



Amsterdam, 10 September 2013

Attention of: International Accountancy Standards Board (IASB)

Via email to www.ifrs.org

**Position Paper of the Nederlandse Vereniging van
Leasemaatschappijen on the Exposure Draft Leases 2013**

‘Complexity leads to *less* transparency’

This position paper expresses the views of the Nederlandse Vereniging van Leasemaatschappijen (Dutch Leasing Association, hereinafter: NVL). Since 1972, the NVL advocates the interests of *general* lease companies in the Netherlands. These lease companies carry out so-called *equipment* leases. They lease objects like trucks and trailers, cranes, buses, earth-moving equipment, industrial machinery for the metal, wood and synthetics industry, printing & copying machines, computers and IT equipment.

EXECUTIVE SUMMARY

Almost three year after the first Exposure Draft ED2010 on Leases (released in August 2010) that brought forth 800 comments, the IASB¹ has released a second Exposure Draft on Leases on 16 May 2013 (ED2013). This new standard on lease accounting will only be applicable to companies accounting under the IFRS system.

The NVL is very concerned about the increase of the complexity in the reporting, as a consequence of the proposed accounting rules for leasing, for both lessors and lessees. These concerns were already expressed after the release of ED2010, but have been insufficiently dealt with by the amendments in the ED2013. Our greatest worries are stated below:

1. The proposed accounting rules for leasing completely miss the mark – which is to increase the transparency of the accounting of lease contracts – because of its enormous complexity. We expect that users of the annual accounts of lessees as well as lessors, mainly financial analysts, will have to correct more figures than was the case in the past, in order to have a realistic view of the actual status. This is largely due to interpretation difficulties when choosing between Type A or Type B leases; the vagueness of the classification of the right of use as an asset, which can have substantial and undesired consequences under Basel III,² the disconnect between cash flow, lease obligations and profit for Type A leases; and the absence of guidance for making the distinction between a lease contract and a service contract.

¹ The *EDLeases 2013* is a mutual effort of the IASB (International Accounting Standards Board) and

² By describing the asset as a ‘right of use’ in the ED, it appears to be an immaterial asset. It would have been better to refer to ‘leased assets’.



2. The increased complexity is the result of the conceptual choice of IASB to define leasing as a combination of a right of use and a financial obligation, and not as object financing. Lessees will be obliged to make use of different reporting structures to report their numbers in a more transparent way. This, in turn, will increase the risk of confusion among analysts and users.
3. The proposals will lead to higher costs arising from the modification of accounting and other systems of both lessors and lessees, producing the various reporting/accounting structures, as well as for the auditing of the annual accounts.
4. The proposals threaten to seriously impede access to leasing as a way of financing for businesses (mainly for the financing of investments), and will lead to higher administrative burdens for those that already make use of leasing.
5. More transparency could also have been realised by an amendment of the current rules (IAS17), in particular by additional guidelines to complete the explanatory notes and disclosures accompanying annual accounts. This can be achieved in a less expensive way, is to be implemented in a relatively short time and is clear and understandable for all.
6. The proposals are neither future-proof nor sustainable. In today's society the use of an object is becoming more important than ownership. Pay-as-you-use models are an unstoppable development. This results in better use of equipment and is therefore more sustainable. The use of equipment will be more in line with the needs of multiple lessees. This transforms a leasing transaction from a financing solution into a service. It is a trend that will only become stronger in the years ahead. Given that the IASB does not address the concept of service at all, a question of definition will arise that again is in conflict with the objective of improved transparency.

The NVL calls on businesses (using leasing as a source of financing), lease companies and employers organisations to reject the proposals. The NVL will also ask European institutions, such as the EFRAG and the European Commission, to assess these proposals with the greatest caution, taking into account access to financing for the entire business community, including small and medium-sized enterprises.

The viewpoint of the NVL is fleshed out below, without the intention of being exhaustive.



CONTENTS

A. Leasing = transparent and safe object financing

- A. 1. What is a lease?
- A. 2. Leasing is a transparent form of financing
- A. 3. Leasing is a safe form of financing

B. Position of the Nederlandse Vereniging van Leasemaatschappijen on the Exposure Draft on Leases 2013

- B. 1. Proposals will not lead to more transparency
- B. 2. Classification as Type A and Type B leases will lead to multiple interpretations
- B. 3. The IASB sees a lease as an obligation, a liability
- B. 4. Assets and liabilities no longer add up
- B. 5. Capital Ratios are at risk
- B. 6. The IASB vision will lead to interpretation difficulties on the profit and loss account
- B. 7. Most problems arise from the disconnect between cash flow and profit
- B. 8. Front loading will have far-reaching side effects
- B. 9. The proposals are not future-proof
- B. 10. The new Exposure Draft will not make things easier
- B. 11. What are the consequences for the lessor?

