**IASB Issues Report: Leases: Practical implications of the new *Leases* Standard**

The report, issued in March, describes the IASB's one lease lessee accounting model. It also provides an overview of some of the possible effects of the forthcoming changes to lessee accounting, and of the work that the IASB has undertaken to assess those effects. The full text is available at **http://www.ifrs.org/Alerts/Publication/Pages/IASB-sets-out-practical-effects-of-bringing-leases-onto-the-balance-sheet-March-2015.aspx**.

Under the IASB one lease model material operating leases will be capitalized with the assets and liabilities combined with capital lease assets and capital lease debt. The P&L lease cost will be front ended as interest is imputed on the declining debt balance.

The IASB report says:
The IASB lessee model will provide a ***richer set of information*** to investors than is available today, providing further insight into an entity's operations. It also says there will be less complexity in reading financial statements since all leases are treated the same. It also claims it will be less costly for lessees as they will not have to classify leases and can use one system to account for al leases.

In my opinion:

- Users of financial statements agree that capitalizing operating leases will give improved information but in my opinion that only occurs when the capitalized operating leases are separately presented on the balance sheet and where the lease cost is recognized as level rent expense.
- The IASB one lease model and the report ignore the substance of lease contracts. If the IASB report had cited the comment letters and advice of independent objective stakeholders like American Accounting Association (AAA) or AICPA, their comment letters plainly say the elimination of lease classification is a step backwards eliminating the "richer set of information" that currently gives users (lenders and credit rating agencies in particular) the breakdown to distinguish between leases that create asset ownership and debt vs. those operating leases that are rental contracts and do not create an asset and debt. Specifically it is commercial law that dictates the treatment of leases in process of a bankruptcy liquidation. Accounting for leases is a special case of accounting for contracts as operating leases will be the first executory contact to be capitalized. The accounting approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.
- The IASB report ignores the needs of preparers as CFOs of IFRS preparers operating in the US will still have to undo the accounting and classify operating leases to accomplish property tax compliance as such taxes only apply to capital lease assets – namely owned physical assets.

- CFOs of IFRS preparers operating under commercial law, as in the US and UK, that recognizes property rights of capital leases differently than operating leases will need to recast information using current lease classification tests if they are applying for a line of credit as lenders need to know the legal nature of lease assets and liabilities.
- The report minimizes the impact of the one lease model on bank capital for IFRS preparers. Having to raise more capital because of the lease accounting rules change is a real cost to banks in any times (the bank's CFO considers the cost of equity as their targeted ROE grossed up to a pretax equivalent - a 10% ROE target with a 40% tax rate equates to a 17% pretax annual cost of equity). It is an even more important now that the European banking system is stressed and banks are already in need of more capital. New Basel rules raise the capital requirements to about 10% of assets. CFOs of IFRS banks will most likely ask for regulatory relief regarding the new operating lease assets that will attract bank capital yet do not currently. They will also ask for relief from the lost capital and deferred tax asset that is caused by the front ending of lease costs versus rent expense that is the tax deductible cost. Undoing the accounting and classifying all leases will be costly and complex but doable. Also, bank branch and other premises leases are the most material of their leases and the terms of those leases are long - the longer the lease the more the permanent capital loss from front ending lease costs. The front ending of operating lease costs also creates a permanent deferred tax asset that attracts bank capital. I do not see an easy way for a bank to recast the lease cost to a straight line to get capital relief from the permanent lost capital and permanent deferred tax asset under the IASB one lease model.

The devil is in the details and the IASB report ignores important issues that IASB preparer CFOs will face in operating under their proposed one lease model.