a comment letter process by the industry when they do not anticipate to respond to the proposed lease standard individually.

Knowledge about the upcoming changes to the lease standard

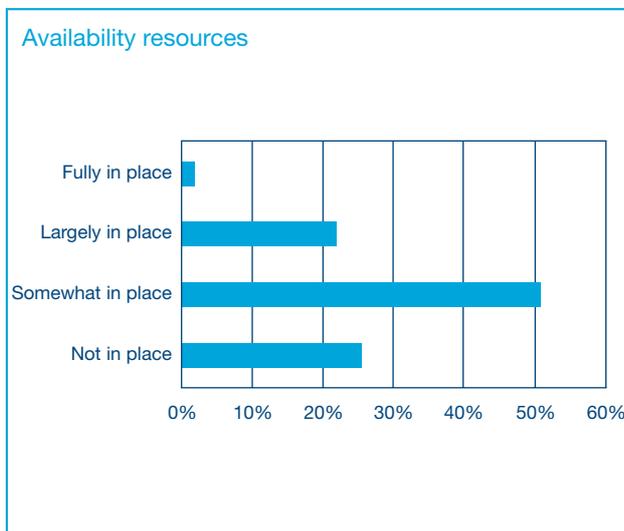
We also asked to what extent respondents were knowledgeable and well-informed about the upcoming changes in the lease standard. 43% of respondents said they are not well-informed or only somewhat informed about these changes:



Respondents are largely aware of upcoming changes in the lease standard but are generally not well-informed at this stage. This indicates that not all preparers are able to keep up with the pace of the lease project and appears to reflect preparers' recent concerns about the pace of standard-setting activities.

Availability of resources to implement the new lease standard

We asked whether respondents have the necessary resources to implement the new lease standard. Approximately 24% of respondents have indicated that they do not have the resources in place and 50% have indicated that they only have the resources available to some extent:



26% of preparers seem to have the resources in place to implement the new lease standard. The remainder of the respondents have the resources available to some extent or do not have the resources available yet.

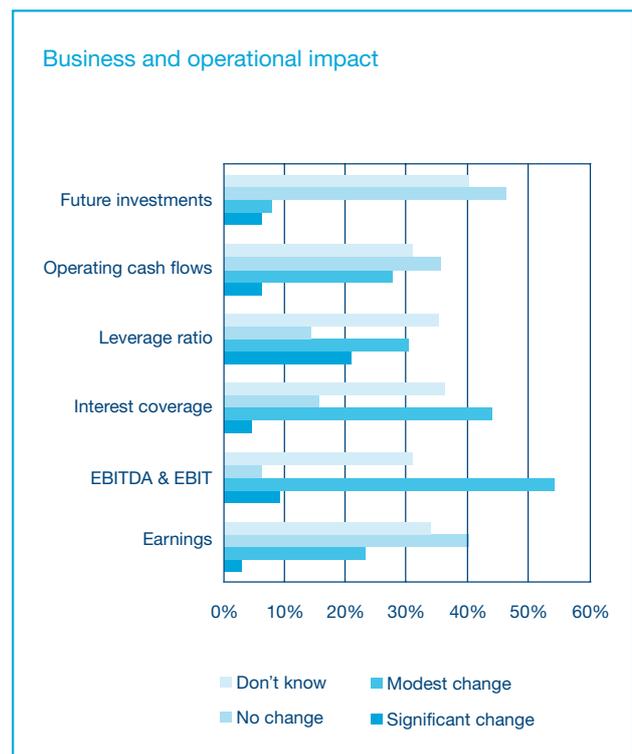
3. Understanding the business and operational implications

Potential impact on preparers' net earnings

The proposed transition rules do not include retrospective application as an alternative for lessees and proposes to consider all existing leases upon transition date as new leases. This means that the 'front loading' of costs will apply to all leases upon transition which increases the negative impact on preparers' earnings. Under the retrospective application option, some leases would be in their early stages of the lease term (higher costs compared to current model) and others will be in later stages of the lease term (lower costs compared to current model) which might overall result in an offsetting of the impact on net earnings. However, as mentioned previously, the current proposed transition rules will result in a more significant downward effect on net earnings in the years after transition to the new lease standard.

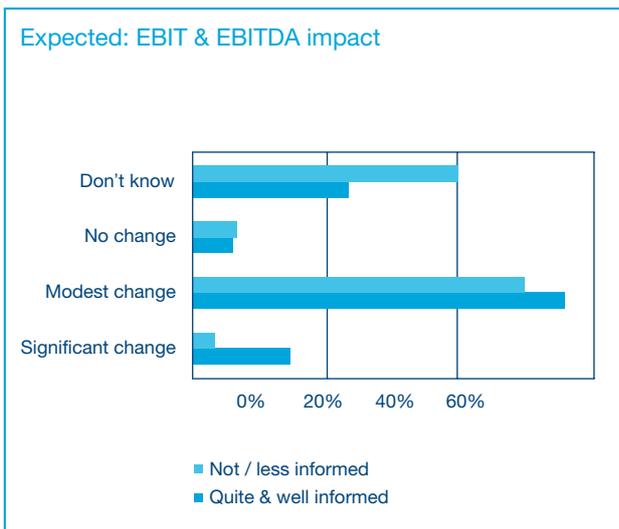
This effect will ultimately neutralise as existing leases end and new leases are entered into (which would be achieved upon adoption if retrospective application were an alternative). The growth of a business and entering into more significant leases after the transition date might have yet another negative impact on earnings. In this scenario there may even be a continued negative impact on net earnings. For example, if asset prices or lease payments are increasing or a business is growing in perpetuity, the net earnings will be permanently lower compared to the continued application of current operating lease accounting. These are key elements that need to be considered by preparers when renegotiating compliance and performance targets in financing arrangements, agreements with suppliers and vendors and employee compensation agreements.

The survey finds that two-thirds of the respondents seemed able to assess the significance of the impact on their leverage, interest coverage, operating income, EBITDA and operating cash flows. However, only 26% of the respondents seemed able to assess the deterioration of net earnings as a result of the previously mentioned front loading of costs under the new lease standard. 71% of the lessee respondents and 89% of the lessor respondents either expected no changes to net earnings or did not know whether net earnings would change at this stage. As mentioned previously, net earnings will deteriorate in the years after transition to the new lease standard. Only 3% of respondents expected significant impact on net earnings and 23% of respondents expected a modest change to their net earnings:



This is surprising as some respondents that expected no changes in earnings or did not know the extent of the changes at this stage had significant operating leases. This might indicate that these respondents are unaware of the front loading of costs and related deterioration in net earnings after transition to the new lease standard.

Also, there are no significant differences in the expected impact between participants that are well-informed and those that are not well-informed about the upcoming changes. The respondents that are well-informed generally expect more significant impact only on EBIT and EBITDA:

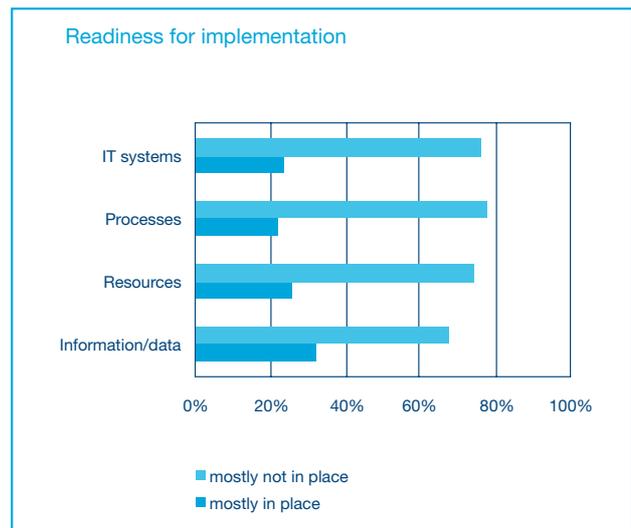


Impact on regulatory capital requirements for banks

Over 70% of bank participants that responded are uncertain about whether the changes will impact their required regulatory capital.

