

European Financial Reporting Advisory Group (EFRAG)  
5 Square de Meeûs,  
1000 Brussels,  
Belgium

8 December 2016

Dear Sirs,

**Preliminary Consultation Document regarding the endorsement of IFRS 16 Leases**

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

***Response***

We welcome the opportunity to comment on EFRAG's preliminary consultation document regarding its endorsement of IFRS 16. We are particularly pleased to see that EFRAG is conducting additional research on the impact of IFRS 16 on SMEs.

As an overarching comment, we note that we are generally supportive of ensuring that EU adopted IFRS is as closely aligned as possible with IFRS issued by the IASB. However, we are concerned that the impact of IFRS 16 on small and mid-size quoted companies has not been fully considered by the IASB during the standard setting process.

We note that non-institutional investors are an important stakeholder in small and mid-size quoted companies. We believe that IFRS 16 will make it more difficult for non-experts, such as non-institutional investors, to clearly and easily identify cash flow commitments entered into by companies.

We note that our members, small and mid-size quoted companies, have finance leases and, therefore, the principle of applying IFRS 16 should be well known. Although we do not believe that the cost of applying the standard would be significant for smaller companies, we are concerned about how IFRS 16 will impact the cost of debt for small and mid-size quoted companies.

We have responded below in more detail to the specific amendments from the point of view of our members, small and mid-size quoted companies.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

*Responses to specific questions*

**Q1 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. 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.**

We note that we have supported the exemptions included in the standard for short-term and low-value leases. Whilst we have not surveyed our members to assess the quantum of leases covered by the exemption, we believe that the exemptions will be used by small and mid-size quoted companies.

**Q2 If you are a preparer, which approach to transition do you expect to take? Please explain your reasons for this decision.**

We have no comments.

**Q3 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.**

We are not aware of any significant concerns in these respects.

**Q4 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.**

We do not have any evidence with regards to how frequently leases of tangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) arise in practice.

**Q5 Do you have any comments on the comparison of IFRS 16 with IAS 17?**

We believe that the adoption of IFRS 16 will have a disproportionate impact on the financial reporting of smaller companies with fewer leases. We believe that the impact on the Income Statement of a material new lease, or of a lease coming to the end of its life, will be greater and will require a greater explanation to investors. We note that the IASB considered this issue but concluded that, for larger companies, the 'portfolio effect' of leases will smooth out the impact in the Income Statement. However, such an effect does not hold true for smaller listed companies.

**Q6 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**

We note that, when endorsing IFRS 16, the IASB made clear that they felt the new standard's benefit would be reflected by a lower cost of capital, and cost of debt. We believe, however, that this analysis was solely focussed on larger listed companies with very different debt and equity markets. In light of this, we are concerned that an insufficient amount of work has been undertaken to assess the impact on the cost of debt for smaller listed companies.

In our experience smaller listed companies are often dealt with by teams within banks that have had less exposure to IFRS. This leads to them having less awareness of the impact of changes in accounting standards. We are concerned that when banking facilities are renegotiated, smaller listed companies will not see covenants being adjusted to reflect the changed accounting rules.

We note that the evidence on the overall application of IFRS indicates that it has resulted in a lower cost of capital for the largest companies. However, we believe that the benefits for smaller listed companies have been much less. Subsequently, we anticipate that IFRS 16 will follow a similar pattern.

**Q7 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.**

We do not currently have views or information on how IFRS 16 might affect entities' use of leasing. We believe that it is too early to comment on this other than by the use of anecdotal evidence.

**Q8 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. Please provide any available evidence.**

We have no comments.

**Q9 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.**

As noted above, we doubt whether the endorsement of IFRS 16 will bring noticeable benefits to smaller listed companies in the form of a reduced cost of debt.

**Q10 Do you have any information or views on whether IFRS 16 is likely to endanger financial stability in Europe? Please provide any available evidence.**

We believe that it is unlikely that the endorsement of IFRS 16 will endanger financial stability in Europe.

**Q11 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**

We believe that US GAAP is preferable in respect of lease accounting because the treatment in the Income Statement for current operating leases will continue to reflect the cash cost paid. This will facilitate more useful information being provided to users. Furthermore, we also believe that this treatment will more closely align financial reporting with the information management used to run the business. As noted in our answer to Q5, the impact on the Income Statement is disproportionately large for smaller listed companies, hence why we prefer the treatment adopted in US GAAP.

**Q12 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). Will preparers that already report finance leases have lower costs than preparers without finance leases? Please provide any evidence you have on the expected magnitude of the costs.**

Although we expect there to be one off costs for preparers, we do not believe that these will be significant for our members due to the relatively small number of leases and the availability of information.

**Q13 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.**

We have no comments.

**Q14 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.**

**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.**

We think that it is unlikely that our members, small and mid-size quoted companies, will need to develop significant new systems to support the accounting for leases.

**Q15 Are there any issues that have not been raised in this Preliminary Consultation Document that should be considered by EFRAG? Please explain your view.**

We welcome the fact that the IASB specifically considered smaller companies in its Effects Analysis. However, we are disappointed that this was not in more depth given the number of smaller listed companies using IFRS.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'TW', is positioned below the closing text.

Tim Ward  
Chief Executive

**Quoted Companies Alliance Financial Reporting Expert Group**

<b>Matthew Stallabrass (Chairman)</b>	<b>Crowe Clark Whitehill LLP</b>
Matthew Howells (Deputy Chairman)	Smith & Williamson LLP
Jonathan Compton	BDO LLP
Amy Shephard	Deloitte LLP
Neil Armstrong	Frontier Developments PLC
Gary Jones	Grant Thornton UK LLP
Anthony Carey	Mazars LLP
Joseph Archer	PKF Littlejohn LLP
Andrew Westbrook	RSM
Donna Caira	Saffery Champness
Ian Davies	Vislink PLC
Edward Beale	Western Selection Plc