C. Access to leasing for businesses will become more difficult

- C. 1. The proposals will lead to high costs
- C. 2. After the large businesses the SMEs will fall victim
- C. 3. Proposals lead to larger administrative burdens
- C. 4. Access to credit in the form of leasing will become more difficult

D. A simpler and more transparent alternative

- D. 1. Amend IAS17
- D. 2. Amend the proposed standard

E. What next?

- E. 1. No done deal
- E. 2. Many questions remain unanswered
- E. 3. It is now up to Europe



A. LEASING = TRANSPARENT AND SAFE OBJECT FINANCING

A. 1. What is a lease?

A lease (or: lease contract) is a form of financing in which an object is made available to a lessee for a fixed term. Characteristic of leasing is (i) it at all times involves a clearly identifiable object and, (ii) the financing and the object are inextricably bound together. Furthermore, a third component can also be part of a lease contract, i.e. services such as insurance and maintenance.

Most of the time, leasing involves equal (usually monthly) lease instalments for the entire duration of the contract.

With a Financial Lease the (Dutch) user (or: lessee) holds economic ownership of the object. With an Operational Lease the lessor (the lease company) holds economic ownership. According to current reporting regulations, a Financial Lease is usually accounted on the balance sheet of the lessee. An Operational Lease is not always accounted on the balance sheet of the lessee, but on the balance sheet of the lessor. In both cases the lease obligations are reported in the profit and loss accounts: Financial Leases in two components ‘depreciation’ and ‘interest expenses’, Operational Leases in the form of lease instalments.

A. 2. Leasing is a transparent form of financing

The IASB starting point is the premise that the lessee has something to hide, because certain lease transactions do not appear on the balance sheet. The term ‘misleading’ that is used by IASB in this respect, could be called tendentious. From now on, the IASB wishes to see all leases on the balance sheet. This will lead to a significant growth of the balance sheet total for businesses with real estate leases; the NVL, representing equipment lessors, points out that these leases are usually not *perceived* as lease transactions as defined above.

However, lease companies are not against the accounting of all leases on the balance sheet of the lessee, in fact the majority of equipment lease contracts are already reported on the balance sheet. In the Netherlands, Financial Leases (FL) are always on balance. Only Operational Leases (OL), less than 20% of the total number of lease transactions for equipment lease in the Netherlands, are not always accounted for in the balance sheet.

Both OL and FL always appear in the profit and loss accounts, so everyone can ascertain that the result has actually been recorded after the deduction of lease charges.

Furthermore, under the current IAS17 regulations, the lessee is obliged to state the ‘obligations that cannot be deduced from the balance sheet’ in the explanatory notes to the annual accounts, which means that OL are reported. This system has worked well for decades. With the explanatory notes, financial analysts, banks and other users have all the data at their disposal, necessary for calculating certain ratios. The operational cash flow currently connects well with the profit and loss account.

A. 3. Leasing is a safe form of financing

As stated earlier, financing of the object is essential in a lease contract. Everyone is aware that the leased object is really financed for the entire lease period and thus for the period of use. This is different for objects that are financed through other financing sources, such as private



capital, long-term loans or even short-term loans. Particularly the latter could become very problematic if a bank cancels the short-term credit. The borrower suddenly sees financing disappear from his assets. This is not possible with leasing. In that sense, equipment leasing means a mitigation of the financial risks for a business: everything that is not financed with a lease contract has a less safe financing structure.

B. POSITION OF THE NEDERLANDSE VERENIGING VAN LEASEMAATSCHAPPIJEN ON THE EXPOSURE DRAFT LEASES 2013

B. 1. Proposals do not lead to more transparency

The IASB has made the conceptual choice to separate the financing completely from the leased object. This fundamental choice has the consequence that the reporting of the financial transaction with liabilities (the financing) will not run parallel to the recording of the right of use on the asset side. This conceptual choice will result in less transparency and is wrong for that very reason.