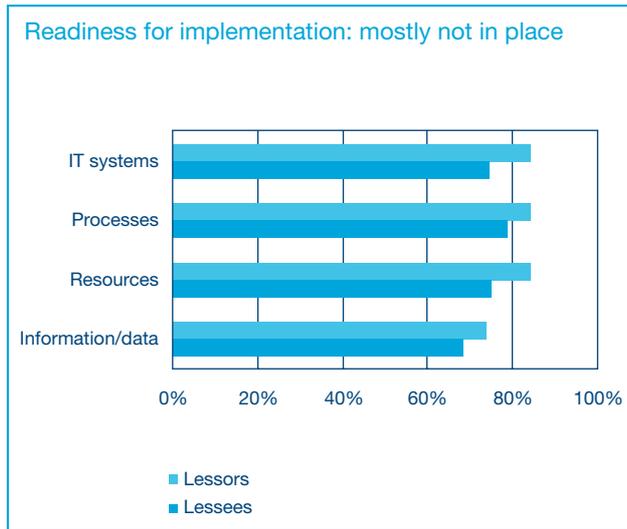
Business and operational readiness

The majority of respondents said that they do not currently have or only to a limited extent have the necessary information and data (68%), resources (74%), processes (78%) and IT systems (76%) in place to implement the new lease standard.

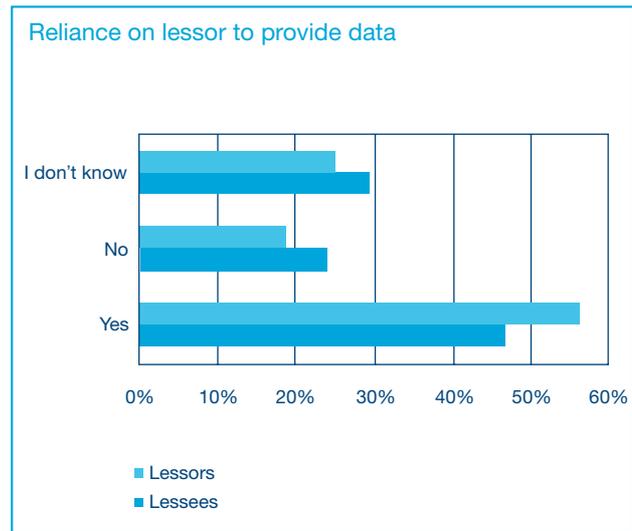


Lessors generally tend to have better document management systems in which they track and trace their leases. 48% of the respondents said that they plan to request their providers of leasing services (lessors) for the data required for the implementation and ongoing accounting for leases. Another 29% do not know yet at this stage whether they will contact their lessors.

There were no significant differences between lessees and those that also act as a lessor in the respondents' readiness to implement the new lease standard. This may be caused by the fact that some of the participants in the survey that act as a lessor do not consider leasing to be their primary business:



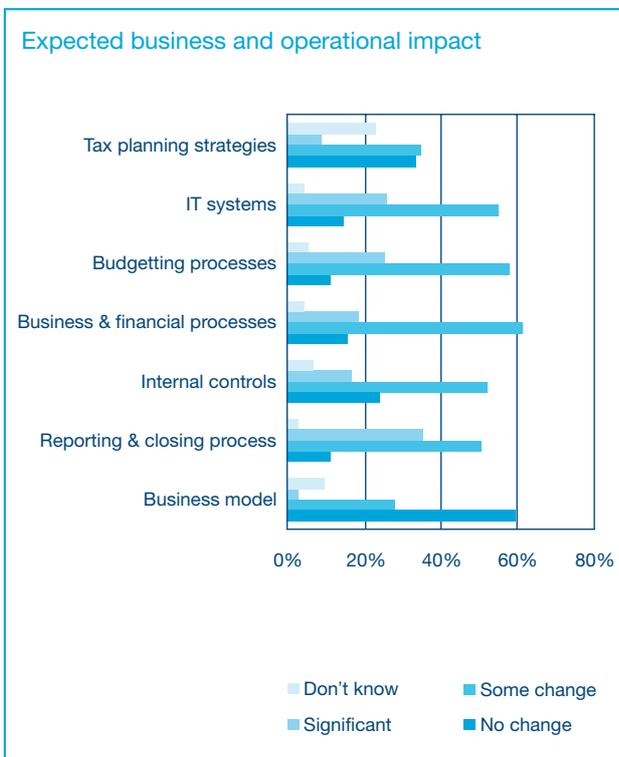
We asked respondents whether they want their lessor/service provider to provide them with the necessary information and data to enable them to account for leases under the new standard:



The survey results currently show that approximately half of the lessees (irrespective of whether they also act as lessor) expect their lessor/service provider to provide the necessary information and data required for the new lease standard.

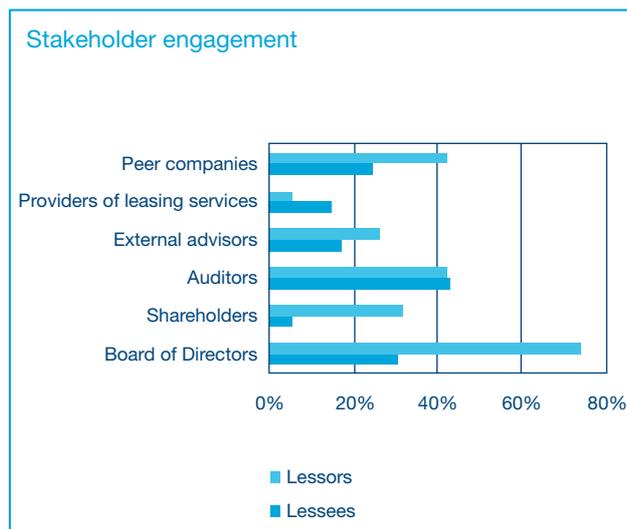
Expected business and operational impact

Nearly half of the respondents expect some changes and one-third of respondents expect that significant changes will be needed to IT systems, performance measurement systems and budgeting processes, business and financial processes, internal controls and reporting and closing processes. The majority do not expect any changes to their business models:



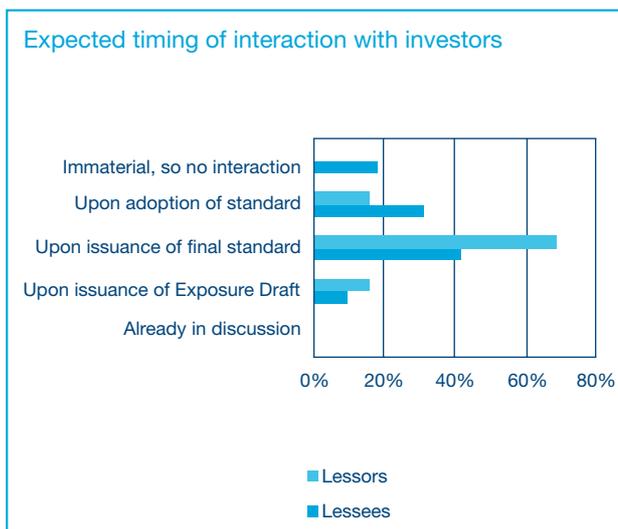
4. Engaging stakeholders

Managing market and stakeholder reactions



To date only 37% of the lessee respondents said they had already discussed the changes and their impact with their Board of Directors. Of those respondents, only 5% have had in-depth discussions with their Board of Directors. The remainder said they only briefly discussed the matter.

