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EFRAG Preparers' Survey on the Effects of IFRS 16 *Leases*

Summary of responses

Objective

1 The objective of the session is to provide the EFRAG FR TEG and the User Panel with the analysis of responses to the preparers' survey on the effects of IFRS 16 *Leases* in preparation for the IASB's request for information related to the post-implementation review of IFRS 16 *Leases*.

Background

2 The survey, published in February 2024, was aimed at preparers, auditors, regulators and national standard-setters.

3 The purpose of the survey was to collect feedback on the overall assessment of and experience with IFRS 16. The input would support EFRAG's development of a preliminary list of application issues arising from applying IFRS 16.

4 As an alternative to the survey, a few preparers gave an interview to EFRAG, or preparer organisations gave a summarised feedback for an industry. The results presented here only include the online survey responses. One online survey response was sent to us on 8 May; this response could not be included in this structured overview, but is included in the other outreach results.

5 For the purposes of offering background information only, the survey is available here.

Definition of terms

6 The following terms are used to describe the extent to which particular feedback was shared among respondents.

Term	Extent of response among respondents
Almost all	90%-100%
Most	75%-89%
Majority	50%-74%
Many, significant	25%-49%
Some, others	0%-24%

Executive Summary

7 EFRAG received 33 completed surveys from respondents in 17 different jurisdictions (of which 14 are European).

8 The majority of respondents (70%) were preparers, of whom the majority (70%) manage more than 5,000 lease contracts.

Overall assessment of and experience with IFRS 16

9 The majority of respondents (52%) considered that IFRS 16 is generally working well but that there is room for improvement, while many respondents (31%) considered that IFRS 16 is working as intended.

10 The industries that found implementing IFRS 16 particularly challenging include extractive companies, transport and infrastructure, retail, airlines and utilities (see Figure 5).

11 Regarding ongoing application, automotive, extractive companies, chemicals, real estate, transport and infrastructure, and retail industries still find it challenging to apply IFRS 16 (see Figure 6).

Cost-benefit analysis

12 Respondents provided mixed views on whether IFRS 16 achieves a fair cost-benefit balance, with the majority of them (18 out of 33) supporting that benefits outweigh costs. Costs and benefits by category, based on respondents' assessments, are provided below.

	Costs	Benefits
Decision-making process	• Budgeting and forecasting are more complex. • Calculation of KPIs with and without the IFRS 16 impact. • New internal control systems and approval processes are implemented, and coordination between different departments. • Management may use an additional set of accounts without the impact of IFRS 16 for decision-making.	• Improved internal controls and monitoring of leases. • Better understanding of lease contracts portfolio. • Improved transparency and data quality on leases. • IFRS 16 impacts can be calculated and updated automatically.
Accounting and financial reporting process	• Lease accounting software / integrated tools implementation, maintenance costs. • Data collection and continuous monitoring is burdensome, time consuming and costly. • Increased cost of personnel and staff training. • The application of some disclosure requirements can require manual workload and therefore may be costly (e.g., when the exemption of low value/short-term leases is applied). • Additional costs for determining discount rates on a regular basis. • It can be costly to manage a large number of immaterial lease contracts, considering the limited impact in the financial statements. • New reconciliation processes.	• Faithful representation of lease contracts in the P&L and Balance Sheet. • Users receive more and better information on leases. • Increased comparability and improved transparency. • Increased consistency of lease accounting across the group. • There is no longer the need to distinguish between finance and operating leases.
Other	• Increased external advisors' costs (e.g., audit fees, discount rate providers); • Conflicting requirements and interaction with other IFRS Accounting Standards may be challenging. • The review of existing contracts might be time-consuming (lessor side)	

Effects of IFRS 16 on performance reporting

13 There were mixed views on whether the implementation of IFRS 16 has reinforced the use of new or adjusted performance measures to stakeholders, with many (48%) mentioning that new or adjusted performance measures were necessary to faithfully communicate the entity's performance (see Figure 7). The most prevalent reason was for removing the impact of IFRS 16.

Effect of IFRS 16 on the decision-making process

14 The majority of respondents (63%) did not consider that the implementation of IFRS 16 had an impact on their decision-making process of signing lease contracts. For those respondents who reported an impact on their decision-making process (37%), the majority stated that the on-balance sheet accounting for all leases under IFRS 16 has made leasing less attractive.

