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## LEASE ACCOUNTING

### EBF COMMENTS ON THE IASB LEASES EXPOSURE DRAFT

The EBF supports the IASB's effort to develop a revised accounting model that would replace the current standard IAS 17 *Leases* and would improve the accounting treatment of lease contracts.

In the light of the Leases Exposure Draft (ED) published on 17 August 2010, the EBF has however a number of significant reservations as to the approach adopted by the IASB. Our reservations are set out below. Overall we would like to refer to the detailed comment letter presented by Leaseurope, whose broad lines are shared and supported by the EBF.

#### **One-size-fits-all-model**

The EBF is concerned about the proposed one-size-fits-all model.

The existing treatment of leases under IAS17 distinguishes between financial/capital leases, which transfer to the lessee substantially all risks and rewards related to the underlying asset, and other leases, which are classified as operating leases.

Under the proposals included in the ED, all leases would be treated the same way by lessees. This approach would in our view result in an excessively burdensome accounting treatment for leases, whilst we would expect the new approach to reduce complexity.

#### **Lessee accounting and right-of-use model**

The ED proposes a lessee accounting model under which the underlying assets of all leases would be recognized on the balance sheet based on the lessee's right to use these assets, whilst liabilities would be recognized for the lessee's obligation to make lease payment. The EBF has a number of significant concerns:

- Clarification of the distinction between leases and service contracts, and why assets arise under leases but not in the case of other non-lease executory contracts are a prerequisite to this model. In the absence of such clarification, the model may result in entities recognizing assets and liabilities for contracts that are service contracts.

- The right-of-use assets are depreciated straight line while lease liabilities amortise like loans resulting in an accounting mismatch and thus an increase in lease costs upon transition and in the early years of all leases.
- The new requirements for reassessment of leases at each reporting date would be both extremely costly for preparers and will also lead to increased volatility in their P&L. Preparers financial statements will thus be significantly affected both in terms of absolute numbers and volatility which is undesirable.
- The EBF has doubts whether the assets and liabilities that would result from the application of the right-of-use model to complex leases - in particular those including renewal options and contingent rentals not linked to a rate or index) - would meet the definition of such items in the Conceptual Framework.
- The extensive use of judgement surrounding the determination of the lease term and contingent rentals adds significantly to the complexity of the standard for preparers, whilst not necessarily improving information for users. In our view, rentals in optional periods and contingent rentals do not constitute lessee liabilities and should not be accounted for as proposed.

### **Lessor accounting**

The EBF believes that at this stage the model for lessor accounting is insufficiently developed and are not convinced by the arguments put forward to support this hybrid model. In our view, if the IASB is to proceed with the right-of-use model, it must aim at establishing a single model for lessor accounting that is consistent with lessee accounting. In particular, we do not support the performance obligation model since it comprises many fundamental conceptual flaws. At this point, we see more conceptual merits to the derecognition model since it is more consistent with the right-of-use approach and it has the potential of being applicable to all lease contracts. It is very important for the banking industry as many banks are at the same time lessees and lessors.

### **Differences between equipment and property leases**

The EBF notes in particular the differences between equipment and property leases as by their nature these two types of leases are very different and do not share many market practices. As an example, real estate leases are granted for longer terms than typical equipment lease contracts and tend to be high value transactions. Therefore, the application of the proposed lease model to both types will lead to significant complications.

### **Conclusions**

The EBF would encourage the IASB to further reconsider the current ED as there are significant concerns expressed by many industry participants as to the workability of the rules as they are proposed.

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