As a result of the proposals, the accounting of the objects on the balance sheet will become different for each type of object according to the lessee's period of use, and according to the type of financing (leasing vs. other financing sources).

Furthermore, the IASB has not taken into account the service component that is found in many lease contracts and which is inextricably bound to the leased object. This makes for a theoretical reality that does no justice to the day-to-day reality of leasing. The absence of guidance for making a distinction between a lease contract and a service contract is problematic.

B. 2. The classification as Type A and Type B leases will lead to multiple interpretations

In the IASB proposals, a new typology of lease contracts is created with regard to the accounting of the leases in the profit and loss account. The familiar classification as Financial or Operational Leases is abandoned. From now on, there will be two types of leasing, Type B or, roughly speaking: real estate, and Type A: all other assets, also known as equipment. The idea behind this classification is that one looks at the consumption rather than the use of the asset; in actual practice this is seen (also by the IASB) as a division into real estate and equipment. The object type thus determines the way it is recorded on the books.

Type A and type B will both be shown as amounts on the asset side of the balance sheet (no different to the ED2010), but each will now have its own recording on the profit and loss account.

The criterion that distinguishes Type A from Type B leases is the measure of consumption of 'more than an insignificant portion'³ of the underlying asset (object) for the duration of the

³ ED2013, p. 7: The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.



lease contract. This phrase immediately leads to interpretation difficulties. Generally speaking we can say that Type B leasing is for objects where consumption of more than an ‘insignificant portion’ is not the case. Here a ‘major part’ is mentioned that does not completely correspond to the concept of an ‘insignificant portion’ mentioned earlier. Indeed, real estate is what comes to mind. A lease contract for a period of 15 years does not lead to the complete consumption of any building, as most have a lifespan of far more than 50 years.

Type A leases are objects that can be written off during the period of the lease contract. For example, a lorry with an economic lifespan of six to seven years that is leased for five years. In that case, there could be a case of consumption of ‘more than an insignificant portion’.

However, the distinction between Type A and Type B becomes problematic when one can demonstrate that the same truck will sometimes be used for longer than seven years, by a second, third or even fourth user in different countries. And what about an aircraft that is leased for 10 years, knowing that the aircraft will fly at least 30 years? Has this object been consumed for ‘more than an insignificant portion’ after 10 years? Or can the aircraft be put to use by another lessee, with fresh paint and a new logo? Other examples within the same scope are ships – both seafaring and inland vessels – flight simulators, printing presses; in matter of fact all objects with a high value and a long lifespan.

But for very current objects, like forklifts, trucks, passenger cars, trailers and other machines, there are also problems with lease contracts of give or take three years. Lessees often opt for these mid-term lease contracts to remain flexible, a healthy way of running their business in these uncertain times. If a transport company receives an assignment for the duration of three years, the company will align their lease contracts for trucks to this period. Is the object consumed for a “not insignificant portion” in that case, or isn’t it? A three-year-old personal computer could be outdated after the expiration of the lease contract to some people, but to others this PC may well serve some good purpose...

The selection by the IASB of this typology and the difficult formulation, so different from the distinction in Financial and Operational Leases that is already in place, creates a grey area leading to interpretation difficulties and requiring more explanation than is now the case.

B. 3. The IASB sees a lease as an obligation, a liability

For the lessee and lessor, leasing is a way of financing in order to make use of an object in the business in a sustainable fashion. The object is essential for both the lessee and the lessor. For instance the use of trucks and trailers is essential to a transport company (just like a printing company would need a press, a crane rental company has cranes, a sawmill uses sawing machines and a services company needs computers, servers and software). But even when the objects are not core to a business, like employees’ cars or the photocopiers at the office, a lease transaction for these objects is also especially focused on the object in use.

Lease companies hire so-called ‘asset specialists’, who monitor the change in value of the leased objects. This is essential for a credit check, mainly because a lease transaction always has a long-term nature and the lessor needs to know the value of his collateral. Lessee and lessor therefore focus on the object and specifically on the asset side of the balance sheet.



However, the IASB views leasing as a total of future obligations for using an object (right of use). Obligations are stated on the liabilities side of the balance sheet. This means the IASB starts off from the liabilities and sees the recording of an object on the books merely as a derivative. This leads to various problems that will be explained below.

B. 4. Assets and liabilities no longer add up

On the balance sheet it will no longer say 'tangible fixed asset' or a clearly identifiable object, but it will say 'right of use'. Nowhere does the IASB give a definition. Is it a 'right' (= intangible fixed asset) or rather a tangible fixed asset (see: B. 5.)?

