

EUROPEAN ACCOUNTING STANDARDS

The drive to uniformity

Alun Richards looks at how new European accounting standards are impacting on Technology Leasing



European accounting practices are undergoing radical change. In 2001, EU finance ministers in the European Parliament adopted new International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). As a result, all publicly traded companies operating in the EU must use IFRS to report any set of consolidated financial statements with a reporting period commencing 1 January 2005 and thereafter. Across the world, there are approximately 75 countries that have adopted IFRS to date, with plans for more to follow.

This approach offers the potential to simplify Europe's complex accounting landscape, achieved by harmonising accounting policies across different countries. For Europe's IT equipment leasing industry, the move appears to offer an opportunity to bridge the gap on the dynamic US market. The timing of plans for convergence of the US financial accounting standards with IFRS remains unclear but this move is certainly not contemplated before 2008.

This article looks at the likely impact of the current changes in accounting practices on the regional "balance of

power" and examines other ways in which Europe's leasing companies can help to redress this balance.

America holds the aces

The global technology equipment leasing market is worth an estimated \$25 billion a year. Currently the US claims the lion's share. The concept of leasing is much more deeply ingrained in the American culture where renting cars, houses and even furniture is the norm. The US is also more homogenous than Europe, both in terms of business culture and with regard to prevailing legal framework, taxation rules and banking and accounting policies.

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This latter area in particular has long been an issue of concern in Europe. US companies moving across the Atlantic are often struck by the complexity of the accounting landscape and the wide array of different regulations and environments and approaches with which they are confronted.

The new IFRS regulations promise to change some of this. Some companies will no longer have to report using the broad range of local statutory accounting procedures currently used. As a result, organisations will generate significant cost savings in financial report preparation and audit costs as well as increased efficiency via standardisation and control. Hence, technology equipment leasing companies will, in theory at least, have a more homogenous accounting environment in which to operate.

Why harmonisation remains a long way off

Unfortunately, the reality is quite different. The current tax situation, for example, presents a significant barrier to

a streamlined accounting environment. Tax is levied in many EU countries on separate tax accounts rather than the filed accounts. And, despite the new regulations, such tax accounts will continue to be based on the format of "old" local statutory accounts, even if the reported financial statements are required to follow the new IFRS regulations.

So, leasing companies operating across the whole of Europe will effectively find themselves hamstrung, unable to move away from dealing with the old statutory accounting practices on a country-by-country basis. The efficiencies of IFRS are being compromised by antiquated tax rules. In addition, companies adopting IFRS will have significant anticipated challenges associated with meeting resource requirements, information systems changes and staff training.

Another important issue is that the move to IFRS is currently only mandatory for publicly traded companies. (Only about 30 per cent of Key Equipment Finance's end customers for example fall into this category). In some EU countries, non-public traded companies have the option to use IFRS. However, there is little incentive for many of these companies to move to the new standards.

For many end customers of technology equipment leasing companies that are not listed companies there are also other factors deterring them from transitioning to IFRS.

Currently, many companies see the ability to generate off-balance sheet financing as one of the key benefits of adopting the equipment leasing route.

Lessees in France – where most leases are operating leases ("location" contracts) – or other European countries where the requirement to fulfil off-balance sheet treatment is not as stringent, will not want to switch to IFRS if it means putting new leases and restating existing leases onto their balance sheet which, under existing statutory rules, they enjoyed off-balance sheet.

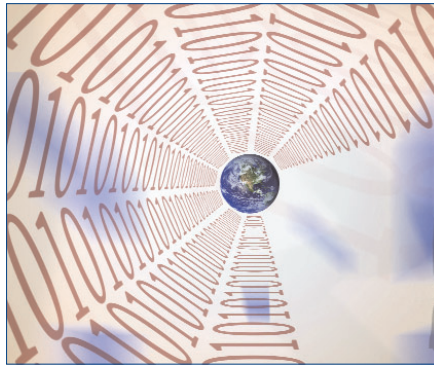
So, Europe is still some way from establishing a streamlined accounting environment. While the principles of harmonisation behind the introduction of international accounting standards are broadly to be welcomed, overall the environment remains complex and sometimes even a barrier to success for European leasing companies.

Rising to the challenge

To negotiate these hurdles, companies need to be innovative, both in terms of developing products that are customised to the local accounting rules while ensuring they conform to the prevailing business environment.

Above all, companies must be pragmatic. Financial solutions providers operating in Europe need to treat individual countries as distinct entities. They must tailor their collateral to the requirements of each market and make it available in the local language and the local currency.

The differences within accounting environments in European countries make it vital to have local operations and sales staff on the ground who understand the local markets and business culture, in



addition to the prevailing banking, legal and accounting regulations.

In short, to achieve success, companies must opt for the type of local-to-local approach that has served Key Equipment Finance well historically.

Looking to the future

So, in the short term at least, the much-heralded introduction of common accounting standards across Europe will not be sufficient to simplify the task facing technology equipment leasing companies or to narrow the gap between the US and European markets.

By contrast, the secret of a successful strategy in Europe lies in being able to formulate a pragmatic strategy tailored to

the needs of each local and regional market, not only in terms of accounting policies but also with regard to legal and tax frameworks and prevailing business cultures.

Leasing companies that will be successful are those that respect the diversity and complexity of the European marketplace and ensure they have the right people and products in place to address these issues.

“Lessors that will be successful are those respecting Europe’s diversity and complexity.”

If this type of approach is followed consistently, there is no reason why technology equipment leasing in Europe should not be able to overcome the continuing complexity of accounting policies and emulate the success of technology leasing in the US.

ALUN RICHARDS
KEY EQUIPMENT FINANCE
WWW.KEFONLINE.COM

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21 New Globe Walk
Bankside
London
SE1 9DT

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Contact Karen Brown
T: +44 (0)1206 211417
E: karen.brown@leasingworld.co.uk

www.leasingworld.co.uk