



European Federation of Accountants and Auditors for SMEs

International Accounting Standards Board (“IASB”)
30 Cannon Street London
EC4M 6XH
Brussels, 30 September 2013

Dear Sir

Comment on IASB’s Exposure Draft – Leases (ED/2013/6)

We have set out some general comments on the Exposure Draft (“ED”) – Leases below. We should state from the outset that we have significant reservations about the proposed standard. After further and detailed consideration we believe that the IASB should reconsider its entire approach to lease accounting. Whilst accepting that the objective of this project was to address imperfections of the extant IAS 17 we are unconvinced that this proposal will yield better information. Our comments are made from the perspective of small and medium-sized entities (“SMEs”) and small and medium-sized practitioners (“SMPs”) but it is clear that these may also be valid from the perspective of other stakeholders.

This letter will outline our observations and concerns and the context to these comments.

About EFAA

The European Federation of Accountants and Auditors for SMEs (“EFAA”) is an umbrella organisation for national accountants and auditors' organisations whose individual members provide professional services to SMEs within the European Union and Europe as a whole. It was founded in 1994 and has 14 member bodies throughout Europe representing over 250,000 practitioners.

EFAA represents accountants (“preparers”) and auditors providing professional services primarily to SMEs. Constituents are mainly SMPs, including a significant number of sole practitioners. EFAA’s members, are therefore, SMEs themselves.

SMPs are European SMEs' most important business advisors. They help entrepreneurs gain access to finance and they provide valued business advice allowing them to grow their businesses in a sustainable manner. An important characteristic of SMEs is that most of their business relations are based on very close personalised cooperation and mutual trust. Hence, their accountants and auditors need to provide targeted services to accommodate the individual needs of SMEs and of the users of their financial statements.

Why is EFAA responding to this matter?

This Exposure Draft (“ED”) establishes a new model for lease accounting. Lease accounting is a common and important method of financing for SMEs.

We believe that the effect of this proposed standard, if implemented, will be significant. Not only will it change the manner in which European listed groups (and other companies voluntarily choosing to adopt IFRS) account for leases but it is likely to have a significant “trickle down” effect to unlisted companies.

SME accounting in Europe is not only framed under the requirements of the European Accounting Directive (“Directive”) but is influenced and driven by the requirements of National Standard Setters. Where the Directive is silent on how to account for certain matters (as it is in the case of Lease Accounting) then National GAAP is usually followed. These requirements in turn often follow IFRS pronouncements. For instance, in the UK, there is



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no difference between how an SME accounts for a lease and how a listed company accounts for a lease. This is an established principle and should the extant IAS 17 be changed to the lease model outlined in the ED, this would likely have a significant effect on how SMEs account for leases; the “trickle down” effect.

Our concerns

Our concerns are set out below.

1. Overall complexity of the ED

The ED is complex in nature and we have outlined some observations to attest to this below.

Definition of a lease

The definition of a lease (where the distinction between the provision of a lease or that of a service contract is now extremely important) makes the practical application for SMEs (and possibly others) difficult. Accepting that users of accounts have often demanded more information (in particular transparency of the actual lease commitment) we are unconvinced that adding further complexity at the very outset of lease accounting (i.e. what is or what is not a lease) will improve the value of accounting information for users.

Asset capitalisation

The creation of an asset (necessarily required as a result of recognising the lease liability) seems theoretically sound but in practical terms this then requires further judgements to be made by preparers of accounts. These include determining the minimum lease term, the discount rate to be used and an annual impairment review.

Type A and Type B leases

Further judgements are required over the type of lease and the resulting accounting model. We question if users will really understand the issue and the determinants of why one lease may be Type A and the other Type B. Why should the nature and level of consumption of the asset determine how it is accounted for?

2. Cost / Benefit Analysis

The cost of accounting under the proposed standard will, in our opinion, exceed the benefits. Preparers will still have to make significant judgements and the results of those judgements when combined with the new accounting requirements may not result in an improvement for users of a magnitude that would outweigh the costs of preparers; no net benefit would result. Fundamentally, we question whether readers and users of accounts will be in a better position following the implementation of this standard than they were before. We also feel that in an SMP / SME environment this approach fails to reduce the potential for “structuring and abuse” and this is important because one could argue that this was its *raison d’être*.



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3. Due process, field testing and effects analysis

We do not believe given the potential that this standard has to significantly change the requirements for lease accounting that sufficient field testing has been undertaken. We are not aware of any field testing of this ED in the SME / SMP arena and this is important because there are several practical consequences of this standard being implemented that surround, for example:

- Burden on preparers;
- Cost / Benefit from a preparer / user perspective;
- Tax and deferred tax implications;
- Impact on disclosure for SMEs when combined with the reduced EU disclosure requirements in the new Accounting Directive. In other words, what will users see and how will these changes be understood?; and
- Effect of gearing, interest cover, and EBITDA performance ratios and the subsequent implications of these effects when in fact nothing (commercially) may have changed.

We call on the IASB to carry out field testing on SMPs, SMEs and users of SME Financial Reports to assess the cost/benefit impact before any change is considered for inclusion in IFRS for SMEs.

4. Timing in relation to the issue of the IASB Discussion Paper (“DP”) – A Review of the Conceptual Framework for Financial Reporting (issued July 2013 with comments January 2014)

The above DP will consider the definition of assets and liabilities amongst other matters. This seems to be at odds with the issuance of such an important standard on leases which itself necessarily deals with the question of what is and what is not an asset and a liability. In this regard, we question the rationale and timing.

Our answers to the specific questions raised for comment

Q1. We do not agree that the definition of a lease has been adequately addressed and there will remain difficult judgements required which will risk comparability and transparency for the users but will add complexity for the preparers as set out in our general comments above.

Qs 2/3/4. We do not agree with the accounting model proposed. We are not convinced that the users of financial statements will gain significantly better information from the change, but there would certainly be substantially greater complexity and preparation costs for the preparers, as explained in our comments above.



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Q5. We do not support the proposals for the lease term. The judgements required will add complexity to the accounting which does not help the transparency for users and increases the complexity as explained in our overall comments.

Q6. We support the proposals with regard to variable lease payments.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Federico Diomeda
Chief Executive Officer