Application issues arising from the application of IFRS 16

15 Many respondents raised application issues mainly in relation to the following topics (see Figures 8, 9 and 10):

(a) the identification of a lease (14 respondents);

(b) determining the lease term (12 respondents);

(c) determining the lease payments (8 respondents);

(d) applying the recognition exemptions (6 respondents);

(e) accounting for contract modifications (5 respondents); and

(f) determining the discount rate (5 respondents).

16 Regarding the **identification of a lease**, many respondents noted that diversity in practice might exist in assessing whether:

(a) A lease is embedded in a service contract, especially in relation to multi-components (e.g., lease of an asset plus maintenance service) and subcontracting contracts.

(b) A contract conveys the right to control the right of use of an identified asset, including whether the lessee receives substantially all the economic benefits and decides how and for what purpose the underlying asset is used when it takes part in the design phase.

(c) The lessors' substitution rights are substantial. Indeed, from the lessee's perspective it is difficult to assess whether they would benefit economically from the exercise of their right, especially with reference to the related benefit, due to the lack of insight into the supplier's business model and common practices.

17 To support preparers in assessing those aspects, a suggestion to provide more illustrative examples and additional guidance was made.

18 Regarding the **determination of the lease term**, many respondents highlighted that current requirements might be complex, that a high level of judgment would be required and that,

therefore, widespread diversity in practice might exist. In particular, they provided the following comments.

(a) The time horizon required for the lessee's judgment would be longer than the one required by other IFRS Accounting Standards (e.g., IASS 36.33(b) refers to cash flow projections for a maximum period of five years).

(b) Assessing the non-cancellable period for contracts with indefinite life (e.g., 'evergreen contracts') might be very complex, and regardless of their similar economic substance, similar contracts might be reflected differently in the financial statements.

(c) Entities developed their own accounting policies to determine the lease term at the inception of the contract and at an ongoing basis. This might impair comparability between entities.

(d) As the lease term is one of the key drivers to determine the amount of the lease liability to be recognised, existing diversity in practice might distort an entity's financial performance and KPI (e.g., net debt position, leverage ratio, etc.) and, therefore, would lead to a counterintuitive outcome. Indeed, an entity with better financial performance will recognise higher lease liabilities than less profitable entities.

19 Regarding the application of the **recognition exemptions**, many respondents highlighted that the current definition of low-value assets might be misunderstood, misinterpreted and does not seem to be in line with a principle-based standard. Indeed, it was noted that the threshold mentioned in IFRS 16.BC100 (i.e., asset with a value lower than $5,000 when new) does not consider the size, the nature or the other circumstances of the lessee and that it therefore does not reflect the materiality assessment in IAS 1. Furthermore, one respondent also questioned the cost for providing disclosure of lease expenses relating to low-value assets, which would reduce the real cost relief that the IASB aimed for when it decided on the related accounting treatments.

20 A suggestion to reconsider such a requirement in order to extend its application to leases that, even on aggregate basis, would not be material was made.

21 Regarding **lease payments**, the major concerns that were raised related to the distinction between variable and in-substance fixed payments as well as the lease payments linked to an index. Some respondents called for additional guidance and more illustrative examples in IFRS 16 to create a clear distinction between variable and in-substance fixed payments.

22 In the case of variable lease payments linked to an index (e.g., Consumer Price Index), it might happen that the updated index becomes available only at a later stage (e.g., after the expected payment date). One respondent noted that IFRS 16 is silent on how to account for revised lease payments when such an adjustment applies retrospectively. In this respondent's view, the IASB should clarify whether these retrospective impacts should be recognised in the statement of profit or loss or as an adjustment of the right of use.

23 In addition, in those cases where there is more than one realistic set of payments (IFRS 16.B42), IFRS 16 requires considering the lowest amount. This approach might not reflect the economic substance of the contract, as the lease liability will be determined at the lowest amount rather than the more probable, though still realistic, amount. A suggestion to reconsider such a requirement, including the probability criterion, was made.

24 Finally, it was also noted that current accounting treatment of variable payments in IFRS 16 would not be consistent with the one required under other IFRS Accounting Standards, such as IFRS 9 and IFRS 15.