Only 10% of the lessee respondents said they had discussed the changes with their shareholders and investors and 28% discussed them with peer companies. Also, the majority of lessee respondents do not expect shareholders and/or investors to request information about the impacts until the exposure draft (11%) or final standard (46%) is issued, or even as late as the transition date to the new lease standard (28%):

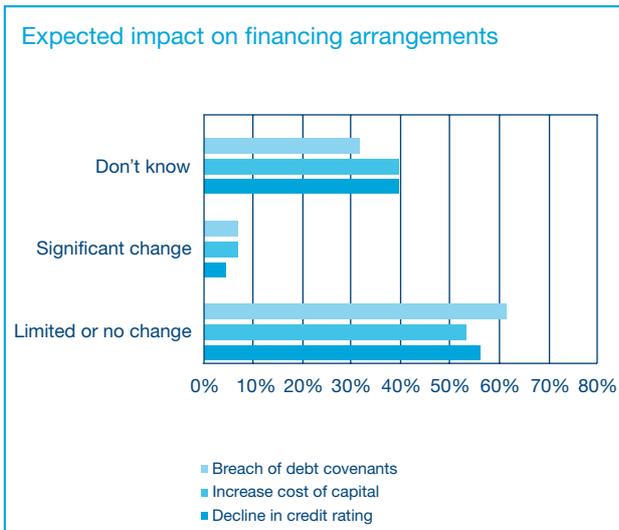


A final standard is planned for mid-2011. Preparers have limited time remaining to perform an impact assessment which they can use to respond to investors' information requests.

Some respondents have raised concerns about whether their analysts will be able to distinguish between changes as a result of amending their accounting for leases and their genuine changes in financial position and performance. Based on past experiences with new standards, it is likely that analysts will rely on entities to explain the effects on key financial ratios and performance measures. Entities will need to come up with a clear communication strategy with analysts and broader stakeholders to inform them about the impacts.

Potential expectation gap on impact of the new lease standard

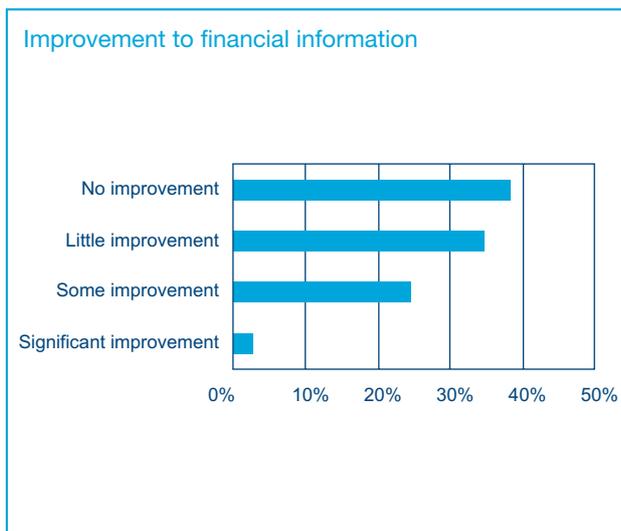
Nearly 60% of the respondents expect limited or no decline in their credit rating, increase in cost of capital or breach of their covenants.



5. Improvements for users of financial information

Improvement to financial information

The majority of respondents (62%) said that the proposed changes will result in some degree of improvement to financial reporting and usefulness of the information provided to investors:

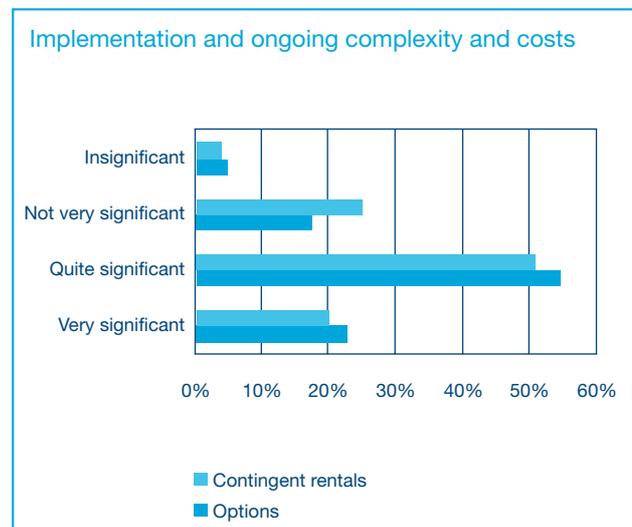


However, only 3% believe this will be a significant improvement, 25% believe there will only be some improvement and 34% believe there will be little improvement. According to some respondents this is largely due to the complexity and judgments required in estimating renewal options and contingent rentals including their periodic reassessment. According to these respondents this will result in more subjective assessments and reduce comparability. Some have indicated that only contractual obligations meet the definition of a liability and that renewal options and contingent rentals should be disclosed in detail to provide investors with information needed to do their own modelling if needed.

Requiring one approach for all companies will increase comparability as opposed to the different methods currently applied by different analysts today to adjust for off balance sheet operating leases. Eliminating the different models of operating and finance lease today will have a significant positive impact on comparability of financial statements. However, respondents believe that the introduction of judgments and subjectivity in estimate likely renewal options, contingent rentals and payments for residual value guarantees will inherently reduce comparability between companies.

Perceptions of implementation costs and ongoing complexity

We asked respondents to assess the ongoing complexity and costs of accounting for renewal options and contingent rentals under the proposed new standard. The majority of respondents said that they expect this would be quite or very significant:



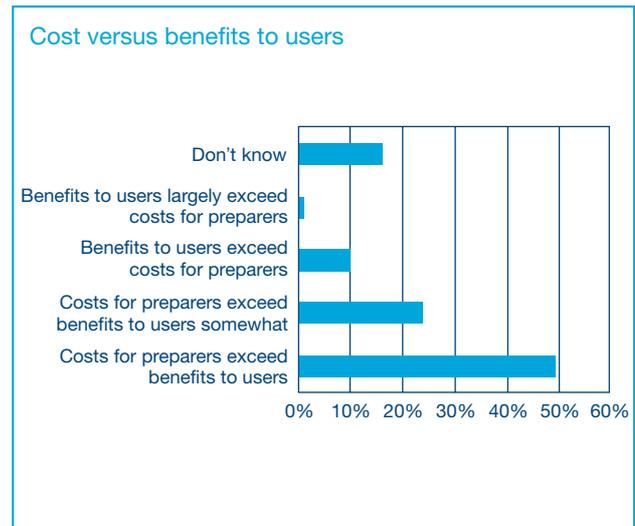
Respondents that believe the implementation and ongoing accounting complexity and costs for preparers will be significant also said that compliance costs for preparers will exceed benefits to users. These respondents also said that as a result of the complexity and judgments in the proposed lease standard they expect little or no improvement to the usefulness of financial information. Some respondents said that the judgments and estimates in respect of (renewal) options and contingent rentals will increase discussions with their auditors.

Perceptions of costs versus benefits to users

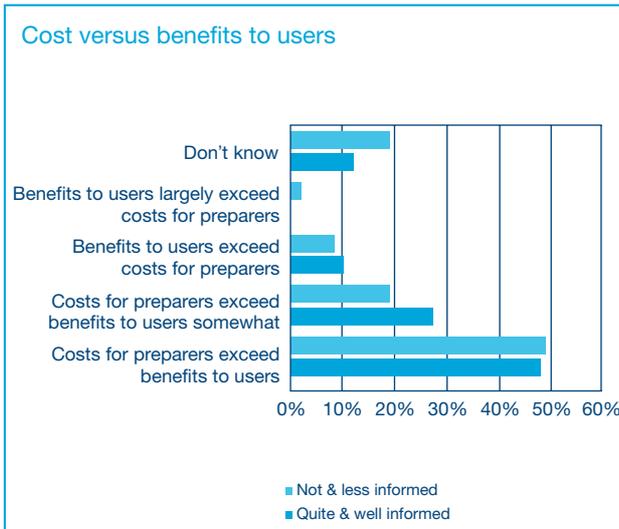
We asked respondents to assess whether costs will exceed benefits for their company. Although, this is subjective it gives an idea of preparers' perceptions of cost versus benefits.

Respondents that believe the implementation and ongoing complexity and costs for preparers will be significant also said that compliance costs for preparers will largely exceed benefits to users.

