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**Sent via Email only.**

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Dear Andrew,

**Preliminary consultation document on the endorsement of IFRS 16 Leases**

EFAA is pleased to provide views in response to EFRAG's consultation, which have been developed with the assistance of EFAA's Accounting Expert Group.

As you know, EFAA is an umbrella organisation for national accountants and auditors' organisations whose individual members provide professional services primarily to SMEs in Europe. EFAA has 16 members throughout Europe and represents more than 360,000 accountants, auditors, and tax advisors on their behalf in Europe and beyond.

We have therefore focussed primarily on the following question from your consultation:

**Do you have any information or views on how the endorsement of IFRS16 can be expected to affect SMEs in Europe? Please provide any available evidence.**

EFAA's principal concerns relate to SMEs. The endorsement of IFRS16 would first impact SMEs using IFRS, but the much greater impact is likely from the alignment of national GAAP with IFRS16. We note that EFRAG has taken the size thresholds from the Accounting Directive to define SMEs for this purpose.

*Cost of implementing IFRS16 for SMEs*

We consider that there will be significant costs for SMEs of implementing the requirements of the new leases standard. Under some systems SMEs will already be accounting for finance leases in broadly the same way as IFRS16, though this tends to be for a lesser extent than operating leases. Though commonly already required to

make disclosures of operating lease commitments the definitions in IFRS16 will require careful consideration, amongst others of the boundary between service elements and leases of assets, of the effect of options and of appropriate discount and depreciation rates. Considerable extra detail on all relevant contracts will need to be collected. There will be more complex accounting calculations required especially of the present value of the obligations and of the split between 'interest' and 'capital' elements of the lease payments.

On the whole these will be covering the same sort of factors as for listed companies. The impact for SMEs would be scaled back for size and diversity of operations. On the other hand SMEs have access to less resource to implement accounting changes.

The practical expedient options included in IFRS16 for short term leases and for small leases are likely to be widely used by SMEs and so would be important elements in reducing the burden of compliance.

We are not aware of any specific study or survey on the cost of implementation by SMEs.

#### *Use of leases by SMEs*

Leasing is a very significant source of finance for SMEs for much of the plant and equipment they require especially for office equipment and for vehicles. It is used for the great majority of real estate and premises that SMEs use in their business. We have noted the research and surveys that LeaseEurope have gathered on the issue which we understand has been submitted to you.

Our member body in Slovenia collected some information on this issue. In a relatively small member state they found that about 32,000 SMEs recorded rent expense in their financial statements, the great majority of which were micro entities. Their survey also identified about 9,000 companies which recorded rental income and again the vast majority were in the micro category.

#### Information on SMEs applying IFRS16

Some SMEs will be applying IFRS16 directly, but these will be the exception in terms of the overall picture in Europe as the major impact is likely to be the application via national GAAP, as noted above.

There will be some companies that fall within the SME definition which are listed on regulated markets that will be obliged to comply with IFRS16 as endorsed in due course.

Many member states have permitted, but not required, the use of endorsed IFRS by other companies. This voluntary adoption of IFRS will include SMEs. We have little firm information on the numbers of companies involved but note that it is reported by our members as happening. Commonly reported are cases of



subsidiaries in groups that are preparing IFRS consolidated accounts. For example in the UK the FRS101 regime, which allows reduced disclosure requirements for group companies when they use EU endorsed IFRS, is now a very standard practice for groups. There will also be companies using IFRS because they are listed on alternative trading platforms, many of whom may be SMEs.

Some member states require the use of IFRS by SMEs such as Cyprus and Malta. We would suggest that EFRAG includes in their consideration other countries that are not member states but who are following EU requirements and so may be affected by the endorsement of IFRS16 – such as EEA countries, candidate countries and those in STAREP the Eastern Partnership.

#### *Implementation of IFRS16 via national GAAP*

We are in the process of completing a study into the extent that accounting treatments in full IFRS come to be applied to the accounting required of SMEs which we have called the “trickle down” effect. This covers five member states and looks at over 90 different requirements of IFRS. We will send this to you when completed.

The overall conclusions are likely to be that there is evidence that “trickle down” has taken place to a significant extent. It has been more pronounced in some countries than others but has clearly been a factor in all. It is more prevalent in the requirements for medium-sized than for micro entities. It is more common where the Directive is silent on the accounting treatment and for more common transactions, both of which would apply to lease accounting. The existing treatment of leases from IAS17 is common, though not completely taken up.

Some of the member states have a general policy direction to align their national GAAP with IFRS. Leases are an example of where tax and accounting treatments often overlap and so a difference between listed companies and others may be difficult to sustain.

It seems very likely that the treatment of leases in IFRS16 will come to be applied to a significant proportion of the many millions of SMEs in Europe and EFRAG should be conscious of this when considering the impact of the standard.

*Access to finance by SMEs*

Implementing IFRS16 would mean that in some cases the borrowings and assets would be differently stated than before. Some lenders may be already adjusting for the effects of leases in a comparable way to IFRS 16, others may not now but may alter their practice in future.

Some lenders are using other ratios such as EBITDA as a way of assessing SMEs for lending purposes. Many of these ratios will be affected by IFRS16 as not only the balance sheet, but also the profit or loss will be affected overall and the balance between the proportions of interest, depreciation and operating expenses. It is not known at this stage what measures may be used in future.

In our view therefore the impact on SMEs access to finance is not known at this stage and is difficult to predict.

*For the future*

EFAA strongly supports the approach taken by this study for the endorsement of the new leases standard. Endorsement requires a thorough assessment of the likely impact and we consider this must include SMEs who may be affected by the 'trickle down' of IFRS to national GAAPs as well as those SMEs applying IFRS directly. Likewise EFRAG needs to ensure that there are adequate post-implementation reviews conducted either by IASB or themselves more focussed on Europe, which again considers the impact on SMEs.

We would also welcome more attention to the issues for SMEs in EFRAG's research programme where relevant.

Please contact myself or Marie Lang for anything further on this.

Yours sincerely



Bodo Richardt  
EFAA President