25 Regarding the **discount rate**, some respondents noted that current requirements are too theoretical and judgmental and that obtaining data might be costly for preparers. They guided preparers in developing their own methods to determine the Incremental Borrowing Rates, which sometimes still reflect highly generalised assumptions rather than entity-specific parameters. Even if practice has been developed after the initial implementation of IFRS 16, this approach might impair information comparability between entities.

26 Some respondents stated that **accounting for contract modifications** might be very complex and burdensome for the following reasons:

(a) it is difficult to assess whether a contract modification is or is not a separate lease (IFRS 16.44), especially when a modification would both increase and decrease the scope of the lease;

(b) managing the calculation and the consequential entries to be posted without the support of specific IT tools is complex; and

(c) some preparers struggle to manage many contract modifications throughout the lease term.

27 In addition, one respondent also noted that small entities often use the reassessment requirements (i.e., to remeasure the lease liability and make a corresponding adjustment

to the right of use asset in accordance with IFRS 16.39-43), which are considered easier than the modification ones (IFRS 16.44-46).

28 To reduce such a complexity, these respondents suggested to include practical expedients to assess multiple contract modifications as a whole and to extend the application of IFRS 16.46(b) to all contract modifications (i.e., to remeasure the lease liability and make a corresponding adjustment to the right of use asset).

Application issues arising from the interaction between IFRS 16 and other IFRS Accounting Standards and Interpretations

29 Some respondents commented on the application issues arising from the interactions between IFRS 16 and other IFRS Accounting Standards (see Figure 11), which can be summarised as follows.

(a) **Interaction with IFRS 9** *Financial Instruments* (three respondents) – There is a lack of clarity on the distinction between lease modifications in the scope of IFRS 16 and lease liability extinguishments in the scope of IFRS 9 in case of a lessor's forgiveness of future lease payments as well as on the application of IFRS 9 requirements to financing lease receivables from a lessor perspective.

(b) **Interaction with IFRS 15** *Revenue from Contracts with Customers* (two respondents) – There is a lack of clarity on the distinction between a lease and an in-substance sale transaction and on which standard has to be applied first to contracts for the construction of an asset on the customer's site ('construction contract').

(c) **Interaction with IAS 16** *Property, Plant and Equipment* (three respondents) – There is a lack of clarity on the distinction between lease and in-substance purchase contract when a purchase option exists and on the potential mismatch between the lease term determined under IFRS 16 and the useful life under IAS 16 for leasehold improvements.

(d) **Interaction with IAS 36** *Impairment of Assets* (two respondents) – There are difficulties and increased complexity in determining the right of use assets' cash-generating unit ('CGU') and in the value in use ('VIU') to be tested against the CGU assets.

(e) **Interaction with IAS 37** *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (two respondents) – There is a lack of clarity on the accounting for onerous lease contracts and increased complexity in accounting for costs for dismantling, removing and restoring the leased asset, which would lead to higher volatility in an entity's KPIs (e.g., Capital Expenditure).

(f) **Interaction with IAS 38** *Intangible Assets* (two respondents) – There is diversity in practice in the accounting of lease contracts related to some intangible assets, such as software licenses.

30 Furthermore, a few respondents provided limited feedback about the interaction between IFRS 16 and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 17 *Insurance Contracts*, IAS 40 *Investment Property* and sustainability reporting standards (ESRS).

IFRS 16 presentation and disclosure requirements, including cost-benefit analysis

31 The majority of respondents (70%) considered that IFRS 16 results in a more faithful representation of lease transactions in all three primary financial statements, among which 17% considered that there is room for improvement.

32 Among those respondents who identified room for improvement or who did not consider that IFRS 16 results in a more faithful representation of lease transactions, the following concerns were mainly stressed: existing structuring opportunities, misleading information, especially in the P&L and in the cash flow statement, and increased use of judgement and estimations.

33 The majority of respondents (63%) noted that presentation and disclosure requirements result in useful information for users and achieve a balance between costs and benefits, among which 35% considered that current requirements need to be improved.

34 In particular, some respondents questioned the cost-benefit balance relating the following disclosure requirements: expenses related to leases of low-value assets, to variable lease payments, to short-term leases, and to interest on lease liabilities as well as the lease liability maturity analysis.

Lessor Accounting

35 Most respondents (87%) considered that current requirements in IFRS 16 for lessor accounting are overall working as intended.

36 Those who faced application issues mentioned the following: the definition of the lease and the present value test for entities that are both lessors and lessees are issues related to finance/operating lease concepts.