With the liabilities on the balance sheet we will see the present value of the lease obligations. Only at the start of the lease contract will the present value be more or less equal to the right of use on the asset side. After that time the numbers no longer add up. Since the total of the assets needs to be equal to that of the liabilities, an inevitable balance difference will occur, which will have to be accounted for in 'accruals and prepaid expenses'.

On the other hand, if a business buys an object with own capital or a bank loan, the object will be recorded on the books as a 'fixed asset' against a nominal value, with a usual linear depreciation pattern. If this same object is leased, however, it will be recorded as a right of use asset. The accounting rules differ according to the object and the finance form.

B. 5. Capital Ratios are at risk

As stated above (B. 4.) the IASB does not specify whether right of use needs to be qualified as a tangible or an intangible fixed asset. Not classifying an leased object as a tangible fixed asset is a serious omission that threatens to be disastrous for the capital ratios of financial institutions falling under Basel III. Financial institutions are 'lessees' for all sorts of assets to a significant degree. The Boards have no intention to intervene in the Basel III ratios, but should not leave this qualification matter to the Basel Committee. The NVL strongly recommends the IASB to clarify this issue: there should be no doubt that leasing concerns tangible fixed assets.

B. 6. The IASB vision will lead to interpretation difficulties on the profit & loss accounts

On the P&L, Type B is treated as an 'operating expense' or 'rent'. That is a serious simplification in comparison to the ED2010 that is welcomed. However, this simplification is mainly beneficial to parties that rent vast amounts of real estate, such as retailers. But why would the treatment of the equipment of transport companies, shipping companies, printers, crane companies and industrial manufacturers be so much more complex?

With Type A (equipment) leases – previously qualified as Operational Leases – the costs are split into three parts: (i) depreciation of the object, (ii) interest charges and (iii) possible costs for extra services (insurance or maintenance costs, for instance).

This method will have the effect that the much-used norm 'operating cash flow' (or: EBITDA) will change, since the interest charges are booked under a different header, making the EBITDA increase, in comparison with the current recording of operational lease contracts on the P&L. In reality however, nothing has changed.



B. 7. Problems arise from the disconnect between cash flow and profit

An important consequence of the proposals will be the mismatch between the accounting of the financing obligation on the one hand, and the right of use on the other. How come?

(i) The lease instalments (interest and repayment components together) from the financing obligation will be booked on the basis of an annuity calculation. This results in an equal outgoing payment flow during the whole contract.

(ii) The right of use however, will be depreciated according to a linear calculation, meaning: with equal depreciation costs for each (yearly) period of the contract time.

In combination with the calculated interest over the book value this means that the costs are higher in the first contract years as compared to those towards the end of the contract. The figure on page 122 in the document *Basis for Conclusions* illustrates this effect. The accounting of extra costs at the beginning of the lease period is called 'frontloading'. When calculating interest and capital the outcome will be different each year, as a consequence of the continuously changing interest component.

In contrast, a typical lease contract usually has equal lease instalments (capital and interest) and when these are added on a yearly basis, they come to the same amount each year. This is the current situation, that has the great benefit that recording on the P&L is identical to the cash flow statement (the lease terms form a 'cash out' for the business).

The result of the IASB proposals will be that the calculation of the cash flow will present a different figure than that of the profit and loss account. During the first years of the lease contract the profit and loss account will show higher (recorded) costs than the actual cash out as a consequence of the lease contract and, as the lease period continues, lower costs than the cash out. As said earlier, the 'cash out' is constant during the entire lease period. This disconnect will lead to interpretation difficulties and interferes with the ambition of increasing transparency.

B. 8. 'Front loading' will have far-reaching side effects

An important consequence of the calculation of the interest component proposed by the IASB is that the recorded profitability of a business will be influenced. We expect that lessees will tend to start using various accounting structures on the one hand to meet the IFRS requirements, and on the other to show 'the real numbers' to analysts, users and the tax authorities.

B. 9. The proposals are not future-proof

The IASB completely ignores the services aspect of a lease contract. It is evident that leasing is evolving more and more from a mere financing solution into a service-oriented solution with added value in terms of convenience, flexibility and risk mitigation. As a result of the one-sided approach of the IASB, a matter of definition will arise that we expect will continue to make the explanatory notes accompanying annual accounts even longer.



