# Comment on Consultation IFRS16 Leases

In 2017, the Dutch Leasing Association, NVL, is having its 45th anniversary. All these years, NVL has provided support for the Dutch equipment leasing companies. NVL, via its website, reports developments which are covering at least 95% of the equipment leasing market.

No formal statistical data are available, but total outstanding volume under leases is estimated to be around € 16 billion, making leasing an important source of finance. The NVL reported production volumes for 2013 were € 4,2 billion, for 2014 € 4,3 billion and for 2015 € 5,2 billion. 2016 Q3 figures reach € 4,0 billion, with full year 2016 expected to be at least € 5,5 billion.

In the appendix, NVL responds to individual questions raised by EFRAG. NVL is aware of various comments from other leasing associations, Yet, in this covering letter, NVL reflects on the wider issue of the benefits of IFRS 16 to the European public good. In this respect, NVL has a number of concerns that are not addressed, when focusing on implementing IFRS 16 itself: SMEs, real estate and bright lines in the standard.

**SMEs**
The new standard is formally just for IFRS reporting companies, that make up less than 1% of total number of companies: Dutch and European figures show roughly comparable figures. It is European practise to consider the benefits to SMEs first (bottom-up first) when creating new rules and legislation; not so with IASB as IFRSs for SMEs are derived from above.

The fear is that in time IFRS 16, formally or informally, will have knock-on effects on SMEs that result in onerous and too burdensome reporting. NVL statistics present a clear view of such an impact:
*Around 85% of contracts are signed with SMEs according to the NVL 2015 production data. The average value of a lease contract in The Netherlands is around €85.000,-.*

**Real estate**
Real estate leases are not represented within NVL. However, we note an almost absolute silence from this sector.

Granted, large companies in the production industries may see hardly any impact, as they already have all their real estate in own use and on balance sheet. And large retail companies (Tesco, Ahold/Delhaize etc.) are so sizable, plus leased assets are declared tangibles, that the impact on their balance sheets is significant, but manageable.

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Non-native English speakers draw a line between rent and lease, which difference is not considered in the IFRS wording. Many fail to understand how renting a premise can become a balance sheet item; the rentee has almost never the intention to become owner of the rented property; all relevant information is comprised within the profit and loss accounts and splitting the rent into interest, depreciation and (large percentages of) services is not helping to understand the economic performance. One cannot understand what is the use of putting rented property on the balance sheet, with the effect of lowering the solvency ratios of companies, putting them into a precarious position towards their banks. NVL estemates that financing will become more difficult to obtain for companies under the IFRS standard.

Again, it would be the proliferation into SMEs, when impact will really hurt. This certainly would be an onerous development that requires consideration before engaging into IFRS 16.

**Bright lines in the standard**

Be it for the transition or for permanent use, the IFRS 16 standard is full of practical expedients. The very numerous comments to the DP 2008, the ED 2010 and ED 2013 have resulted in a standard that is not close to its original intent. Moreover, the practical expedients themselves are bright lines, even when IASB is playing down the role of the practical expedients. It is, however, just a matter of time before companies are making use of the expedients, which now are fully legalized by the IASB.

The result will be that IFRS 16 is not providing the improvements looked for in comparison to IAS 17 and shies away companies and institutions from the leasing product.

NVL wants to make clear, that not the leasing industry is to blame when claims of incomparability or lack of transparency and understandability arise.

Best regards,

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## APPENDIX

## Consultation Document regarding the endorsement of IFRS 16 Leases

Issued 12 October 2016 Comments requested by 8 December 2016

*Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.*

### Summary of questions to constituents

*Note: certain questions are intended primarily for preparers or users, and this is indicated in the question. However, EFRAG welcomes responses from any constituent to any of the questions.*

| Question | After para |
|---|---|
| *Appendix 1* | |
| *1* | *24* |

*A. Do you have any information or evidence on the extent to which leases (that you are party to or otherwise aware of) will be eligible for each of the short-term and low-value assets exceptions identified in paragraph 24? If so, please provide details.*

*B. If you are a preparer, do you expect to use the exceptions? If so, please:*

*(i) quantify the number and annual lease payments for each category;*

*(ii) indicate the proportion of your leases (by volume and/or value) you estimate to be covered by each of the exceptions.*

**A1. Yes; the volumes involved, however, are not yet clear. Companies have yet to start with elaborating the technical aspects of the new IFRS 16 standard, let alone make the choices for transition.**

