



The Alta GroupSM

Global Experience Provides Direction *For Equipment Leasing And Asset Finance*



HOW THE ALTA GROUP CAN HELP YOUR ORGANISATION

Our worldwide capabilities uniquely position Alta to help you understand and address the new rules and implement a strategy appropriate to your organisation.

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EXPOSURE DRAFT ON LEASES EXPOSED

MARC TENDLER

The ED takes the leasing industry out of its comfort zone and poses a number of significant challenges to surmount as well as the opportunity to create new business initiatives.

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CONTACT US

If you would like to discuss, confidentially, any of the issues facing your organisation and learn how Alta can help, call Malcolm Ogle on +44 1825 713356 or +44 7740 723466, or email malcolmogle@thealtagroup.eu.com

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Out of the Comfort Zone

The two major Accounting Standards Boards have been working together since 2006 to produce a revised standard for lease accounting. Although there are unanswered questions such as: “Why has this topic been chosen in the first place?” or “Are there not more important issues?”, the reality is that the joint **Exposure Draft (ED) on Leases** has now been published and the project has entered a crucial phase for the leasing industry and its customers.



On 17 August 2010, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board published their long-awaited joint ED setting out proposals for a new International Financial Reporting Standard (IFRS). Comments are due to the IASB by 15 December 2010.

It is unlikely that every proposal in the ED will appear in the new IFRS but, although there is ongoing uncertainty, the certainty is that a new standard and significant change are inevitable. This uncertainty means that organisations need to ensure that their strategy is flexible in order to meet the coming enormous challenges.

Malcolm Ogle, Chairman of Alta’s EMEA Region, says: “Alarm bells are ringing throughout the leasing industry. The new approach not only impacts the whole of the industry, including customers, parent organisations and funders, but also has widespread ramifications throughout organisations, beyond the obvious accounting implications.”

In this newsletter, Marc Tendler, Alta Principal,

outlines the main thrust of the ED and identifies the impact on customers, systems, financial offerings, accounting, funding and staff. Marc identifies the critical issues, explains the necessary remedial action and highlights the desired outcomes.

Malcolm adds: “The business challenges must not be under-estimated. The ED has not removed the layers of complexity nor the multiple approaches. A new regime means that every current lease would need to be re-analysed and the transition could be an extremely costly exercise for many organisations.”

The Alta Group has spoken to a wide range of organisations to ascertain their views of the proposals from a business perspective and to determine whether they have started to identify and plan for radical change. Malcolm stresses: “Our research confirms that many organisations are under-resourced or under-skilled to cope with this momentous exercise and this necessitates immediate remedial action.”

It is therefore crucial that organisations evaluate the implications across the business **now** and have a clear vision and strategy for action.

How The Alta Group can help your organisation



Manage compliance with the new leasing accounting proposals and seize the opportunities created by them, with The Alta Group as your management advisors. Our worldwide capabilities uniquely position Alta to help you understand and address the new rules and implement a strategy appropriate to your organisation.

The proposed rules will have a profound effect on lessors' business activities, financial statement presentation, financial metrics, internal controls and lease accounting systems. Lessors will need to revamp risk and asset management strategies, accounting processes, corporate governance and marketing and sales approaches to continue creating value for their customers.

As a result of the proposed rules, lessees will have to rethink decisions about how to finance their equipment.

Alta's Accounting Compliance and Implementation experts, backed by our full team of management advisers, can help you:

- 1 UNDERSTAND THE NEW LEASE ACCOUNTING RULES**
- 2 REDESIGN CUSTOMER STRATEGIES**
- 3 DEVELOP APPROPRIATE BUSINESS PROCESSES**
- 4 MAXIMISE REVENUE RECOGNITION**
- 5 ASSESS AND IMPLEMENT NECESSARY SYSTEM CHANGES**



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Alternatively, [CLICK HERE](#) to contact any of our Principals direct

IT IS CRUCIAL THAT ORGANISATIONS EVALUATE THE IMPLICATIONS ACROSS THE BUSINESS NOW AND HAVE A CLEAR VISION AND STRATEGY FOR ACTION



Exposure Draft on Leases Exposed


Marc Tendler, Alta Principal
dissects the proposals



By Marc Tendler
Alta Principal

THE ED PROPOSES THAT A NEW STANDARD ON LEASE ACCOUNTING FOR LESSEES AND LESSORS WOULD REPLACE INTERNATIONAL ACCOUNTING STANDARD 17 - LEASES. IT IS PROPOSED THAT THERE WILL BE NEW MODELS FOR LESSEE AND LESSOR ACCOUNTING, WHICH WOULD RADICALLY CHANGE CURRENT LEASE ACCOUNTING REQUIREMENTS FOCUSING ON THE BALANCE SHEET TREATMENT OF A "RIGHT-OF-USE" ASSET AND A LIABILITY TO PAY LEASE RENTALS.

