

EFRAG SECRETARIAT PAPER FOR PUBLIC MEETING

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IFRS 16 Leases Project Update

Objective

- 1 The objective of this session is to provide the EFRAG Board with an update on the work undertaken by the EFRAG Secretariat in preparing for the anticipated request from the European Commission to provide endorsement advice relating to IFRS 16 *Leases*.
- 2 This paper does not address impact assessment specifically as that will be the subject of a separate session at the June EFRAG Board meeting.

Endorsement advice

Components of an endorsement advice

- 3 Based on the endorsement advice for IFRS 9 *Financial Instruments*, an EFRAG endorsement advice is expected to have the following components:
 - (a) Covering letter;
 - (b) Appendix 1 – understanding the main changes brought by the standard;
 - (c) Appendix 2 – EFRAG’s assessment against the technical endorsement criteria (leading to a conclusion on the true and fair view principle); and
 - (d) Appendix 3 – assessing whether the standard is conducive to the European public good. This Appendix will include the various analyses making up an impact assessment

Preliminary work on IFRS 16

- 4 EFRAG Secretariat has been preparing preliminary drafts of the topics that are highly likely to be included in a draft endorsement advice if a request for advice were to come from the European Commission. This work is as follows:

Component	Status of work
Covering letter	Not started
Appendix 1	Second draft reviewed by EFRAG TEG and now relatively close to being ready for consideration by the EFRAG Board
Appendix 2	Fully drafted: second draft of relevance and reliability and first draft of the remaining sections reviewed by EFRAG TEG
Appendix 3	Drafts considered by EFRAG TEG: <ul style="list-style-type: none"> • Whether IFRS 16 is an improvement over IAS 17 <i>Leases</i> • Whether companies applying IFRS 16 are disadvantaged compared to entities applying US GAAP

European public good

Topics to be addressed

- 5 The full range of issues in considering whether IFRS 16 is conducive to the European public good will only be identified when a formal request is received from the European Commission and the EFRAG Board determines whether any further issues should be considered.
- 6 In the meantime, EFRAG Secretariat has identified the following issues (including previous comments by EFRAG Board members):
 - (a) whether IFRS 16 is an improvement over its predecessor IAS 17 across the areas which have been subject to changes;
 - (b) whether companies applying IFRS 16 are disadvantaged compared to companies applying US GAAP due to the lack of convergence of certain requirements of IFRS 16 with the equivalent US GAAP pronouncement;
 - (c) the possible impact of IFRS 16 on the behaviour of preparers, investors and lenders;
 - (d) whether IFRS 16 could endanger financial stability in Europe;
 - (e) how IFRS 16 might have a particular impact on small and medium-sized entities (SMEs); and
 - (f) the costs and benefits of applying IFRS 16 for both preparers and users.
- 7 EFRAG Secretariat is aware of concerns that additional effects may arise based on any decision by Member States to introduce changes in their local accounting principles or tax legislation. EFRAG Secretariat considers that any effects that are of the exclusive competence of Member States should not be considered in preparing the EFRAG endorsement advice. Further, EFRAG is not in a position to assess the likelihood or impact of these changes.

Questions to EFRAG Board

- 8 Are you aware of any issues other than those identified above that should be analysed as part of developing a view on the European public good?
- 9 Do you agree that changes by individual Member States to their local accounting principles or tax legislation should not be considered in preparing the EFRAG endorsement advice? If you disagree, how do you suggest that EFRAG Secretariat assesses potential changes in individual Member State jurisdictions?

Data collection

Quantitative data

- 10 EFRAG Secretariat is collecting quantitative data that might assist in understanding the impact of IFRS 16. Wherever possible, data in the IASB effects analysis is used to the extent possible.
- 11 EFRAG now has access to a commercial database which enables, to some extent, an analysis of the likely effect of IFRS 16 on the financial statements of listed companies. The commercial database collects data from published financial statements in a standardised format. This has the benefit of enabling some assessment of the impact of implementing IFRS 16. However, because of the limitations of disclosures required by IAS 17, this information is not specific enough

to answer questions such as the number of entities that will benefit significantly from the low-value assets practical expedient.

- 12 EFRAG Secretariat has contacted the National Standard Setters in all Member States to seek information on the availability of databases for non-listed entities reporting under IFRS. Indications received to date from some Member States suggest that such databases do not generally exist. If this is the case, analyses such as the analysis undertaken for listed companies will not be possible for unlisted entities applying IFRS in either their consolidated or separate financial statements.

Academic studies, surveys and other information sources

- 13 EFRAG Secretariat is reviewing existing academic and professional studies and surveys to identify any quantitative data or other information that may assist in the impact assessment. Studies that have been found relate to:
 - (a) the potential impact of IFRS 16 on users as the need for the current shortcuts to estimate the impact of leasing on balance sheets will be reduced; and
 - (b) use of leases by SMEs.
- 14 EFRAG Secretariat is also reviewing comment letters from user organisations sent to EFRAG or the IASB during the development of IFRS 16 for evidence of users' views.

Field work

- 15 In 2015, EFRAG conducted a survey on the potential impact on loan covenants. A number of other consultations were carried out in prior years. In 2016, EFRAG Secretariat is planning two major items of field work:
 - (a) Case studies on the identification of a lease; and
 - (b) A broad ranging questionnaire, together with specific outreach events.

Case studies

- 16 One of the concerns raised during the development of IFRS 16 was the perceived difficulty in determining whether a contract included a lease or a non-lease activity (such as a service). In order to test the level of judgement required by IFRS 16 standard, EFRAG Secretariat (in conjunction with National Standard Setters) is conducting a "case study" type of outreach with companies that are likely to have contracts where the classification of the contract as lease or non-lease could require significant judgement. National
- 17 The case studies are being undertaken during May-June 2016 with companies in 10 Member States being selected. The companies are being contacted with a request for them to participate in an individual interview, as the relevant information is likely to be commercially sensitive.

Questionnaire and associated outreach

- 18 Once the EFRAG Board has identified the full range of issues to be addressed in the draft endorsement advice, a questionnaire for preparers and users will be prepared. Before publication, the content of the questionnaire will be shared with the European Commission. The approved questionnaire will be made available on the EFRAG website, advertised widely (including requesting support from the organisations represented by EFRAG Board members) and supported by outreach events.

- 19 At this stage, it is envisaged that the issues that the questionnaire will address will include:
- (a) Likely effects on behaviour;
 - (b) Costs and benefits from adopting IFRS 16; and
 - (c) Exceptions to recognition: short-term leases and leases of low value items.
- 20 It is expected that the best timing for this outreach will be September-October, but the final timing will depend on when the issues to be consulted on are complete.

Commissioned studies

- 21 EFRAG Secretariat is investigating external “think tanks” and other providers of macro-economic advice to understand how practical it would be to commission studies to identify the likely impact of IFRS 16. This will be especially important for any consideration of the impact of IFRS 16 on financial stability and economic growth.

Question for EFRAG Board

- 22 What are your views on the proposed activities and what other activities do you recommend be undertaken?