The Leasing Society, a recent study instigated by the European Parliament states that our economic models are subject to dramatic changes and that we are evolving or should be evolving into a so-called ‘circular economy’. This means that manufacturers or suppliers of objects continue to be connected to those objects they sell: after the use (or consumption) of an object the manufacturer or supplier has the responsibility to take it back. The object could subsequently be refurbished, or its parts or base materials can be recycled. A sustainable use of materials and assets is necessary to stop exhausting our planet’s resources. In that regard, the European Parliament advocates that businesses should shift from ‘ownership’ to ‘use’. Leasing will be essential to support this model.

‘Pay-as-you-use’ models are an unstoppable trend. Recent developments, such as data storage in the cloud for example, show that renting (or: leasing) space for data storage means it is shared with others. This makes it more difficult to determine which part of a data centre is being used by which lessee. But it also is a better use of equipment, because it makes data storage more sustainable. The use of equipment by several lessees is better attuned to the need.

From the above, it can be gathered that the theoretical framework of the IASB is very far from the actual reality, that the proposed accounting rules are not future-proof and sustainability aspects that will – increasingly – become part of lease contracts are not taken into account.

B. 10. The new Exposure Draft will not make things easier

The draft guidance consists of 35 pages of text with 50 pages of appendices and amendments and other standards, accompanied by 160 pages of explanations (*Basis for Conclusion*) and 26 full examples of the various elements or subjects. This makes the basic document relatively small, just like the previous guidance (IAS 17). But the fact that it took three years from the first draft to the second to present this end product indicates it has not been a simple exercise.

It can already be said that the explanatory notes with the annual accounts will become much longer, simply because there are more options, the formulations are not clear and differences will arise between parts of the annual accounts, as stated above.

We will not even go into interpretation differences between the IASB and the FASB, making the results different on each coast of the Atlantic.

The difference to the Exposure Draft from 2010 that immediately catches the eye is the fact that short-term leases no longer fall under the new rules. That is positive, since it makes no sense in creating an entire accounting structure for short-term rented objects for which the rent contracts happens to end beyond the closing balance sheet date.

A second positive difference to the first ED is that the IASB has abandoned the even more complex notion of ‘performance obligation’. It was feared that this concept would lead to a lease obligation being recorded not once but twice on the balance sheet. Fortunately the Boards have seen that one entry would suffice...

Then again, an – arbitrary – typology has been brought in, Types A and B, which in itself has a certain logic but since the specification of these types is so vague it will create a considerable grey area. The IASB has not succeeded in placing the various typologies of



leases within a new transparent framework; the organisation refrains from defining ‘bright lines’ out of the fear that every line will automatically lead to ‘misuse’.

B.11. What are the consequences for the lessor?

Where most of the observations stated above are mainly important to the lessee, there will also be far-reaching consequences for the lessor when the proposed standard is implemented. It can be expected that the lessee will turn to the lessor for more information for substantiating the balance sheet positions and results accountability. But these are not easily explained. Fundamental discussions could arise about the nature of the services of the lease between the lessee, the lessor and the auditor with respect to the division of interest and repayment versus service charges.

It is also very possible that a Type A lease to the lessor might be a type B lease for the lessee, as a consequence of the differences of opinion as to consumption for ‘a more than insignificant portion’. In view of the fundamental differences in the accounting, the proposals also mean an increased workload in the handling leases in the preparatory phase: the decision-making will take longer and have more selection moments, which may well increase the risk of wrong choices.

The lessor is supposed to record the lessee’s obligations on his balance sheet as well as recording a possible (open) residual value position separately as a residual asset. According to the IASB these two elements no longer belong under the same header, making the presentation on the balance sheet of the lessor less transparent.

The differences will only become greater, because with the intended regulations under IFRS9, which will become applicable to lease receivables, different rules will apply to impairment than to the residual asset.

The distinction between a lease and a service contract will also lead to a discussion about the clarity and implementation of the rules. For example, when making use of coffee machines, photocopying machines it is mainly the output (coffee, documents) i.e. the service that is relevant, while the object itself is merely an instrument. Does this make it a 100 per cent service or is it outweighed by the object component? In any case: murky and clearly a matter for discussion.

And finally, for captive lease companies there will be another special case regarding Operational Leases: the profit on the production of an object is now recorded in part immediately, while the income will only be realised during the lease term. This creates unrealised profits in the accounts, leading to more complex balance sheet analyses and estimates of equity corrections.