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 The current accounting treatment of finance and operating leases will no longer exist.

The ED sets out two accounting models for lessors: the **derecognition** approach and the **performance obligation** approach. If a lessor retains exposure to significant risks and benefits associated with the leased asset, the lessor would apply the performance obligation approach. If the lessor does not retain significant risks and benefits associated with the leased asset, the lessor would apply the derecognition approach.

The proposed changes will also impact on the calculations of depreciation and interest in the profit and loss account.

A lessee will no longer differentiate the accounting treatment between finance and operating leases but will recognise the "right-of-use" asset representing its right to use the underlying asset and a liability representing its obligation to pay lease rentals over the term.

LESSOR ACCOUNTING Is there a significant transfer of risks or benefits of the underlying asset?			
YES		NO	
DERECOGNITION		PERFORMANCE OBLIGATION	
Balance sheet		Balance sheet	
Residual asset	x	Underlying asset	x
Right to receive lease payment	x	Right to receive lease payment	x
		Lease liability	(x)
		Net lease asset/(liability)	x
Income statement		Income statement	
Revenue	x	Lease income	x
Cost of sales (gross or net based on business model)	(x)	Depreciation expense	(x)
Interest income	x	Interest income	x

TODAY - TWO DIFFERENT TYPES OF LESSEE ACCOUNTING

Finance lease

- Underlying asset and lease liability recorded on balance sheet
- Interest and depreciation expense in P&L
- Disclosure of future minimum lease payments
- Investors use financial statement information

Operating lease

- No asset or liability recorded on balance sheet
- Rent expense in P&L
- Disclosure of future minimum lease payments

PROPOSED METHOD

One model for all leases

- Lease results in a right-of-use asset and a liability to make lease payments that will be recorded on the balance sheet
- Amortisation and interest in P&L
- Additional information in notes



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ISSUES

There are very few occasions where an accounting-led ED could potentially impact the whole of an organisation. Currently, all organisations are relatively comfortable with the accounting standards and have a thorough understanding of the requirements and their obligations. The ED has created massive upheaval with the proposal to abandon the operating lease and finance lease concepts and introduce a right-of-use approach for all leases.

The ED takes the leasing industry out of its comfort zone and poses a number of significant challenges to surmount as well as the opportunity in embracing change to create new business initiatives.

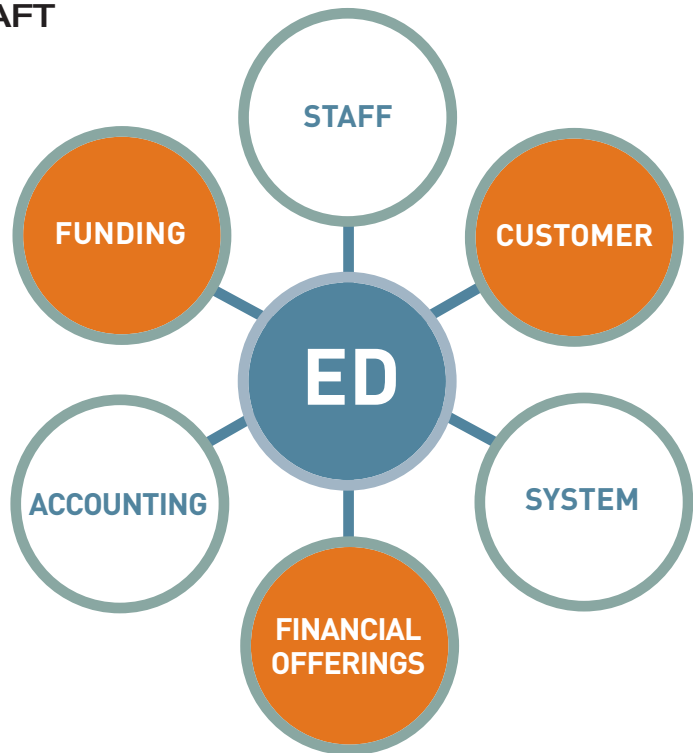
Currently 'Clear' understanding of IAS accounting by customers, funders & lessors

