



EFRAG
35 Square de Meeûs (fifth floor)
1000 Brussels
Belgium

Via website (<http://www.efrag.org/News/InvitationsToComment>)

8 December 2016

Dear Members of EFRAG

PRELIMINARY CONSULTATION DOCUMENT REGARDING THE ENDORSEMENT OF IFRS 16 LEASES

The Corporate Reporting Users' Forum welcomes the opportunity to comment on EFRAG's Preliminary Consultation Document relating to the endorsement for use in the EU of IFRS 16 Leases.

In the following pages, we would like to comment on some of the questions raised in the consultation document. We would also like to draw attention to previous CRUF comment letters to IASB and EFRAG on the new Leases standard and reiterate CRUF's position on this standard, and that leases are brought onto the balance sheet, as a positive change:

<http://www.cruf.com/pdf/cruf-comment-letter-to-efrag-re-leases-sept-2014.pdf>
<http://www.cruf.com/cruf-lease-300913.pdf>

Qu 6: Do you have any views or information on how IFRS 16 can be expected to affect the behaviour of investors and/or lenders?

Having the lease obligations on balance sheet, and the enhanced disclosure package, will significantly improve comparability across companies, irrespective of their financing structure and lease vs buy decision.

There will be further adjustments needed for a minority of industries where leasing is highly material (retail, energy, trucking, hotels, restaurants, etc.) in order to capture the true leverage and risk in those types of businesses. But the starting point will be better and the disclosure will make adjustments more accurate. Any future improvements to the standard could also consider requiring disclosures within the maturity analysis of lease terms and discount rates used, as this would assist users further in their analysis, without creating additional costs for preparers.

If so, do you have any views or information on whether and how IFRS 16 could, for European companies that apply IFRS, positively or negatively affect:

- (i) the overall cost of capital;**



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It is hard to say in reality at this stage. It is possible that under IAS 17, understatement of risk, due to liabilities being held off balance sheet, leads some companies to have a cost of equity that is too low and therefore, discounted cash flows of purely equity related flows might be optimistic, thus creating an inefficient market and heightened risk for less sophisticated (retail) investors who might buy those shares. On the other hand, the changes brought about by IFRS 16 might increase cost of equity, but this makes the market more efficient and safeguards the interests of those less sophisticated investors. Furthermore, at an enterprise level, it is probable that clarity around lease obligations under the new standard, will actually reduce perceived risk and lead to a lower cost of capital in the future.

(ii) access to finance and cost of credit?

Unlikely to have much of an impact as lenders typically adjust for leases and often have access to better data than is available in the published accounts.

Qu 7: Do you have views or information on how IFRS 16 might affect entities' use of leasing? For example, do you expect lessees to:

(i) reduce their use of leases with a corresponding increase in purchases of assets;

Leases should only ever be used by management to optimise risk-adjusted after-tax cash flows – balancing residual value risk, cost of finance and tax structuring that is often possible through a lease structure. This should never be driven by presentation of results.

If management are optimising shareholder value currently through their use of leases, then there should be no impact.

(ii) reduce their use of leases without a corresponding increase in purchases of assets;

Again, there should be no impact, if management's intentions are to optimise risk-adjusted after-tax cash flows.

(iii) seek to change the terms of new or existing leases?

It is possible that a greater focus on leases by boards may lead to a review of how to optimise lease terms, and therefore, it is to be encouraged. Again, structuring of terms to get a particular treatment is to be discouraged.

Qu 10: Do you have any information or views on whether IFRS 16 is likely to endanger financial stability in Europe?

Presenting leases on balance sheet should reduce risk in the financial system over a cycle as it will be easier to monitor risk in the system and manage it. There is some chance, however, that if this is done when liabilities have already built up, and then we enter a recession, it is possible that there might be greater economic volatility. This is not a reason to defer or avoid recognition.

Qu 13: If you are a user, are you aware of any costs in addition to those identified by EFRAG in paragraphs 116 to 118 of Appendix 3? Please quantify if possible and provide any available evidence.



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We are unlikely to incur any extra costs as we already attempt to adjust for material leases and as such we should see a reduction in time taken to make the adjustments as the disclosure is improved. We will be able to make fewer estimates (guesses) since we will be presented with factual and consistent information. We therefore anticipate that we should be able to improve our company assessment and enhance capital allocation – when taken together with other users, one would hope that the capital markets overall will be more efficient, to the benefit of all participants.

Qu 15: Do you agree with the benefits for users and preparers identified above? Are there any additional benefits for users and preparers?

Refer to answer to Qu 13 which highlights some overall benefits to the system.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.



The Corporate Reporting Users' Forum

(Signatures)

Jed Wrigley

Fidelity International

Paul Lee

Aberdeen Asset Management

Biharilal Deora

Marietta Miemietz

Primavenue

Peter Reilly

Jefferies International

Ben Peters

Evenlode

Lothar Weniger

ALIAG