The majority (73%) of respondents said that costs for preparers will exceed benefits to users at least to some extent:



Whether respondents were well-informed or not did not result in any significant differences in respect of their assessment of cost versus benefits:



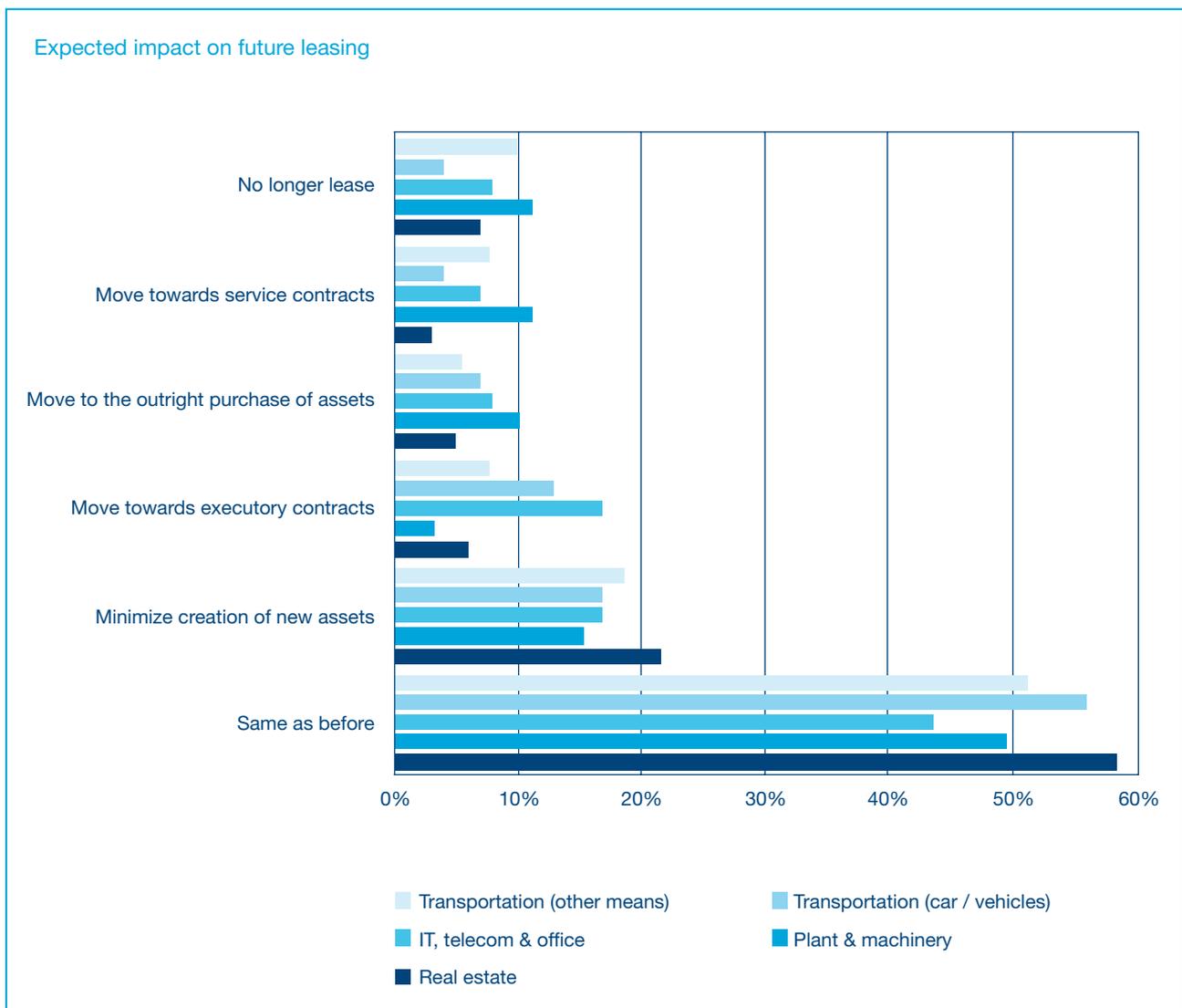
We asked the respondents whether they want to include certain scope exemptions in the final standard. Of these exemptions, only an exemption for short-term leases obtained the support of the majority of the respondents (85%). Other exemptions (such as for non-core assets and service components) did receive some support from respondents, but were largely rejected by most respondents.

6. Future use of leasing

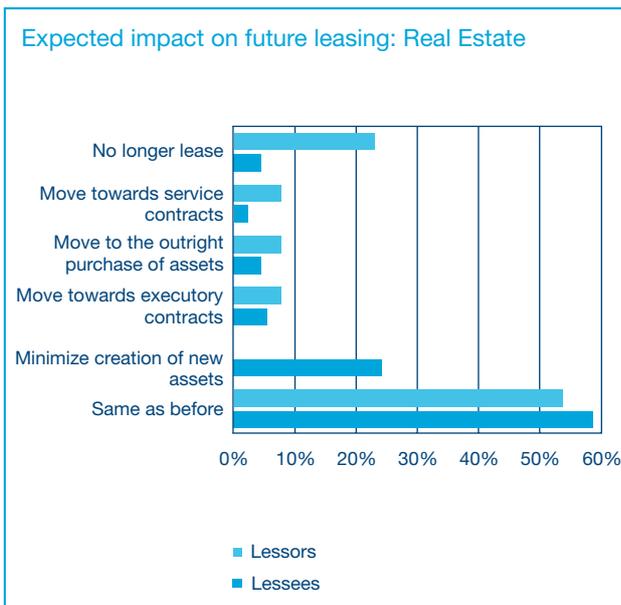
Expected impact on future lease decisions

When asked about the impact of the proposed changes on future use of leases, the respondents viewed various alternatives for leases.

These alternatives include moving to more service and executory type contracts, outright purchase of assets and shorter-term leases:



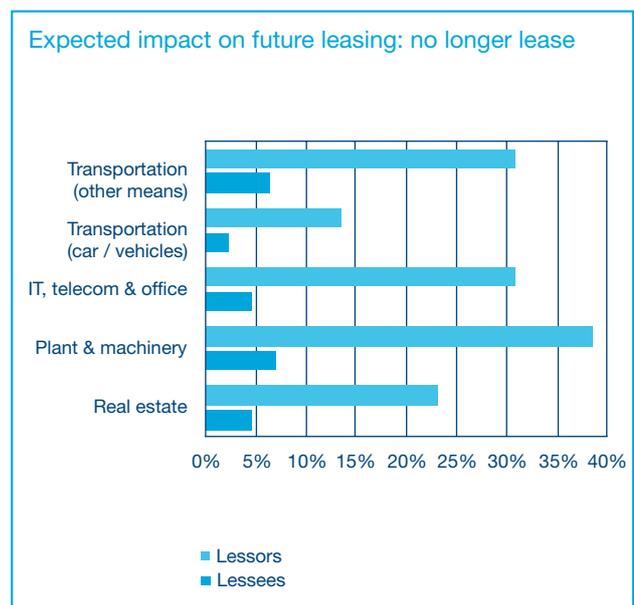
Expected impact on future real estate lease decisions
 Given the importance of real estate leases to respondents' businesses (for example retail) the majority of lessees of property (nearly 60%) expect to continue to lease much the same way as today:



22% of the respondents expect to move to shorter leases for their real estate leases. However, this is primarily the case with lessees. Lessors have not indicated to move to shorter leases. A reason may be that lessors understand what the commercial and other implications are of negotiating shorter leases whilst lessees are not fully aware of what this would mean in terms of contract pricing, availability of assets and related business risks etc.