C. ACCESS TO LEASING FOR BUSINESSES WILL BECOME MORE DIFFICULT

C. 1. The proposals will lead to higher costs

In the first place, the lessees – who are accounting according to IFRS rules – will have to adapt their accounting systems to the new accounting rules. Also the auditor will inevitably have extra work and control activities, for the assessment of the value of each asset on the



balance should be thoroughly done.

It can also be expected that the tax authorities will want to retain existing methods. Tax authorities do not like accounting rules influencing the result, certainly not when the profit, and the subsequent tax owed will decrease. The effects of the IASB proposals will have to be neutralised in the fiscal annual accounts. And lastly, lessees will need to work with different accounting systems. All in all, it will come down to more work, for external parties as well, and a higher auditor's invoice for the lessee.

Lease companies will also be confronted with costs for modifications and accounting. Not only will they have to modify their accounting systems, they will also have to collect and hand out more information to the lessee. For instance, the estimate of lease companies of the value depreciation of an object, information that is useful when determining the consumption for 'more than an insignificant portion'. However, with so many parties involved, there are equally many estimates: what is of no value to one, might well be valuable to another.

It is virtually impossible to determine exactly how high all these costs will be. It is estimated that for the entire country the modification costs will amount to hundreds of millions of Euros. These costs will precede the implementation that will be carried out not earlier than 1 January 2017 (with comparable figures for 2016). This might seem a long time to prepare, but bearing in mind that there will be no certainty before mid-2014, the capacity for change will be under pressure in 2015.

C. 2. After the large businesses, SMEs will fall victim

At the moment, the IASB proposals will only 'hit' companies that are accounting according to IFRS regulations. In the Netherlands these are all listed companies, or companies with listed parents or those that have voluntarily opted for IFRS regulations, generally speaking: large businesses and financial institutions.

Even though the Raad voor Jaarverslaggeving (Council for Annual Reporting) doesn't automatically apply the IFRS regulations to small and medium-sized businesses (SMEs), it is realistic to assume that the new structure – once it is implemented – will penetrate through to SMEs. This means that all businesses at one time or another will be confronted with accounting rules that are so complex only specialists will be able to understand them. There is a risk that entrepreneurs will not even be able to read their own books in the future.⁴

C. 3. The proposals will lead to larger administrative burdens

In fact, this will bring greater administrative burdens for companies and institutions. Governing and regulatory bodies should do everything in their power to counteract increasing administrative burdens. Due to the enormous complexity of its proposals, the IASB is placing a larger administrative burden on companies.

⁴ It should be noted here that the accounting rules of the FASB would be applicable immediately to all businesses and institutions in the US.



C. 4. Access to credit in the form of leasing will become more difficult

An important consequence of the proposals is that leasing will be less accessible to businesses and institutions. In a time when there is great concern about the financing of companies, a simple and safe form of object financing will be made more difficult and expensive.

There is a special circumstance for businesses in which external analysts have an important influence. For companies with substantial rental obligations for their shops, for instance, putting rental contracts on the balance sheet will lead to a significant increase in the balance sheet total. This will lead to an unwanted distortion of the solvability, while in an economic sense nothing is changing. In the current business climate an unfair questioning of a business' solvability will not improve their chances of obtaining finance.

The NVL would like to draw attention to the diversification of financing sources for companies. In a recent study, *Leasing en Factoring, kansrijke financieringsinstrumenten* (Leasing and Factoring, promising financial instruments) by EIM/Panteia⁵ it was observed that businesses often only think 'bank' when contemplating finance sources. Entrepreneurs neglect other financing sources that could be very suitable to fund investments, such as leasing. A good entrepreneur will ensure that all assets are financed in the most adequate way, in other words: will strive for an optimal financing mix.

D. A SIMPLER AND MORE TRANSPARENT ALTERNATIVE

D. 1. Amend IAS17

The Dutch leasing sector sees an alternative in the amendment of IAS17, in the sense that the explanatory notes with the annual accounts are modified in such a way that leased assets and obligations are clear to all. Leaseurope has argued for this proposal for a long time and EFRAG (European Financial Reporting Advisory Group) has also adopted this viewpoint.

This alternative solution builds on the entry rules for leasing that have been familiar for lessees, lessors, accountants, analysts and other users for many decades. This proposal can be implemented in a relatively short time, at a low cost. In this way, there will be maximum transparency. We cannot understand why the IASB has chosen for years of debate about the proposals at hand and has rejected this simple, easily implemented and obvious solution.