**A2. Short-term leases (by class of underlying assets):**

- **(1) all leases expiring in 2019 as companies may need (or take) an extra year to adjust systems;**
- **(2) certain leases for equipment with high turn-over will turn into contracts of 12 months maximum.**

**A3. Low-value assets (on a lease-by-lease basis):**

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**(1) Office furniture,**
**(2) small office equipment, including desk top computers, lap-tops and hand-held devices (I-pads, telephones, etc.),**
**(3) small printers, etc.**

**C. Note: the exemptions for short-term leases and low-value leases were provided to ease the acceptance of this standard to preparers. It should be noted that, as a result, extra disclosures were considered necessary to present the full lease-picture. The disclosure requirements will impose an undue burden on the reporting, whereas notably the International Accounting Standards Board (IASB) argued in favour of these exemptions as the overall impact would be immaterial for balance sheet totals. Disclosures about these exemptions should therefore be deleted.**

| | |
|---|---|
| *2* | *39* |

*If you are a preparer, which approach to transition do you expect to take? Please explain your reasons for this decision.*

**In line with the previous answers, it would seem too early for companies to having made a managerial decision as to the most appropriate transition. To be able to make such a decision, quite a more elaborate calculation should take place, for which systems are not yet available and the full extent of eligible leases still has to be investigated.**

*Appendix 2*

| | |
|---|---|
| *3* | *20* |

*Are you aware of:*

*(i) any contracts that you consider to be leases that would not be classified as leases under IFRS 16; or*

*(ii) any contracts that you consider to be service contracts (or other non-lease contracts) that would be classified as leases under IFRS 16?*

*If so, please provide details of these contracts and why you consider that the classification would not be appropriate.*

**In general, one will see a shift/switch for a large range of contracts, that are considered more services than leases, to be documented in a way that it fits management intentions best. It may be that companies loving high EBIT(DA) will choose to get as many contracts under the leasing standard, whereas other companies may, even from time to time for new transactions, decide that reducing balance sheet totals outweighs, is more beneficial, than classifying as leases.**

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**Examples of industries already voicing to bring as many as possible transactions under the leasing standard are telecom companies and private equity financiers. These type of lessees will even include all of the lease terms payable into the calculation of balance sheet (initial) values. Current market circumstances with very low interest rates will further be to the benefit of those companies seeking high initial value outcomes.**

**It might proof that the introduction of IFRS 16 triggers other conduct than intended. With exemptions and practical expedients introduced by IASB, there is ample room for deviating developments, without companies being blamed for abuse as in the current IAS 17 situation.**

**Whether transparency, understandability, relevance, reliability and comparability are served is really to be questioned.**

***Recently, following a presentation by one of the Big4 about an example of truck leasing by a distribution company, the audience was completely puzzled by the outcome which of the trucks under what circumstances were leases and when not. A small survey learned that commercial staff had interpreted the outcome to be that white trucks were no leases and painted trucks were leases. Experts know better, but how to tell the public at large? And the illustrative examples released together with IFRS 16 on 13 January are indicative, not absolute either.***

*4* *24*

*EFRAG is interested in understanding whether leases of intangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) are common. Do you have any information or evidence as to how frequently such leases of intangible assets arise in practice? If so, please provide information about the types of intangible assets that are subject to leases and the significance in operating and monetary terms.*

**It should be noted that the IFRS 16 standard was developed with the knowledge of 1990-2010. Before the break through of big data, cloud servicing, outsourcing, in-house shops, etc. By the time the standard sees its initial application in 2019, the world looks different altogether. Leases will still be around, and may be called leases still, but may no longer be in a form that fits the standard; it may be that leases have turned into services for complete other than reporting reasons. However, bringing about a momentum of change with the start of IFRS 16, it could result in expediting the move away from (reported) leases.**

*Appendix 3*

*5* *18*

*Do you have any comments on the comparison of IFRS 16 with IAS 17?*

**As you may observe from the answers to the above questions, one actually is comparing apples and pears. The IFRS 16 standard too much has focused on improvements over IAS 17 and this has been the focus of EFRAG in its assessment for the (preliminary) Consultation Document, too.**