ED moves from comfort zone to new challenges, issues and opportunities

THE ED TAKES THE LEASING INDUSTRY OUT OF ITS COMFORT ZONE AND POSES A NUMBER OF SIGNIFICANT CHALLENGES TO SURMOUNT AS WELL AS THE OPPORTUNITY IN EMBRACING CHANGE TO CREATE NEW BUSINESS INITIATIVES

IMPACT OF EXPOSURE DRAFT

The new approach not only impacts the whole of the leasing industry but also has widespread ramifications throughout organisations, beyond the obvious accounting implications. It necessitates careful scrutiny of how an organisation is structured, the approach to markets, its business processes and interaction with external parties. It is crucial to develop a clear strategy to evaluate the business-wide issues and implement the consequential changes.

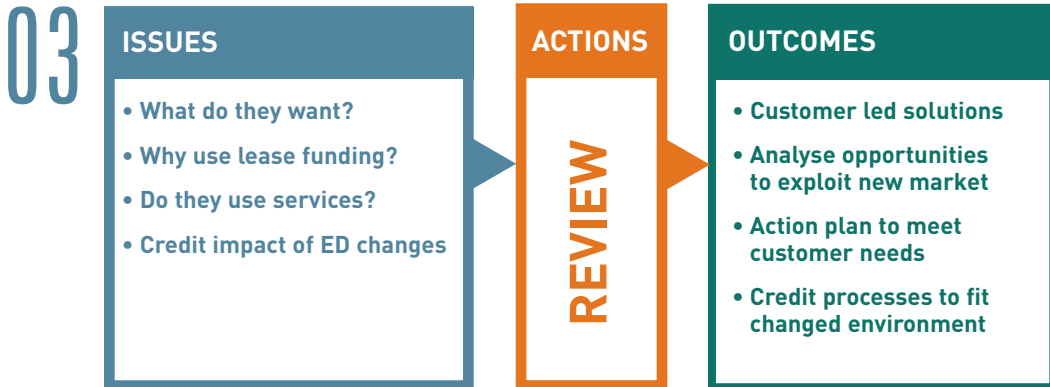


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■ CUSTOMER

It is time to ask fundamental questions about what customers want and why they choose a leasing solution. Do they use additional services and, if yes, what is the charging policy? Are they bundled in a rental? Asking pertinent questions will paint a clear picture of customer needs and expectations and enable the provision of optimal customer-driven solutions. Will you, for example, be able to capture new customers who did not use operating leases because of their perceived lack of transparency? It is also important to be mindful of the credit implications for customers and to implement processes that are suitable for the new regime.

Talking to customers and carefully appraising their requirements will provide a better understanding of the marketplace and be a cornerstone of developing and implementing an action plan for success and creating value.

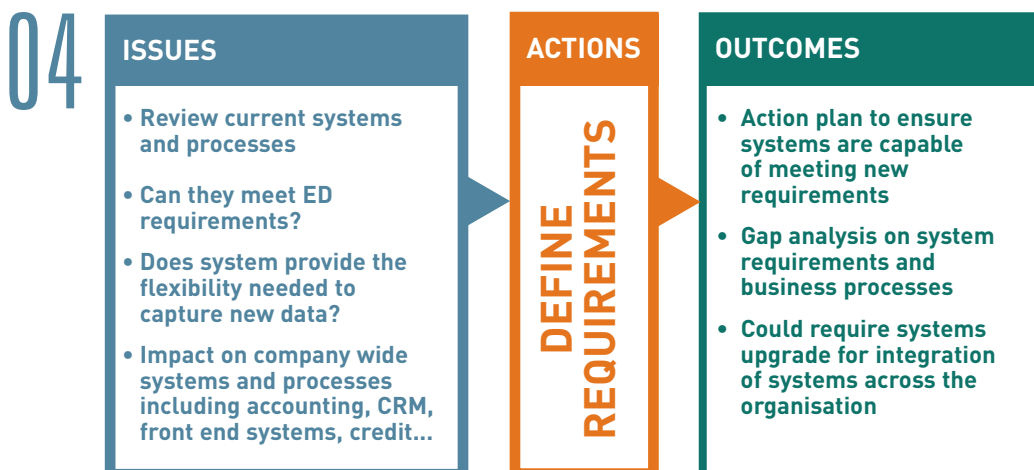


IT IS TIME TO ASK FUNDAMENTAL QUESTIONS ABOUT WHAT CUSTOMERS WANT AND WHY THEY CHOOSE A LEASING SOLUTION

■ SYSTEM

Your current systems will no doubt meet today's accounting and reporting requirements but are they capable of dealing with the ED proposals? Do they have the capability to capture new and additional data and how will you act on it? Will they cope with detailed statistical analysis; for example, of minimum lease periods and extensions? Are they sufficiently flexible to handle all the balance sheet presentation requirements? Can they map the existing balance sheet requirements into both the derecognition and performance obligation approaches and track them in your balance sheet?

