



Proposed Changes to Lessee Accounting Standards for companies accounting to International Financial Reporting Standards

What is happening?

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are working on a common standard for accounting for all leases which will ensure that the assets and liabilities arising from any lease contracts are recognised in financial accounts for companies accounting to International Financial Reporting Standards (IFRS). The IASB published an exposure draft which was open for comment until 15 December 2010. Following a review of the responses to the draft the IASB decided to consult again due to significant changes which had been made, this is currently expected to be published in quarter 1 2013.

Historically, financial leases have had to be reported on the balance sheet, but not operating leases. The new approach to lease accounting, referred to as the 'right of use approach', differs substantially from today's standard which is based on an analysis of the risks and rewards inherent in the lease. Under the right of use model, a lessee would always recognise an asset, (the right to use the leased item), and a corresponding liability, i.e. rental payment, on its balance sheet, whereas under the current standard, a lessee recognises the leased asset only under so-called finance leases with a note to the accounts for operating lease liabilities.

Will my company be affected?

The proposed lease accounting rules will only apply to companies that report to the standards of the IASB and to the public sector. Publicly listed companies already have to make a note to the annual report, which reflects any operating lease gross liabilities.

The changes will not apply to companies using UK Generally Accepted Accounting Practices (UK GAAP) to compile their financial accounts.

How will this impact my business?

Your company will need to ensure it reports its liabilities (payment arising under the lease) and its asset (the right to use the leased asset). This is relatively straightforward if you are able to measure these two values and account for them in a consistent and simple manner. It is possible that matters could get complicated if these values are treated differently or if you are required to make minor re-forecasting adjustments for every leased item during a financial year.

Right of use model – lessee

Asset	Liability
Right to use the leased asset	Rental payments (finance element only) Net present value discounted at customer's incremental borrowing rate

Should we be supporting these changes?

While no one likes change, the recent global economic climate has made it imperative that a complete picture of a company's assets and liabilities is available to investors and users of company accounts.

The proposal to bring such leased items on to a company's balance sheet itself will not erode the commercial benefits of leasing. In fact the vehicle leasing industry has proved its value, sheltering you from the risks associated with vehicle values and importantly ensuring your business capital is freely available and not tied up having to buy your company vehicles.

What aspects of the lease will we have to report?

The IASB simply wishes to ensure that all of the company's liabilities are clearly reported. If your company is leasing a motor vehicle, then they will only need to report the finance element of the lease payments. This will exclude any payments your company makes for maintenance or servicing contracts linked or related to the leased vehicle. This principle will apply to all the assets being leased by your company, such as property, computers, photo-copiers etc.

What about excess mileage charges and other contingent rental payments?

Your company will have to account for the cost of any damage and excess mileage charges which may be payable at the end of the lease contract. The BVRLA believes that calculating this for each and every leased vehicle would be impractical. Having discussed this with the major accounting firms, the association believes that your company could meet its reporting obligations on a fleet portfolio basis, thereby simplifying the process.

What if I extend my vehicle lease?

If your company has a formal option to extend the term of its lease, and it expects to do so, then the company would be required to calculate the value of the asset and include the period of the extension on your balance sheet. Your company will be required to consider all relevant factors, including options to renew at market value at the date of renewal.

In practice, as most vehicle leases are fixed-term closed end leases without formal options to extend, this requirement is therefore unlikely to affect many customers. If the leasing company has informally permitted your company to continue using a vehicle after the lease term has expired – whilst awaiting delivery of a new vehicle, for example – your company would not have to account for the rentals for the period of informal use.

What about short term rental vehicles?

A simplified method of reporting is proposed for short-term leases, defined as a lease which has the maximum possible lease term, including options to renew or extend, of twelve months or less.

Under this so-called simple method your company would note the undiscounted amount of the rental payments and recognise the rental payments in its profit and loss account over the rental term. If the total annual rental payable is not financially material or 'non-core' to the business your company may be able to agree with its auditors that this liability does not have to be reported as it has little financial impact on the balance sheet.

When will the changes take place?

There is currently no expected date for when the final standard will be published.

There is likely to be a transitional period, as yet to be defined, before any new standard becomes mandatory.

The new standard will apply to your company's financial statements for periods beginning on or after a date to be announced by the IASB. As with all other changes to accounting standards, your company will need to ensure that it produces a set of comparative accounts relating to the

year prior to the new standard being implemented. For example, if the standard becomes mandatory on 1 January 2014, then your company will need to produce comparative accounts for 2013 using the new standard.

What should my company be doing now?

Your company may wish to speak to its auditor or accountant to fully understand what changes will need to be made with the way your company prepares and reports its accounts. This may also lead to a requirement for system changes to your accounting IT systems.

If there are specific concerns with the changes then please feel free to provide comment on the exposure draft direct to the IASB via their website which is detailed below.

For more information visit the [IASB's website](#) or contact your vehicle leasing provider.