D. 2. Amend the proposed standard

If the Boards are not prepared to enhance IAS 17 as proposed above, the NVL calls on the IASB to drastically simplify the current proposals. This can be done, for example, by using only Type B for all leases. This would prevent front loading and the disconnect in the cash flows. A simplification of the accounting of the profit and loss account should also be considered. Under Type B interest, repayment and service would fall under the same header. It would also have been much easier to create an extra category under the heading 'Leases', both on the balance sheet and on the profit and loss account, with the leased object put with the assets, and the credit (the unpaid lease terms) with the liabilities.

⁵ <http://www.nvl-lease.nl/Leasing-en-factoring-kansrijke-financieringsinstrumenten.pdf>



In the disclosures, the medium interest rate of the lease transactions can be put beside the remaining time of the lease period (if necessary, per asset type); users will thus have sufficient information for their analysis, if combined with the estimate of the linear depreciation. And the very necessary ‘connect’ with the cash flow statement will be guaranteed.

E. WHAT'S NEXT?

E. 1. No done deal

The second version is certainly no done deal for the regulators and differs greatly to the first version. The question is: what have we gained with this exercise when compared to the current standard?

If this draft standard takes effect in an unrevised form (which is not expected to take place before 1 January 2017 in view of the major system modifications needed) it has taken more than ten years since the start of the project, basically all criteria have been turned upside down and have been ‘simplified’ afterwards to a great extent. But from the above it appears that conceptual choices do not lead by definition to more transparent annual accounts. As a consequence of this concept there would be a cry for more information accompanying the annual report. This is contrary to the intention the standard: more transparency.

E. 2. Many questions remain unanswered

Despite the great number of pages filled with explanations and examples, many matters remain unclear, such as:

- The intermediary termination of contracts, significant for determining an obligation;
- The distinction between ‘non-lease components’ versus ‘lease components’, important for determining contracts with a predominantly service elements so they will not unnecessarily add to the balance sheet total;
- How to apply variable payments, options to extend, modifications of the interest rate;
- The question for lessors: how to deal with residual value guarantees.

E. 3. It is now up to Europe

The constituents have been given a period of four months to respond to the second draft guidance. Will there be hundreds of responses or are people tired of the debate, despite the criticism, use or necessity of the proposed changes? We fear that the IASB will claim a lower number than the 800 responses received last time as a victory, or even as approval.

The European Authorities now play a crucial role in the eventual endorsement of the IASB proposals. The Nederlandse Vereniging van Leasemaatschappijen calls on them to make careful considerations, taking into account elements like access to financing and additional administrative burdens on businesses, sustainability and whether or not the regulations will be future-proof.

In a draft response, on 8 July 2013, EFRAG (European Financial Reporting Advisory Group) has expressed worries about ED2013, and has called for a three-tier plan to arrive at cohesive regulations: ‘[...] EFRAG is therefore concerned that without a proper debate on the

Nederlandse Vereniging Leasemaatschappijen



underlying concepts and the related transactions, the right-of-use model will not be understandable for constituents and this will add to the feeling that this proposed IFRS is unduly complex.’

Based on these observations, EFRAG recommends that the IASB proceeds to finalise its project in steps:

- 1- To require without delay relevant disclosure on lease arrangements to ensure that users have access to the information they need;
 - 2- To take advantage of the discussion on the conceptual framework to refine the definition of the right-of-use, distinguish this right from the other rights which are bundled in the asset, investigate whether the consumption of economic benefits of the underlying asset has a role to play, and refine the guidance to identify what activities convey the ability to direct the use of an asset and how this links with the business models of lessors (providing finance or managing assets). Such discussion could in our view be concluded before completion of the conceptual framework project itself;
 - 3- Finalise the accounting for leases, with the benefit of clarified objectives and a carefully identified lease population and the results of the current consultation.
- [...]

*In other words, EFRAG qualifies the proposals as insufficient.
It may be an idea to start at the beginning...*

On behalf of the Board of the NVL,

(Signed) 10 September 2013

Peter-Jan Bentein

Contact:

Nederlandse Vereniging van Leasemaatschappijen (NVL)
Peter-Jan Bentein
Secretary General

Email: peterjan.bentein@nvl-lease.nl
Telephone: +31 654 793 488