Transition requirements

37 The majority of respondents (73%) considered that the transition requirements achieved a cost-benefit balance mainly due to the option provided to apply the modified retrospective approach.

38 All preparers that have responded to this question have applied the modified retrospective approach mainly because it was less costly and complex.

General information

Figure 1: Geographical split of respondents

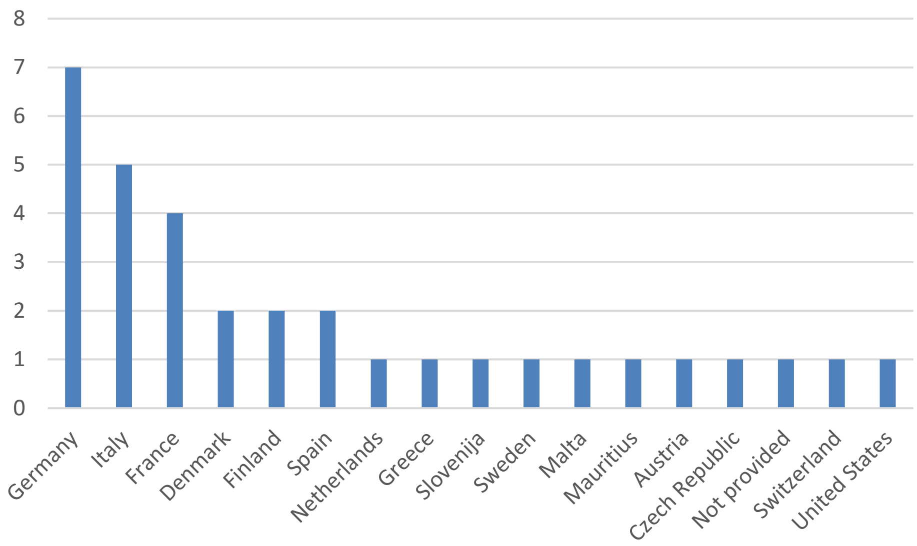


Figure 2.1: Respondent's organisation – Type

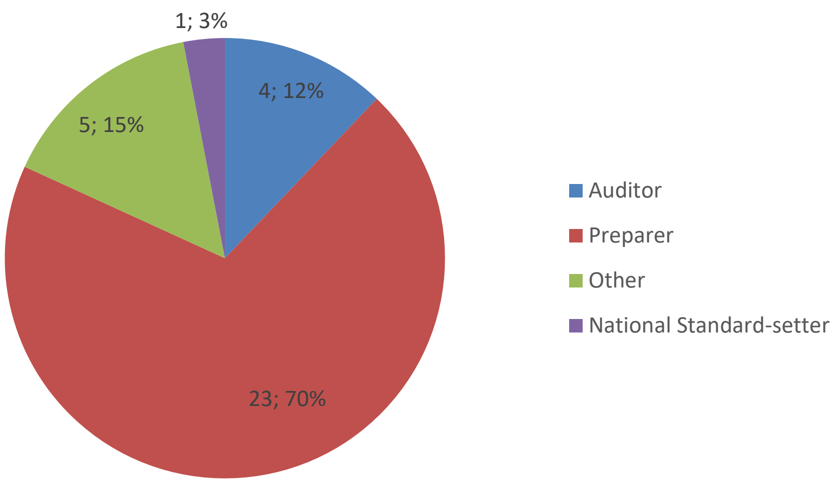


Figure 2.2: Respondent's organisation – Preparers' industry
(number of respondents)