Expected impact on future lease decisions for smaller ticket leases

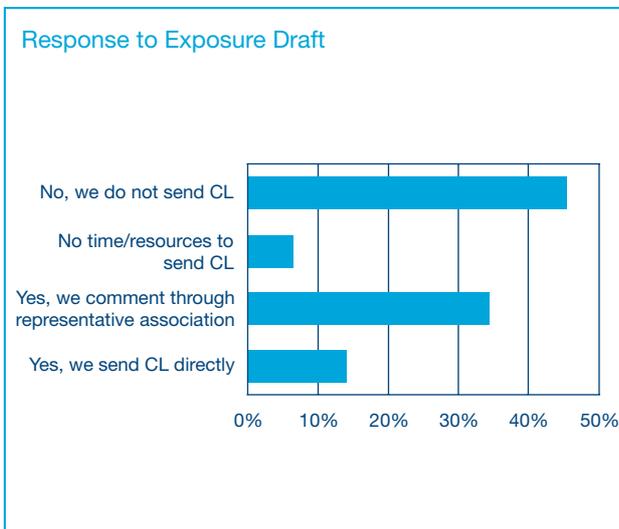
Favoured alternatives for smaller leases were shorter-term leases and service/executory contracts. Respondents that also act as lessors in addition to being lessees were more inclined to seek alternatives to leasing in comparison with those that only act as lessees. For ICT and plant and machinery, more than 10% said that they would consider moving to service contracts:



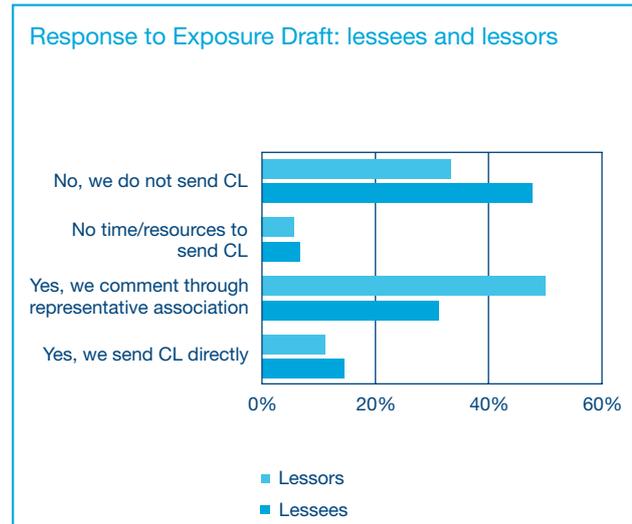
7. Looking ahead

Responding to the Exposure Draft on leases

We have asked respondents whether they expect to comment on the upcoming Exposure Draft for leases. Approximately 52% of respondents have indicated that they will not respond to an Exposure Draft on the new lease standard. 48% of respondents have indicated that they will respond to the Exposure Draft, of which the majority will do so through a representative (industry) association:



The following illustrates the different responses between lessees and lessors:



Lessees indicated more often that they will respond directly, while lessors more often indicated they will respond through their industry representative associations. The comment period for the Exposure Draft for leases will close on 15 December 2010. Lessees might not be able to identify all implications before that time unless they start assessing the impacts today.

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Finance and Leasing Association

Steps to accounting for a lease under the International Accounting Standards Board's proposals

Step	What to do	Information needed	Link to IASB proposals
1.	<p><i>Work out whether it's a lease: Work out whether you are renting specific equipment</i></p> <p>Check whether an asset is identified in the contract and how it is described.</p>	The lease agreement and accompanying paperwork.	B1 (a)
2.	Work out whether the leasing company can change the equipment that you are renting.	The lease agreement and accompanying paperwork.	B1 (a)
3.	Find out whether the lessor has a pool of assets, any one of which could be used to fulfill the contract.	Advice from lessor.	B2
4.	Work out whether it is actually practical for the leasing company to change the equipment that you are renting.	<p>Details of any modifications made to the equipment to suit your requirements during the rental period.</p> <p>An assessment from someone with a reasonable degree of expertise in the type of equipment being rented.</p>	B2
5.	Work out whether the leasing company can only change the equipment when it is not working properly.	The lease agreement and accompanying paperwork.	B3
6.	Work out whether the leasing company can change the equipment now, rather than only after a certain date in the future.	The lease agreement and accompanying paperwork.	B3
7.	<p><i>Work out whether you are controlling the equipment</i></p> <p>Work out whether there are any restrictions on using the equipment</p>	The lease agreement and accompanying paperwork.	B4 (a)

Step	What to do	Information needed	Link to IASB proposals
8.	Work out whether anyone else will use the equipment for a significant part of the output / utility.	<p>Details of the expected actual output and theoretical capacity of the asset.</p> <p>An assessment from someone with a reasonable degree of expertise in the type of equipment being rented.</p>	B4 (a and c)
9.	Work out whether you can stop other people using the equipment if you want to.	The lease agreement and accompanying paperwork.	B4 (b)
10.	Check if the amount you pay is fixed by the contract.	The lease agreement and accompanying paperwork.	B4 (c)
11.	Check whether the amount that you pay depends on the use you make of the equipment.	The lease agreement and accompanying paperwork.	B4 (c)
12.	<p><i>Work out whether the lease is in-scope</i></p> <p>Check the lease is for an asset in an excluded category.</p>		5
13.	Check whether you will automatically own the equipment by the end of the lease.	The lease agreement and accompanying paperwork	8 (a)
14.	Check if you expect to receive all but a trivial amount of the risks and benefits associated with the leased asset.	<p>Details of the expected actual output and theoretical capacity of the asset.</p> <p>An assessment from someone with a reasonable degree of expertise in the type of equipment being rented.</p>	B9

Step	What to do	Information needed	Link to IASB proposals
15.	Check if there is a bargain purchase option.	Expected market prices of asset.	B10
16.	Taking into account all of the above, assess whether the contract is in-scope.	Above	9
17.	Consider whether this is a short-term lease		64
18.	If so, decide whether you want to use the alternative treatment for short term leases or the full standard. If you elect to use the short term treatment, apply steps below, except for steps 37, 41, and replace steps 44 and 45 with the following: recognise the lease payment in P&L		
19.	<i>Determine the possible lease terms</i> Check the minimum rental period.	The lease agreement and accompanying paperwork	B18 (a)
20.	Check how much you would have to pay after the minimum rental period.	The lease agreement and accompanying paperwork	B18 (a)
21.	Check the rules for returning the equipment.	The lease agreement and accompanying paperwork	B18 (a)
22.	Check whether there are any special charges for returning the equipment at different times.	The lease agreement and accompanying paperwork	B18 (a)
23.	Check what there are any legal considerations that could affect the possible lease terms	Legal advice	B18 (a)
24.	Check whether there are any regulations that could affect the cost of returning the equipment at different times.	An assessment from someone with a reasonable degree of expertise in relevant regulation.	B18 (b)

Step	What to do	Information needed	Link to IASB proposals
25.	Check whether there are any tax consequences of returning the equipment at different times.	An assessment from someone with a reasonable degree of expertise in tax rules.	B18 (b)
26.	Check whether there are any operational consequences of returning the equipment at different times, e.g. costs of lost production.	An assessment from someone with a reasonable degree of expertise in the business operations.	B18 (b)
27.	Check other business reasons for keeping or returning the equipment, such as whether the equipment is particularly specialised and so difficult to replace, or in a location where it is difficult or expensive to replace or return to lessor.	An assessment from someone with a reasonable degree of expertise in the business operations.	B18 (c)
28.	Check the intentions of managers in the area of the business using the equipment.	Views of relevant managers.	B18 (c)
29.	Check the businesses' past practice in keeping or returning similar rented equipment.	Company records, discussions with relevant managers.	B18 (d)
30.	Check whether there are any pre-defined options for extending the lease or whether you would have the right to continue to use the asset after the end of the contract	The lease agreement and accompanying paperwork	B19
31.	Check any requirement to pay the leasing company extra money if the value of the equipment is lower than a certain amount at the end of the lease.	The lease agreement and accompanying paperwork. Views of equipment valuation expert.	B19
32.	Taking into account all of the factors above, identify each reasonably possible lease period that could occur.	Above information.	B21 (a)
33.	Determine the probabilities associated with each possible lease period		
34.	Determine the longest possible lease term that is more likely than not to occur		