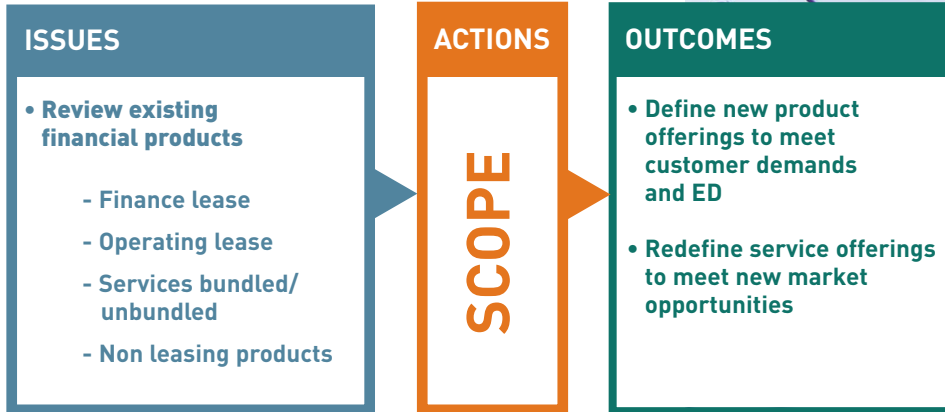
It is crucial to undertake an early in-depth gap analysis of the ED's impact across the organisation's systems and processes to identify deficiencies and then decide on an action plan of new systems and/or upgrades, being mindful of the need for flexibility to accommodate further changes.



■ FINANCIAL OFFERINGS

A review must be conducted of existing financial products from the perspective of both customers and lessors to identify the best offerings to meet the changed financial needs. Documentation will also need to change as organisations will no longer have finance and operating leases. It is important to keep abreast of the ED's evolution and look for openings to create new products to seize business opportunities.

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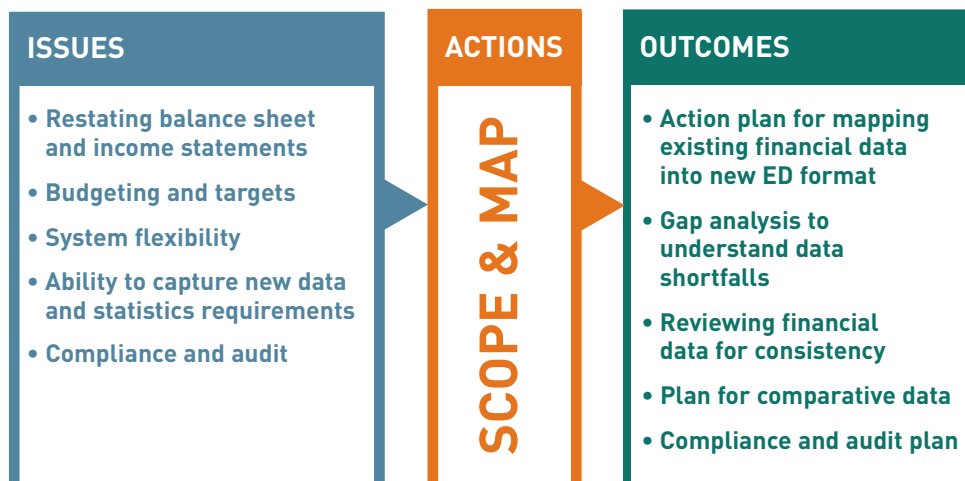
IT IS IMPORTANT TO KEEP ABREAST OF THE ED'S EVOLUTION AND LOOK FOR OPENINGS TO CREATE NEW PRODUCTS TO SEIZE BUSINESS OPPORTUNITIES

■ ACCOUNTING

Restating balance sheet and income statements in the proposed new format and undertaking a gap analysis will be an enormous exercise, particularly for lessors with a wide product set. It will be necessary not just to achieve a snapshot of the balance sheet when the new standard is implemented but there must also be comparative figures, necessitating a restatement of historic data on the new basis.