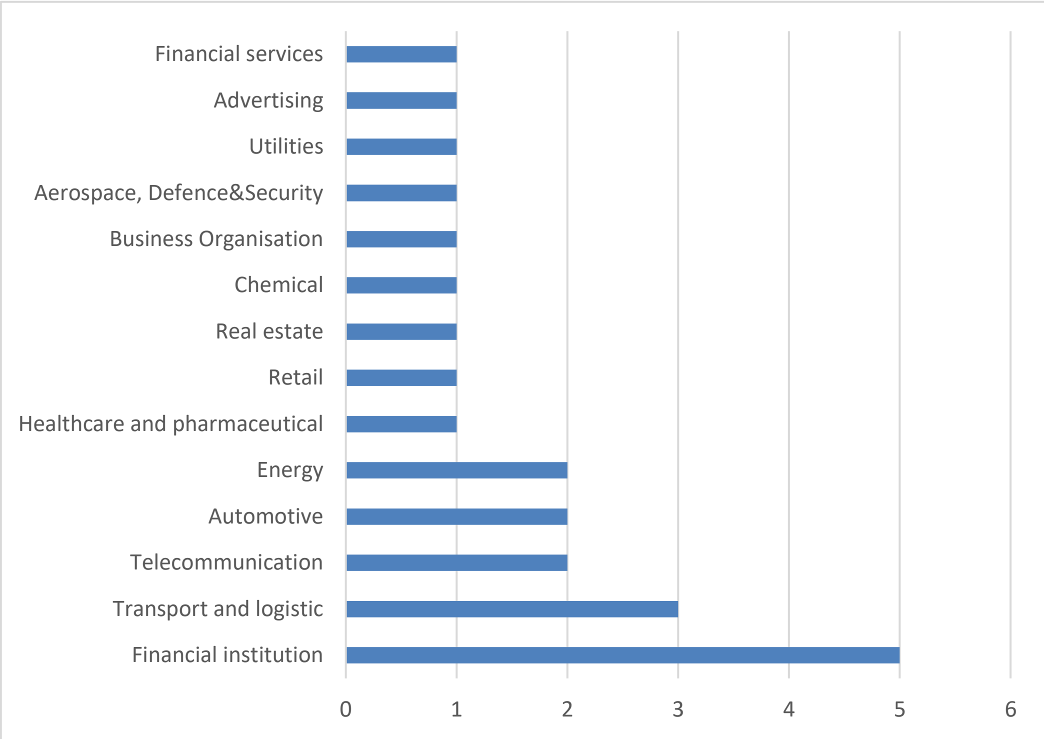


Figure 3: Respondent's organisation - Perspective
(number of respondents)

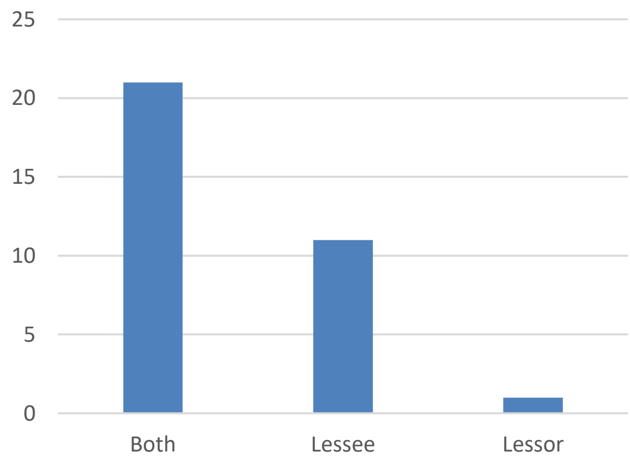
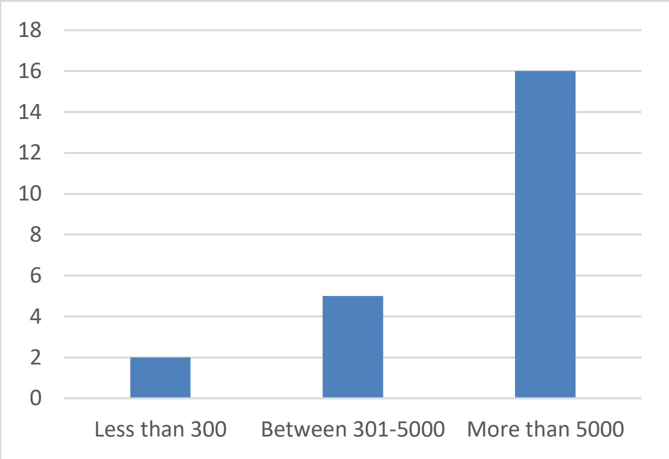


Figure 4: Average number of lease contracts
(number of respondents)



Structure of this paper

39 The rest of this paper is structured as follows:

(a) Overall assessment of and experience with IFRS 16;

(b) Application issues arising from the application of IFRS 16;

(c) Application issues arising from the interaction with other IFRS Accounting Standards and Interpretations;

(d) IFRS 16 presentation and disclosure requirements

(e) Lessor accounting; and

(f) Transition requirements (Optional).