Step	What to do	Information needed	Link to IASB proposals
35.	<i>Determine the amount of lease payments</i> Estimate the amount and timing of the cash flows for each reasonably possible outcome.	The lease agreement and accompanying paperwork.	B21 (b)
36.	Check if lease payments include any charges for services that are 'distinct'	Assessment of the lease agreement together with information from lessor on whether an identical or similar service is sold separately	B6, B7
37.	If information on amount of service component is not available, compare contract with equivalent lease without services or service only contract to make estimate of service amount (probably means going to look for a lot more info in the next column)		
38.	Deduct from the lease payments any charges for services, if possible. (If not, include in lease payments?)	The lease agreement and accompanying paperwork.	6, B5
39.	Calculate initial direct costs, including commissions, legal fees, preparing and processing lease documents, etc.	Managers involved in arranging the lease.	B14-15
40.	Add initial direct costs to lease payments	Calculation	12 (b)
41.	Work out the relevant discount rate	Quotes from banks for equivalent types of financing, or information from lessor on rate used in pricing.	12 (a) B11-13
42.	Identify whether the contract contains contingent rental payments	Forward rates from finance dpt Plans from operational managers of likely use of equipment Obtain budgets and other forecasts	14 (a)
43.	Are there payments linked to a rate or index? If so, obtain forward rates or indices		
44.	Are there payments linked to the usage of the asset? If so, determine what your usage of the asset would be under different scenarios		

Step	What to do	Information needed	Link to IASB proposals
45.	Are there payments linked to your performance (e.g. turnover)? If so, determine what your turnover would be under different scenarios		
46.	Make an estimate of any contingent rentals payable under these scenarios		
47.	Assign a probability to each of these scenarios.		
48.	Make an estimate of any amounts payable under residual value guarantees under various scenarios Assign a probability to each scenario.	Advice from expert in the type of equipment	14 (b)
49.	Make an estimate of expected payments under term option penalties under various scenarios Assign a probability to each scenario Before 41. Calculate your expected payment using a probability weighted outcome technique	Plans from operational managers of likely use of equipment	14 (c)
50.	Calculate the present value of each of the expected payment (except for relevant short-term leases).	Calculation	14, B21
51.	<i>Interest expense</i> Measure the interest expense on the liability to make lease payments using the effective interest method		11 (a)
52.	<i>Amortisation of right of use asset: Work out the annual amortisation charge in accordance with IAS 38</i> Determine the useful life of the underlying asset Compare this to the lease term established in step [x] and select the shorter period as the amortization period		20
53.	Select the amortization method on the basis of the expected pattern of consumption of the future economic benefits embodied in the right of use asset.		
54.	<i>Impairment losses on right of use asset: Apply IAS 36 Impairment of Assets to determine whether the asset is impaired</i> <i>Test for any indication of impairment at each reporting date</i>	Market values Condition reports	24

Step	What to do	Information needed	Link to IASB proposals
55.	Determine the recoverable amount of the asset (i.e. the higher of its fair value less costs to sell or its value in use)	Whether there have been significant changes affecting your business or the market to which the right of use asset is dedicated	
56.	If the recoverable amount of the asset is less than its carrying value, recognise an impairment loss	Information on the future cash flows you expect to derive from the asset	
57.	Recognise any impairment loss in accordance with IAS 36		24
58.	<i>Subsequent measurement</i> Reassess the lease term, contingent rentals and expected payments under term option penalties at each reporting date	Updated information as collected in steps above	17, B20
59.	Revalue the right-of-use asset (optional) if you revalue all equivalent owned assets in the property class and recognise gains and losses	Evidence of fair value of asset	17, B20
60.	Perform revaluations regularly	Paperwork from leasing company, equipment reports e.g. damages.	
61.	Recognise differed tax assets/liabilities for book/tax timing differences that will arise		
62.	Review the amortization period and method at least once a year		

Step	What to do	Information needed	Link to IASB proposals
63.	<p><i>Accounts preparation</i></p> <ul style="list-style-type: none"> Carry out book entries at time of delivery (e.g. book initial payment obligation as liability, book right of use as asset) Carry out book entries for monthly invoices (e.g. book the rent / decrease payment obligation) Carry out book entries for monthly closing (to be repeated over contract life) (e.g. Book amortization of right of use, book interest on payment obligation, book depreciation if necessary) Carry out book entries for any contract adjustments Carry out book entries for monthly closing (e.g. book rent to payment obligation) Carry out book entries for end of contract (e.g. book additional mileage invoice, book refurbishment invoice) 	As above, plus invoices and other communications from lessor	25-27
64.	<p><i>Disclosure</i></p> <p>Provide a general description of lease arrangements</p>	Catalogue of lease agreements	73 (a) (i)
65.	Provide the basis and terms on which contingent rentals are determined	Details of lease agreements	73 (a) (ii)
66.	Provide details of options for renewal and termination	Details of lease agreements	73 (a) (iii)
67.	Provide details of options for purchase of the underlying asset	Details of lease agreements	73 (a) (iv)
68.	Provide information about assumptions and judgements relating to amortization methods	Details of lease agreements	73 (a) (v)
69.	Provide information on the existence and terms of residual value guarantees	Details of lease agreements	73 (a) (vi)
70.	Provide information on initial direct costs	Details of lease agreements	73 (a) (vii)
71.	Provide information on restrictions imposed by lease agreements	Details of lease agreements	73 (a) (viii)
72.	Provide information on future leases	Details of lease agreements	73 (b)
73.	Provide information on significant subleases	Details of lease agreements	74
74.	Provide information on short-term leases		75
75.	Provide information on sale and leaseback transactions		76
76.	Provide a reconciliation of opening and closing values for right of use assets and lease liabilities, disaggregated by underlying asset class. Show the cash payments separately		77
77.	<p><i>Record keeping</i></p> <p>Maintain records of all leased equipment</p>	Operating system to monitor usage, location, maintenance, damage etc by individual asset.	

Steps to accounting for an operating lease under IAS 17

Step	What to do	Information needed	Reference
1.	Determine if lease is in a small number of categories that are out of scope		17.2, 17.3
2.	Classify individual leases as finance lease or operating lease based on the substance of the transaction at the inception of the lease		17.7 to 17.13
3.	If the provisions of the lease change, treat as a new agreement		17.13
4.	Measure lease payments expense for each year usually on a straight-line basis over the lease term		17.33
5.	Measure cost of services such as insurance and maintenance as incurred		17.34
6.	Disclose total of future minimum lease payments under non-cancellable operating lease by prescribed periods		
7.	Disclose lease payments recognised as an expense in the period, separately disclosing minimum lease periods, contingent rents, and sublease payments		
8.	Provide a general description of the lessee's significant leasing arrangements		

Steps to accounting for a finance lease under IAS 17

Step	What to do	Information needed	Reference
1.	Determine if lease is in a small number of categories that are out of scope		17.2, 17.3
2.	Consider fair value of assets at time any options are exercisable		
3.	Consider useful economic life of asset		
4.	Consider whether lease asset is of a nature so specialised that only the lessee has the option of using		
5.	Classify individual leases as finance lease or operating lease based on the substance of the transaction at the inception of the lease		17.7 to 17.13
6.	If the provisions of the lease change, treat as a new agreement		17.13
7.	Identify the interest rate implicit in the lease, or the businesses' incremental borrowing rate		17.20
8.	Measure the initial value of the asset as the present value of minimum lease payments plus any initial indirect costs		17.20-17.24
9.	Measure the initial value of the liability as the present value of minimum lease payments		17.20-17.24
10.	Apportion the lease payments between the finance charge and the reduction of the outstanding liability		17.25
11.	Measure the finance charge for each year so as to produce a constant periodic rate of interest on the remaining balance of the liability		17.25
12.	Measure the expense of contingent rents in the periods in which they are incurred		17.26
13.	Assess whether it is likely that ownership will transfer by the end of the lease term		17.27
14.	Calculate depreciation expense each year, either in accordance with IAS 16 <i>Property, Plant and Equipment</i> or IAS 38 <i>Intangible Assets</i> , or over shorter of the lease term and its useful life		17.27
15.	Adjust the asset value by the depreciation charge.		

Step	What to do	Information needed	Reference
16.	Apply IAS 36 <i>Impairment of Assets</i> to determine whether a leased asset has become impaired, and if so make appropriate adjustments		17.30
17.	Recalculate the liability as the present value of the minimum lease payments.		
18.	For each class of asset, disclose the net carrying amount at the reporting date		
19.	Disclose a reconciliation between the total of future minimum lease payments at the reporting date and their present value		
20.	Disclose contingent rents recognised as an expense in the period		
21.	Disclose total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date		
22.	Disclose a general description of the lessee's material leasing arrangements		

Attachment: An Alternative: A Simplified Right of Use Model for All Leases.
(Draft) proposal by Leaseurope

This section of our (read: Leaseurope) response recaps what we consider should be used as an alternative right of use model applying to all leases.