**By eliminating the classification distinction between finance (FL) and operating (OL) leases, not just the operating leases are pulled on board. The effect of less FL on balance sheet is at least as big as the impact of OL on balance sheet: there will be more disclosure requirements for (current) FL. A shift into more residual values for FL transactions would support further decline in balance sheet totals when IFRS 16 has become effective. The extent of change is difficult to predict and will also depend on uncertain general economic developments.**

*6* *34*

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

*(ii) access to finance and cost of credit?*

*Please provide any available evidence.*

*7* *41*

*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;*

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

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

*Please provide any available evidence.*

*8* *43*

*Do you have any additional information or views on how the endorsement of IFRS 16 can be expected to affect the leasing industry in Europe? EFRAG is particularly looking for views from the leasing industry.*

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*Please provide any available evidence.*

**Whether there is impact on the European leasing industry is more dependent on the behaviour of the ultimate finance providers, banks in general.**

**There have not been clear signals from the banking industry yet, as they are involved in their own regulatory situation. The extent to which conflicts arise between regulations for financial institutions, banks, and lessor companies, over risk weighted (physical) assets is hard to predict. The combination of reporting (IASB) and regulatory (BASEL, ECB) regulations may be hindering sound developments.**

**Also, there are the first signals that the uncertainty in the developments of leasing are not conducive to the public good: it obstructs the application of new developments like the circular economy. In a circular economy the producer / supplier seeks to control the goods at the end of a period of (first) use for renewed, refurbished, etc. application of the (rare) materials. When profit taking is prohibited, lessors, as in-betweens, may come in handy, but only when banks allow for financing residual-value-rich assets. An area, where banks find themselves traditionally very uncomfortable and where supervisors have not shown a lenient view either.**

*9* *48*

*Do you have any information or views on how the endorsement of IFRS 16 can be expected to affect SMEs in Europe?*

*Please provide any available evidence.*

**The IASB has time and again indicated that the full IFRS 16 standard was for large companies only.**

**In order to make application at SME level possible, the standard should have been created bottom-up: think small first. This bottom-up approach is not the way IASB currently works. Application of a 'small version', see IAS 17 for SME's, has failed dramatically as it has not provided any real relieve.**

**If an IFRS 16 for SME's is to be derived from the full version, it will result in a very onerous reporting burden for more than 99% of European companies. And in this case (again): without adding major improvements in transparency, reliability, etc.**

*10* *49*

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

*Please provide any available evidence.*

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*11* *66*

*What is your view on the relative costs of applying IFRS 16 and US GAAP? Do you have any other views as to the advantages or disadvantages of IFRS 16 compared to US GAAP?*

*Please provide any available evidence*

*12* *115*

*What is your view on the one-off and ongoing costs for preparers? (Please indicate whether you are (a) a lessee; (b) a lessor; (c) both a lessee and a lessor or (d) neither a lessee nor a lessor).*

**[leasing association, so formally neither lessee nor lessor]**

**One-off costs depend on the state of current systems; all staff need to be educated (which may have immaterial benefits) and transition costs may be extensive as (a) large companies may need to perform extensive investigations into (possible) lease transaction and (b) due to external auditors having to agree to existence, valuation, completeness, etc, of items that come onto the balance sheet for the first time.**

**Ongoing costs are**

**(1) larger internal transaction systems are required at more (maintenance) costs, or**
**(2) when outsourced, information has to be monitored, audited, etc.**

*Will preparers that already report finance leases have lower costs than preparers without finance leases?*

**Prepares of current finance leases may have higher costs as the transition to IFRS 16 will not go unnoticed for finance leases. At least, extra work is required to investigate for all current, *and potential leases*, for which type of transition to decide.**

*Please provide any evidence you have on the expected magnitude of the costs.*

*13* *118*

*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.*

*14* *128*

*If a lessee has to develop new systems to support the accounting for leases, to what extent do you, as a lessee, expect internal benefits from the information provided by the new information? Please quantify to the extent possible.*

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

*Please provide any available evidence.*

*And finally …*

*16*

*Are there any issues that have not been raised in this Preliminary Consultation Document that should be considered by EFRAG? Please explain*

**In reality, on 1-1-2019, the economic circumstances have not changed for the same leases that were present on 31-12-2018.**

**The effect of putting items on balance sheet is that a company's balance sheet is looked at differently.**

**A second effect is that the composition at start date (1-1-2019) may have changed from today's situation, when newly classified leases come into play and former leases classified as services leave the balance sheet.**

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