

IFRS 16 Leases

Transition requirements for lessees

Objective

- 1 The objective of the session is to discuss an issue raised by some constituents in relation to the first time application of the requirements in IFRS 16 *Leases* by a lessee on leases previously classified as operating leases. Agenda paper 05.04 for this meeting is a letter sent to the IASB by ACTEO-AFEP-MEDEF.

Information for EFRAG Board

- 2 IFRS 16 is effective for annual periods starting on or after 1 January 2019. The Standard defines the initial application date as the beginning of the period in which the Standard is applied for the first time. When applying the new Standard for the first time, a lessee shall recognise assets and liabilities for leases previously classified as operating leases.
- 3 IFRS 16 allows a number of options when applying the Standard for the first time. In particular, a lessee can choose:
 - (a) Whether or not to reassess if contracts already existing at the date of initial application are, or include, a lease;
 - (b) Whether to use a **full retrospective approach** in line with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, or use a **limited retrospective approach**. The election is applied to all leases.
- 4 Under the limited retrospective approach, there is a simplified method to measure right-of-use assets and lease liabilities for leases previously classified as operating leases. Moreover, the lessee has some additional practical expedients available (such as, for instance, ignoring those operating leases that end within 12 months from the date of initial application) and carries forward the amounts recognised for leases previously classified as finance leases.
- 5 However, under the limited retrospective approach, IFRS 16 prohibits the restatement of comparative information. Instead, a lessee explains any difference between the liability recognised at the date of initial application and the present value of operating lease commitments disclosed at the end of the period before IFRS 16 is applied for the first time.

What are the concerns about the limited retrospective approach?

- 6 Under the limited retrospective approach in IFRS 16, the amount of the lease expense in the comparative period for leases previously classified as operating will be based on the requirements of IAS 17 *Leases*. No information will be provided on the amount of cost that would have been recognised had the entity already applied IFRS 16. Moreover, the presentation of the operating lease expense in the statement of profit or loss and operating lease cash flows in the statement of cash flows under IAS 17 is different from the presentation of lease expense and cash flows under IFRS 16.
- 7 EFRAG Secretariat is aware that some constituents disagree with the requirement that a lessee shall not adjust comparative amounts. Those constituents argue that it is important to allow a lessee to provide comparable information without losing the cost reliefs of the limited retrospective approach.

- 8 It is also noted that the prohibition to restate comparative amounts is a further element that hinders comparability with US GAAP preparers, since Topic 842 requires an entity to determine the adjustment to the opening balance of the earliest period presented (while granting a number of practical expedients).

How did the IASB reach its final position on transition requirements?

- 9 In the 2013 ED, the IASB was proposing either a full retrospective approach or a limited retrospective approach with restatement of the comparatives and a cumulative adjustment at the beginning of the earliest period presented.
- 10 EFRAG commented only briefly on the transition requirements. While noting that generally it supports full retrospective application, EFRAG accepted that lessees may not have the information to apply the new requirements fully retrospectively and that practical reliefs were needed to reduce implementation costs. Respondents to the EFRAG comment letter generally agreed with EFRAG views on transition requirements.
- 11 In November 2013, the IASB discussed the summary of feedback on the 2013 ED. In relation to the transition requirements, it was noted that:
- (a) Most constituents thought the proposals were costly and complex. Some questioned the cost-benefit analysis of providing comparative period information, noting that the volume of data needed to include comparative information was significant;
 - (b) In contrast, many users did not support giving preparers an option in transition method because this would reduce comparability;
 - (c) Many constituents recommended a cumulative adjustment to retained earnings at the effective date rather than restating comparative periods.
- 12 Finally, in February 2015 the IASB modified the limited retrospective approach and decided that comparatives would not be restated. This is consistent with the transition requirements in IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. The IASB acknowledged that this would limit comparability and added transition disclosures to assist users better understand the impact of the first application.

Preliminary EFRAG TEG discussion

- 13 EFRAG TEG had an initial discussion on the concerns raised in its April meeting. Since there had been no official communication at that time, the discussion was based on informal input received by EFRAG Secretariat. EFRAG TEG did not reach a conclusion on the issue.
- 14 EFRAG Secretariat noted that:
- (a) IFRS 16 already provides four different transition approaches based on the elections described above in paragraph 3;
 - (b) the limited retrospective approach as proposed by the IASB allows an entity to ignore operating leases ending before the end of the period when the Standard is applied for the first time. If operating leases were recognised at the beginning of the comparative period, without an additional transition relief an entity would be obliged to recognise operating leases ending between the end of the comparative period and the first annual period of application;
 - (c) existing IFRS would not prevent an entity from applying the limited retrospective approach in IFRS 16 and also disclosing *pro-forma* comparative information. However, the use of *pro-forma* may be discouraged in some jurisdictions and makes the information less accessible.

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- 15 Finally, EFRAG Secretariat notes that, in order to change the transition requirements, the IASB would have to expose the amendments and go through its due process. This could create uncertainty in the application of IFRS 16, especially if the IASB due process takes a significant time.

Question for EFRAG Board

- 16 Do members of the EFRAG Board consider that EFRAG should take any action in relation to this issue?