

## EFRAG SECRETARIAT PAPER FOR PUBLIC MEETING

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### **Leases**

#### **EFRAG activities for the effect analysis**

##### **Objective**

- 1 The objectives of this session is to discuss what activities EFRAG should plan to perform to assess the likely effect of the new Leases Standard in the context of the future endorsement process, and how to coordinate our activities with the IASB.

##### **Previous meetings**

- 2 In February, EFRAG Board discussed a paper prepared by the IASB staff for the March ASAF meeting that explained the proposed content of the effects analysis of the new Leases Standard. For reference purpose, the appendix to this paper reports the scope that was initially proposed by the IASB staff.
- 3 The EFRAG Board made some suggestions to integrate the proposals, and as a result of these suggestions and subsequent discussions at the ASAF, the IASB agreed to:
  - (a) Include a comparison of the effects of the IASB lessee accounting approach with the effects of the FASB lessee accounting approach based on a sample of entities; and
  - (b) Discuss also the potential effects on the leasing market and the access to financing for SME.
- 4 EFRAG secretariat had an initial exchange of views on the scope of activities that the IASB intends to perform and the quantitative and qualitative information that will be included in the IASB's analysis. Based on this preliminary discussion, EFRAG secretariat has understood that:
  - (a) The IASB can provide EFRAG with European data on total undiscounted lease commitment of listed entities and an estimate of the additional lease liability that would be recognised on the balance sheet (and their impact compared to total liabilities and equity). Those data can be disaggregated, for instance by industry;

*EFRAG activities for the effects analysis*

- (b) The IASB has identified the same diversity of covenants that EFRAG has, without gathering any evidence on what triggers the diversity: different banks, different customers, different strategies... We therefore propose that EFRAG and National Standard Setters in Europe participate in a survey of which scope is agreed with the IASB and other members in ASAF to gather appropriate evidence on how frequently breaches of covenants could actually occur. The questionnaire would aim at obtaining information on the type of covenants used by banks and how they are used in relation to different types of clients.
- 5 The IASB staff is currently working on the wording of the criteria to identify a lease and illustrative examples, within the boundaries of the decisions taken by the IASB Board in December 2014. EFRAG secretariat believes that it would be useful to field-test the final definition in order to assess whether constituents will be able to apply it in practice and identify any implementation issue. However, the field-test would require that the material is made publicly available before the final Standard is issued.
- 6 Some European constituents are calling for a public fatal flaw review of the Lease Standard, with the same objectives as highlighted above. The IASB has indicated that they consider to have fully complied with their due process and that no further exposure of the final proposals is needed. The IASB could be concerned that providing publicly the Standard could be perceived by constituents as an additional round of consultation.
- 7 On the other side, any lack of clarity, especially in reference to the identification of leases, is likely to result in requests for clarification and submissions of issues to the Interpretation Committee. The interaction with the TRG on Revenue Recognition shows that identifying possible amendments after publication is not an ideal solution.

**Question to EFRAG Board members**

- 8 Does the EFRAG Board consider that the quantitative information to be provided by the IASB are sufficient for their assessment? Additional analysis would require access to proprietary databases of financial information for listed entities.
- 9 Does the EFRAG Board support the launch of a survey on the impact on loan covenants?
- 10 Does the EFRAG Board support the request for a public fatal flaw review before issuing the final Standard?
- 11 Are there other activities in relation to the understanding of the effects of the new Leases Standard that the EFRAG Board would recommend to perform?

SCOPE OF THE EFFECTS ANALYSIS – ORIGINAL IASB PROPOSAL

- An overview of the lease accounting requirements in the new Leases Standard;
- The likely effects of the new requirements on reported information;
- Information about the entities that are likely to be most affected (eg particular industry sectors or particular regions);
- The likely benefits of the new requirements;
- The likely costs of applying the new requirements, to include costs on initial application as well as ongoing costs;
- The likely effects on key financial ratios; and
- Other possible effects of the new Leases Standard, such as the possible effect on:
  - the cost of borrowing and debt covenants; and
  - regulatory capital requirements.