Compliance and auditing will also be impacted. How will you convince your auditors on lease classification? How will you account for a new customer with, for example, a 36 month lease where you know that a certain subset of customers usually extend for six months? If you have no experience of the customer, will you consider it a 36 month or 42 month contract? With compliance you may need to consider the impact of Sox reporting and your Basle II requirements alongside any potential governance issues.

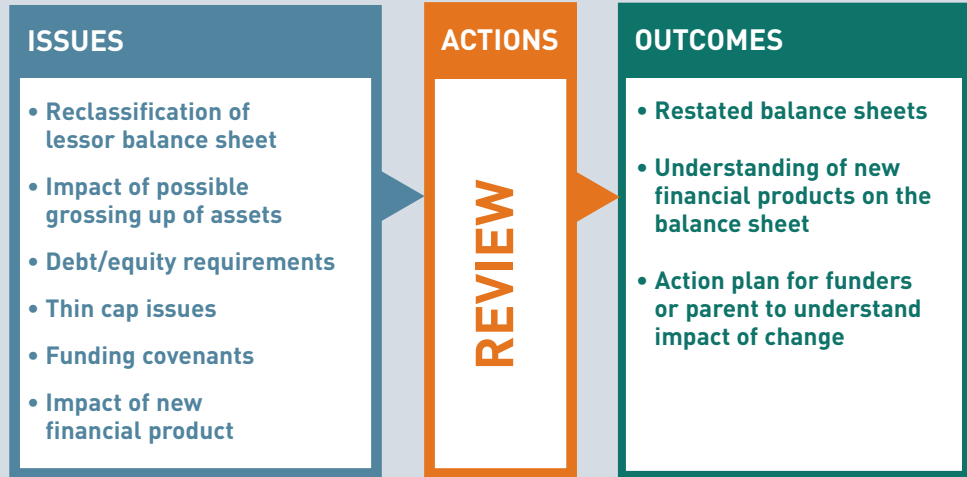
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07 FUNDING

There are several significant funding considerations with the new ED, compounded where organisations are financially challenged or under balance sheet pressure. It is imperative to address the diverse issues and identify potential problems, such as the higher level of balance sheet assets and the impact of restating them, to understand fully the funding challenges of the new regime and develop an appropriate action plan. Organisations must ensure that their funders and/or parent have a complete understanding of the impact of change.

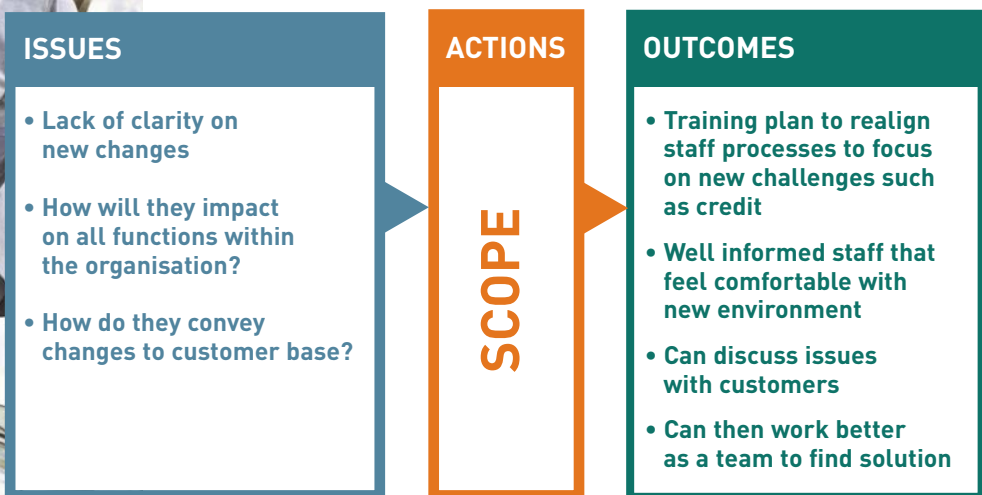
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08 STAFF

The ED affects all aspects of an organisation and, therefore, it is crucial that all staff are informed, and kept informed, of the proposals as they now stand and as they evolve. All staff must be conversant with the proposals, to a level appropriate to their specific role, to be able to perform their duties knowledgeably and confidently. What are the implications for different parts of the organisation and their staff and what are the knowledge gaps and the necessary training requirements? An action plan for informing staff and training should be drawn up now.



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