40 The structure follows the same structure (questions) as the survey.

Overall assessment of and experience with IFRS 16

Question on the overall assessment of and experience with IFRS 16 (Question 2)

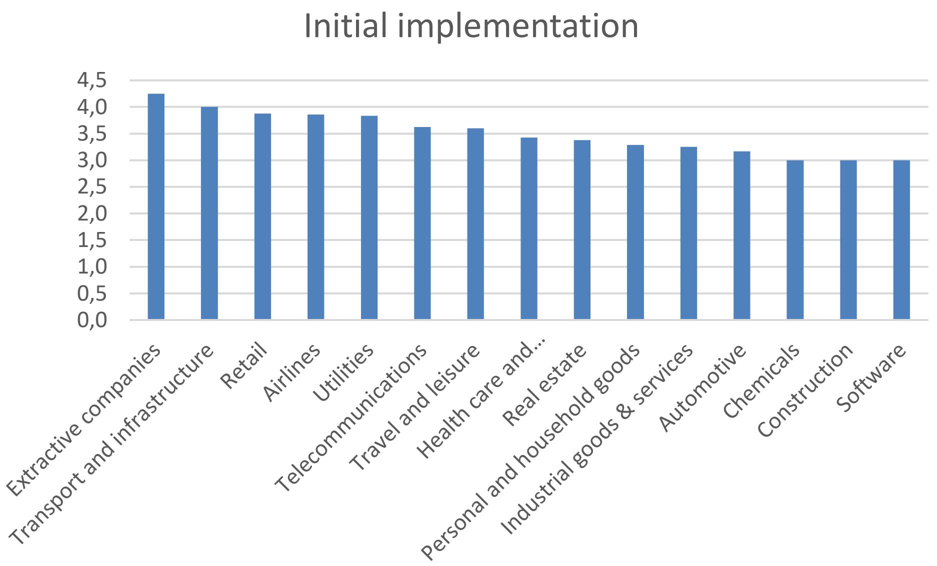
41 The majority of respondents (17 out of 33) considered that IFRS 16 is generally working well but that there is room for improvement. Many respondents (10 out of 33) considered that IFRS 16 is working as intended.

42 The remainder of the respondents (6 out of 33) either considered that significant application issues exist or that IFRS 16 is not working as intended.

Question on the initial implementation challenges across industries (Question 3)

43 Based on the feedback received from respondents, the industries that found implementing IFRS 16 particularly challenging include extractive companies, transport and infrastructure, retail, airlines and utilities (ranked by order of difficulty).

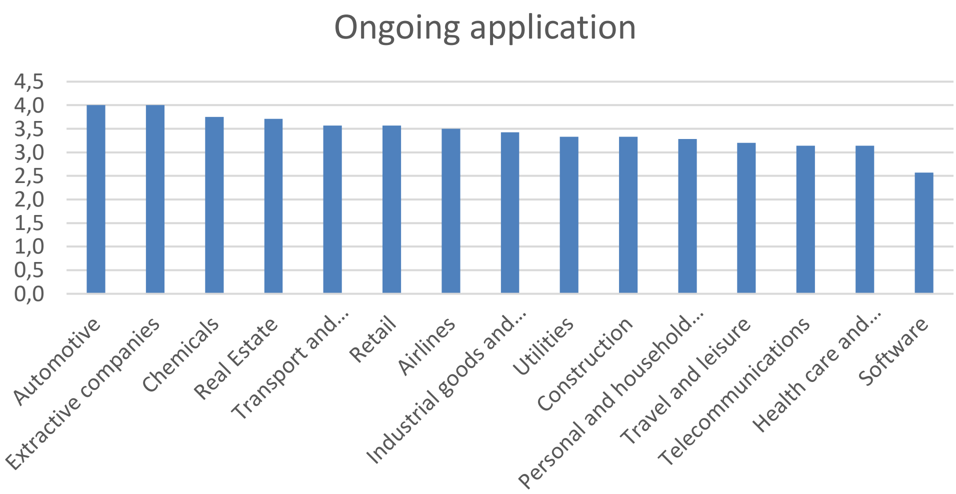
Figure 5: Ranking of industries that found it challenging to implement IFRS 16



Question on the ongoing application challenges across industries (Question 4)

44 The industries that are faced with the most ongoing challenges stemming from the application of IFRS 16 are automotive, extractive companies, chemicals, real estate, transport and infrastructure, and retail (ranked by order of difficulty).