I. Scope

Definition of a lease

A lease is a contract that, in exchange for consideration, conveys to a lessee the right to use a specified asset for a period of time that is more than a minor part of its economic life.

Control

The lessee will have obtained a right to use when it controls the asset for more than a minor part of its economic life. The lessee will have obtained control when the contract conveys the ability to the lessee to direct the use of the asset for more than a minor part of its economic life and when it has obtained the right to consume more than a minor share of the future economic benefits of the asset through its use of the asset over the lease term.

Indicators of when a contract is a lease (as opposed to a service contract)

The existence of one or more of the following features implies that an agreement conveying the right to use a specified asset is a lease *and not a service contract*. This list is non-exhaustive:

- An option to purchase the asset
- A renewal option that allows the lessee to extend the contract to a term that equates to substantially all of the economic life of the asset
- A residual value guarantee provided by the lessee or a party related to the lessee

Specified asset

An asset is specified when:

- The agreement specifically identifies the asset (or part of a larger asset)

An asset is not specified when, even though the agreement specifically identifies the asset:

- The lessor can substitute the asset at any time without requiring the lessee's consent or,
- If the lessee's consent is required, it is feasible or practical for the lessor to substitute the asset, having obtained that consent

Assets that are fungible and easily replaceable on an open market do not therefore generally qualify as specified assets.

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Economic life of an asset

The economic life of an asset is the period over which the asset is expected to be economically useable by one or more users or the number of production or similar units expected to be obtained from the asset by one or more users.

- ▭ This approach does not define whether an agreement constitutes a sale of the underlying asset. This distinction is not required as the accounting treatment of the purchase of an asset and a lease that conveys a right of use equivalent to 100% of the asset are very similar under this model. Moreover, the need to distinguish between leases and purchases/sales within the leases guidance arose only when manufacturer/dealer lessors were precluded from recognising sales revenue under a performance obligation approach to lessor accounting. This model uses a partial de-recognition approach to lessor accounting which allows manufacturer/dealer lessors to recognise sales revenue proportionately to the right of use asset they have sold (see below). Not defining sales/purchases within the leases guidance also avoids the creation of several such potentially different definitions with the IFRS literature.
- ▭ The existing guidance currently set out in IFRIC 4 and which has been subject to significant criticisms from IASB constituents is replaced by the definitions above.
- ▭ The definition of a lease is slightly narrower under this approach than under existing guidance. The advantage of this definition is that it allows for the application of one, simple right of use model to lessees and lessors, thereby addressing concerns surrounding the current guidance (i.e. assets and liabilities not recognised under operating leases) and clarifies that outsourcing-type contracts involving the incidental or ancillary use of assets and contracts where the asset is readily substitutable are not leases, thus avoiding a significant amount of the complexity that would be generated for preparers were the existing proposals to become a new standard.

When a lease contains both right of use and service components, an entity shall separate the service components from the components for the right of use and account only for the latter part under the leases standard. The service component should be accounted for under the appropriate IFRS (Revenue Recognition).

If a lessee does not have precise information relating to the service components of a lease it should make an estimate of this component. If this cannot be done, it should make an assessment of whether it has acquired a lease or a service.

- ▭ Lessees should be required to make estimates of their service components if precise information is not available. Defaulting to treating the entire rental payment including service payments as a lease would be inconsistent with the treatment of an outright asset purchase. Additionally, given the narrower scope of the standard proposed here, the requirement to estimate the service component should not be significantly complex.
- ▭ Lessors will always be able to clearly identify service components of their leases as this is part of their business model. A lessor that does not have such information will not be able to price a lease contract.

Leases of intangible assets should be covered by the standard

- ▭ Constituents have shown strong support for including leases of intangibles in the scope of the guidance. The exclusion of intangibles from this standard would represent a step backwards from existing lease accounting guidance rather than an improvement.

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Arrangements granted for a maximum possible lease term of no more than 12 months should be excluded from the scope of the standard, and be accounted for as service contracts under the relevant IFRS (Revenue Recognition) (both lessees and lessors).

Lessors shall not apply this standard to leases of investment property. Lessors of other types of property should use existing operating lease accounting.

II. The Model

Accounting for lessees: right-of-use model

Lessees recognise, for all leases, a liability for their obligation to make rental payments and an asset for their right-to-use the leased asset.

Accounting for lessors: partial de-recognition model

The lessor de-recognises the rights it has transferred to the lessee via the lease contract from the underlying leased asset. Any remaining rights are the lessor's residual asset.

III. Initial Measurement

Lessees

The initial measurement of the obligation to make lease payments is the present value of the lease payments (defined below), discounted using the lessee's incremental borrowing rate or, if it can be readily determined, the interest rate implicit in the lease.

The initial measurement of the lessee's right-of-use asset is the amount of the obligation to make lease payments, measured as above plus any initial direct costs.

Lessors

A lessor recognises a receivable for its right to receive lease payments at the present value of lease payments (defined below) discounted at the rate implicit in the lease, which includes any initial direct costs incurred by the lessor.

The lessor de-recognises from the carrying value (i.e. purchase price in the case of a third party lessor) of the underlying asset an amount equal to the portion of the rights of the underlying asset it has transferred to the lessee. To determine this portion, the lessor considers the share that the fair value of the rights transferred to the lessee, measured at the PV of lease payments, represents in relation to the fair value of the underlying asset.

In other words the lessor calculates the fraction

$$\frac{\text{PV (lease payments)}}{\text{Fair value of the asset}}$$

and applies it to the carrying amount of the asset. The remaining rights are reclassified as the lessor's residual asset.

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Day one gains on releases may occur if the carrying value of the asset is different to its fair value. This is an asset valuation issue and the gain that would occur on a release is similar in nature as gains that arise when a wholly owned asset is sold.

Lease payments

Lease payments are the minimum lease payments the lessee is required to make over the lease term together with

- 1) any amounts paid by the lessee to obtain the ability to extend the lease term beyond the initial contractual term or to obtain the ability to purchase the asset at the end of the contract
- 2) if the lease includes a renewal or purchase option, any amounts the lessee is required to pay if it does not renew the lease or purchase the asset
- 3) the maximum amount payable under a residual value guarantee provided by the lessee to the lessor¹
- 4) variable lease payments based on an index or rate
- 5) contingent rentals meeting the requirements below

Variable lease payments

Variable lease payments are payments that are based on changes in an index or rate. They are included in the lease payments, using the index or rate existing at inception of the lease upon initial measurement. Changes in amounts payable arising from variations in the underlying rate or index should be recognised in profit or loss in the period in which they become payable.

- ▭ Variable rentals are different in nature to contingent rentals. With the former, the lessee is unable to avoid making the required payment, whereas with the latter, the lessee is only obliged to make payments once the contingent event has occurred. This should be reflected in the accounting model for leases.
- ▭ The proposed treatment of variable rentals is consistent with the treatment of other financial liabilities.

Contingent rentals

Contingent rentals should not be taken into account in the lease payments and should be recognised in profit and loss when they occur unless they are included in lease contracts to compensate for below market committed rentals

Such situations could be determined by comparing the amount of the asset that is being financed through the minimum lease payments to the portion of the economic life of the asset that has been transferred to the lessee with the lease contract:

$$\frac{\text{PV(MLP)}}{\text{fair value of the asset}} < \frac{\text{lease term}}{\text{economic life of the asset}}$$

¹ Cases where residual value guarantees are granted to protect asset values in optional periods will need specific treatment.

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If the first fraction is smaller than the second, there is a strong indication that the lessee will effectively systematically be obliged to make contingent rent payments. Consequently, when this is the case, lessees and lessors should be required to include their estimate of the most likely contingent rental payments in the lease payments.

