



EUROPEAN COMMISSION

Directorate General Financial Stability, Financial Services and Capital Markets Union

INVESTMENT AND COMPANY REPORTING
Acting Director

Brussels, **09 JUN 2016**
FISMA B3/WF/gb (2016) 3350458

Roger Marshall
President
EFRAG
Square de Meeûs 35
B-1000 Brussels

Subject: Endorsement advice on IFRS 16 Leases

Dear Mr Marshall,

Dear Roger,

Following the publication by the International Accounting Standard Board (IASB) of IFRS 16, Leases, on 13 January 2016, the European Commission would like to request the European Financial Reporting Advisory Group (EFRAG) to deliver its opinion, on the new standard.

The opinion of EFRAG should be based upon the following conditions, against which endorsement is assessed in the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards, i.e. that the standard:

- is not contrary to the principle set out in Article 4(3) of Directive 2013/34/EU and is conducive to the European public good, and
- meets the criteria of understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG should support its advice by an impact analysis, including a cost-benefit analysis and an analysis of broader economic impacts. This impact analysis should be independent, objective and Europe-focused. *Annex 1* to this letter describes a standard structure of this assessment that EFRAG and the Commission discussed prior to this letter.

As you are aware, members of the Accounting Regulatory Committee (ARC) vote on the adoption of each standard taking into consideration the endorsement advice provided by EFRAG to the European Commission. Accordingly, members of ARC have been asked to identify matters which they consider to be important in reaching their conclusions on whether to endorse IFRS 16. *Annex 2* to this letter describes the matters raised by some ARC members together with other issues that have been brought to the attention of the Commission services by European stakeholders. I would like to request that EFRAG take these matters into consideration, as appropriate, in its reply to this letter.

I should be grateful if EFRAG would provide its opinion within 6 months following receipt of this letter taking into account the need to address the matters raised and appropriate due process and consultation with European stakeholders.

We thank you in advance for your cooperation.

Should you have any questions, please contact Mr Wojciech Furmański (Telephone: +32 2 298 12 62).

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized 'E' followed by a series of loops and a final flourish.

Erik NOOTEBOOM

cc.: Andrew Watchman (EFRAG TEG Chairman), Valérie Ledure, Christelle Fontbonne-Proniewski, Wojciech Furmański (DG FISMA)

Annex 1

Impact Analysis – Standard structure

EFRAG shall advise the European Commission on the adoption of the new lease standard for undertakings in the mandatory scope of Regulation 1606/2002.

It shall also assess IFRS in respect of companies' financial statements prepared under IFRS as a result of a Member State option (Article 5 of the Regulation), upon specific request. Such an analysis would be limited to the effects resulting from the use of these options, on which Member States have no means of action (e.g. it would exclude national tax and social legislation).

EFRAG is not expected to consider theoretical scenarios such as amending a proposed standard or its predecessor. As such, in the present document, the "options" to be considered by EFRAG are the baseline scenario (existing situation) and the new IASB standard.

The details of an impact analysis shall be proportional to the importance of the relevant IFRS.

The endorsement advice letter would be structured based on the following:

- The cover letter, containing the endorsement advice on the standard and the bases for conclusion.
- An appendix describing the reasons for a new standard and how it responds to the problem. In particular it will cover:
 - o **The problem definition.** This includes the answer to the following questions: what is the problem the new standard aims at solving, who is affected and how, what is the magnitude of the problem, what are the causes and consequences, what will happen without further EU action?
 - o **The objectives of the new standard,** how it responds to the problems identified.
- An appendix on EFRAG's analysis of whether the new IFRS is not contrary to the principle set out in Article 4(3) of Directive 2013/34/EU (**true and fair view principle**) and whether it meets the **technical qualitative criteria** (understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management). This analysis will cover the new standard as well as its interaction with the other set of adopted standards.
- An appendix on EFRAG's **impact analysis of the options¹**, including whether the new IFRS is conducive to the **European public good**. This will include:
 - o A description of the impacts and of the stakeholders affected, including small and medium size entities (SMEs) where relevant. Impacts will cover, economic aspects and where relevant environmental and social aspects, in addition to financial reporting aspects.

¹ The options are the baseline scenario (existing situation) and the new IASB standard

- A comparison between the options in terms of their effectiveness and efficiency (benefits and costs), including for SMEs where relevant;
- Whether the new standard does not endanger financial stability, does not hinder economic development and what the impact on the competitiveness of European undertakings is.

Annex 2 details a list of matters to be considered for the specific standard going through endorsement.

Annex 2

Impact Assessment – Scope

1 General

We would like EFRAG to analyse some general issues relating to IFRS 16's content.

For instance, is the *definition of a lease* appropriate or does it also cover some services? Does the *asymmetry between lessee and lessor accounting* pose a problem? Is not IFRS 16 *overly complex*? Is it an *improvement over IAS 17*?

2 Potential effects on stakeholders' behaviour

We would like EFRAG to analyse how increased transparency and comparability over companies' indebtedness could affect the behaviour of main groups of stakeholders.

For instance, are *companies* likely to change the way they use leases? Are *capital providers* (investors and banks) likely to change their investment / lending patterns with regard to companies with previously off-balance sheet leases? Finally, what would be the impact of these changes on the *lease industry* and how could it adapt?

3 Potential effects on competitiveness

We would like EFRAG to analyse the impact that IFRS 16 could have on Europe's competitiveness.

In particular, EFRAG should analyse how IFRS 16 could affect small and medium-sized enterprises (SMEs) that use IFRS under Article 4 and 5 of the IAS Regulation or to meet reporting requirements of non-regulated markets. For instance, is IFRS 16 *appropriate for SMEs*? Will the impact of IFRS 16 on the lease industry have any knock-on effects on *SMEs' access to leasing as a source of finance* (see also above)? Finally, EFRAG should analyse *differences between IFRS 16 and its US equivalent* to assess whether *EU companies would not be at a disadvantage in relation to their US competitors*.

4 Potential effects on financial stability

IFRS 16 is likely to impact the functioning of the financial sector in a number of ways.

For instance, extra assets and liabilities will have a knock-on impact on companies' *financial ratios, debt covenants, credit scores* and *required levels of bank capital*. Furthermore, greater transparency and comparability under IFRS 16 may enhance *investor protection* and *market confidence*. In the long term, this could lead to greater *financial stability* and lower *costs of capital/credit*. Finally, changes affecting the lease industry may in certain measure affect *leasing as a source of financing*.

We would like EFRAG to analyse these impacts, both positive and negative, with a view of assessing whether IFRS 16 will not be detrimental to financial stability.

4 Cost-benefit analysis

This assessment should cover *one-off costs* of implementing the standard, *ongoing costs* of applying it and possible *cost savings due to exemptions* from its scope. Possible benefits could include increased *transparency* and *comparability*, improved *accounting quality*, greater *confidence in financial markets* or *greater investor protection*. IFRS 16 can also have an impact on *financial stability*, *costs of capital/ credit* and *access to finance* (see also above).