- ▭ When not taken into account by the lessee, contingent rentals are also not de-recognised from the lessor's underlying asset, thus reflecting the fact that, by granting such rentals, the lessor has potentially exposed itself to significant risks, shown by a higher level of residual asset.
- ▭ This approach addresses concerns surrounding contingent rentals when they are used to minimise lease payments while not imposing a blanket approach treating these as liabilities even in circumstances that do not meet Conceptual Framework definitions.
- ▭ The approach should be significantly easier for preparers to apply than the current proposals.

Options

Apart from upfront payments for options or payments for non-renewal of a lease or non-exercise of a purchase option, options are not taken into account in the lease payments.

This is because they will fall under one of the following categories:

1) Renewal options

- Renewal options allowing the lessee to extend the lease after the initial lease term at the then market rate (or an equivalent one-off payment)

Such an option has no intrinsic value as the lessee could simply obtain a new lease at the end of the initial lease.

- Renewal options allowing the lessee to extend the lease after the initial lease term at a rate lower than the market rate rentals (or an equivalent payment)

Renewal options at lower than market rentals (or an equivalent payment) will either have been priced into the level of rentals of the initial lease term (they will be higher than if there is no such option) or will be granted in conjunction with a residual value guarantee designed to protect the lessor from the shortfall between the secondary period rentals and market rentals. In the first case, the value of the option reflected in the higher rentals will already have been taken into account into the lessee's obligation to make rental payments and its right of use asset. In the second case, the maximum amount payable under a residual value guarantee is included in minimum lease payments. Consequently, the value of the option is appropriately taken in to account.

- Renewal options allowing the lessee to extend the lease after the initial lease term at a rate higher than the market rate rentals (or an equivalent payment)

Renewals could also be granted at an above market rental. In such situations, if the rentals in the initial lease period are lower than they would be otherwise, the lessor is exposing itself to a significant risk that the lessee will not renew the lease. The lessor accounting model will reflect this situation clearly, showing a large residual asset. Lessors will therefore only grant such leases if they are effectively comfortable with taking on such risk. In practice, it is unlikely that they

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will do so to any great extent and the accounting will always appropriately reflect the true risks and commitments of both parties.

2) Purchase options

The same reasoning as above can be applied to purchase options:

- Purchase options where the exercise price is at market value of the asset do not have any intrinsic value
- The value of a purchase option where the exercise price is lower than the market value of the asset will be priced into the rentals and thus reflected in the lease payments
- Purchase options where the exercise price is higher than the market value of the asset could be used as a tool to structure lower rentals. However, if this is the case, the lessor will have a higher residual asset reflecting its larger exposure risk.

3) Termination options

Leases with termination options should be viewed as being the economic equivalent of a lease (for a shorter initial term) with a renewal option and the same reasoning applies.

- ▭ This approach addresses the Boards' concerns surrounding the use of options to structure contracts.
- ▭ At the same time, it overcomes the issues raised by a significant number of constituents on the proposed treatment of options under the new standard. These constituents argue that although options are an asset for the lessee, the accounting method proposed by the Boards is inconsistent with the Conceptual Framework and leads to an overstatement of the lessee's asset and liability. This treatment is also a significant source of complexity within the new proposals.
- ▭ The approach suggested above alleviates this complexity as lessees and lessors do not have to undertake subjective and burdensome probability assessments and reassessments. It also leads to increased comparability between entities and less volatility of the accounts.

IV. Subsequent Measurement

Lessees

Absent impairment and revaluation, subsequent measurement should continue to reflect the linked nature of the obligation to make payments and the right of use asset recognised at the start of the lease.

The lessee's liability should therefore be apportioned between a finance charge and a reduction in the outstanding liability consistently with the treatment of other financial liabilities

The lessee's right of use asset should be measured on an amortised cost basis (unless the revaluation provisions apply) using mortgage-based amortisation to appropriately reflect its pattern of consumption of economic benefits (the lessee effectively uses the asset as it pays for it).²

² We accept that in some cases (e.g. impairment, re-valuation, upfront payments, etc.) the value of the asset and liability will not always be strictly equal.

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If the lessee has included the most likely payment under contingent rentals in its lease payments (i.e. in the cases described above under the contingent rentals section), the lessee should reassess this estimate at each reporting date. Any changes in its estimate arising from its reassessment should be included in the carrying value of the right of use asset as the lessee has effectively purchased more or less of the right to use the leased asset.

The lessee would apply IAS36 (Impairment) and, if it revalues equivalent classes of owned assets in accordance IAS16 (PP&E), the revaluation provisions of IAS38 (Intangible Assets) to its right of use asset.

If a lessee exercises a renewal option, it would account for this transaction as if the lease were a new lease.

Lessors

After the commencement of the lease term, the lessor measures the right to receive rentals at amortised cost using the effective interest method and applies IAS39 for impairment.

The residual asset should be accreted at the rate implicit in the lease so that, absent impairment:

- For 3rd party lessors it equates to the fair value of the asset at the end of the lease term that was projected at the outset of the lease
- For manufacturer/dealer lessors it equates to the expected fair value of the asset at the end of the lease term less the future value of the unrealised manufacturing profit (i.e. if the asset is sold at fair value at the end of the lease, a manufacturer/dealer will realise its 'deferred' profit at this time).

This subsequent measurement method of the residual asset reflects the fact that, as the lease term progresses, the residual asset becomes gradually less "encumbered" by the lease (i.e. the lessor comes closer to reuniting all the rights associated with the asset).

The residual asset should be assessed for impairment in accordance with IAS36.

▭ This approach to subsequent measurement for the residual asset is the only measurement approach that effectively reflects the economics of a lease transaction as it shows the lessor's true, constant return on assets. Freezing the residual (or using another rate than the rate implicit in the lease to accrete the residual) leads to a different/variable return on assets. Indeed, for a given transaction where the terms are negotiated at the start and remain unchanged throughout the contract term, one would not expect any other return pattern than the constant, contractual yield. Consequently, this measurement basis provides superior information to users than freezing the residual as currently proposed.

If the lessee exercises a renewal option, the lessor treats this lease as a new lease where the value of the residual asset is used as the cost of the underlying asset.

V. Presentation

Lessees

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(Draft) proposal by Leaseurope

The lessee's obligation to make lease payments should be presented separately from other financial liabilities

The lessee's right-to-use asset is a specific asset and should be presented under a separate, dedicated balance sheet caption.

- ▭ This form of presentation reflects the specific nature of a lease and allows users to clearly identify lease related assets and liabilities.
- ▭ Moreover, it can be argued that a right of use is neither a tangible nor an intangible asset. Therefore, it should be presented separately, thereby recognising the fact that it is different to owned assets and avoiding the intangible asset association which would have severe capital consequences for entities operating in regulated industries such as banks.

Lessors

Lessors should present separately under a specific category "leases", their lease receivables and residual assets

- ▭ More transparency for users
- ▭ Separate presentation also justified by specific measurement of residual assets

VI. Sale and Leaseback Transactions

An entity shall account for a sale and leaseback transaction if the transfer of the underlying asset meets results in the purchaser/lessor obtaining control of the asset as described in the relevant IFRS (Revenue recognition). This will be the case when the purchaser/lessor has the ability to direct the use of and receive the benefit from the asset. The seller/lessee shall account for the sale in accordance with the relevant IFRS requirements and for the right of use asset and obligation to make lease payments in accordance with the leases standard.

- ▭ This approach is straightforward to apply as it refers to the revenue recognition definition of control and avoids multiple definitions of control throughout the IFRS literature.
- ▭ Given that the leaseback is dealt with under the right of use model, the potential for structuring to obtain the off-balance sheet benefit of a sale & leaseback under today's guidance is no longer an issue.

VII. Transition

Lessees shall either apply the standard retrospectively or use the simplified retrospective approach developed by the Boards (including the provisions for simple finance leases).

Lessors shall apply the standard retrospectively or use the simplified retrospective approach developed by the Boards modified so as the residual asset is recognised at the present value of the future fair value of the asset at the end of the lease term.

- ▭ Entities should not be prevented from applying the new standard retrospectively.
- ▭ For lessors, the above 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.

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