Figure 6: Ranking of industries that still find it challenging to implement IFRS 16



Question on the cost-benefit analysis (Question 5)

45 Respondents provided mixed views on whether IFRS 16 achieves a fair cost-benefit balance, with the majority (18 out of 33) supporting that benefits outweigh costs. Notably, preparers also expressed mixed views on the topic; the majority (12 out of 23) supported that benefits outweigh costs.

46 Respondents who have provided a cost-benefit analysis regarding the implementation of IFRS 16 examined the impact on the decision-making process, on accounting and financial reporting process and on other processes. The costs and benefits for each category are outlined below.

Costs

(a) **Decision-making process**

(i) *Budgeting and forecasting (two respondents)*: The business planning has become more complex, as the IFRS 16's impact may not be considered for internal purposes. In addition, the budget function is now interdependent of other functions.

(ii) *Adjusted KPIs (six respondents):* Stakeholders (e.g., customers, investors, tax authorities, lenders) may request financial information without the impact of IFRS 16, including for bank covenants purposes. Therefore, the calculation of some KPIs may be duplicated.

(iii) *Internal control and coordination between departments (three respondents)*: New internal control systems and approval processes have been introduced (e.g., due to the impact on KPIs). In addition, maintenance and operating processes had to be enhanced as more than departments (e.g., accounting and procurement) are involved in implementing IFRS 16 and managing lease contracts.

(iv) *Additional sets of accounts (two respondents)*: The impact of IFRS 16 in the statement of profit or loss does not give a fair economic view of the entity's performance, which is distorted. Therefore, the entity needs to issue an additional set of accounts that is used by management to monitor performance and to make decisions.

(b) **The accounting and financial reporting process**

(i) *Software implementation (seven respondents):* New lease accounting software and maintenance costs, integration existing tools/software.

(ii) *Data collection (seven respondents)*: The data collection and continuous monitoring is burdensome, time consuming and costly.

(iii) *Staff training (two respondents)*: Increased cost of personnel and staff training

(iv) *Disclosure requirements (two respondents)*: There are many costs involved in providing some of the IFRS 16 disclosures (e.g., high manual workload), for example, when the recognition exemption in IFRS 16.5 is applied and therefore some data might not be integrated in the IT tools.

(v) *Determination of discount rates (one respondent):* Additional external costs are involved in the process of determining discount rates, as group discount rates are performed, audited and published on a regular basis.

(vi) *Managing lease contracts (two respondents):* Managing a large number of small contracts led to significant cost, regardless of their limited impact in the financial statements.

(vii) Reconciliation process (*one respondent*): There was an additional cost for implementing the new reconciliation processes.

(c) **Other**

(i) *Interaction with other IFRS Accounting Standards (two respondents):* IFRS 16 has conflicting requirements with other IFRS Accounting Standards (e.g., IFRS 15, IFRS 3, IFRS 9, IFRS 10, IFRIC 12), or it can be difficult to coordinate with other IFRS Accounting Standards (e.g., IFRS 17).

(ii) *External advisory fees (two respondents):* Increase in external consultant fees, for example auditing fees and discount rates providers.

(iii) *Debt position (two respondents):* The impact of IFRS 16 on some KPIs (e.g., leverage ratio) may disadvantage entities in the capital market.

(iv) *Review of existing contracts* (*one respondent*)*:* The review of existing contracts may be time-consuming.

Benefits

(d) **Decision-making process**

(i) *Internal control (four respondents)*: Entities have now increased control over their lease contracts (e.g., (non)-execution of options, avoidance of exit costs, contract termination, contract negotiations), improved their budgeting system and better understood lease contracts.

(ii) *Improved data quality and transparency (two respondents):* More transparent and better information to perform profound decision-making is now available.

(iii) *Automatic calculations (one respondent):* IFRS 16 impact can be automatically calculated and immediately available in accounting.

(e) **The accounting and financial reporting process**

(i) *Improved usefulness of information (one respondent)*: Users receive more and better information on leases.

(ii) *Faithful representation (three respondents)*: The IFRS 16 accounting treatment results in a more faithful representation of lease contracts in the P&L and Balance Sheet.

(iii) *Improved transparency (one respondent):* Increased disclosures about leases have improved transparency.

(iv) *Increased consistency (two respondents):* Lease accounting is consistently applied within the group.

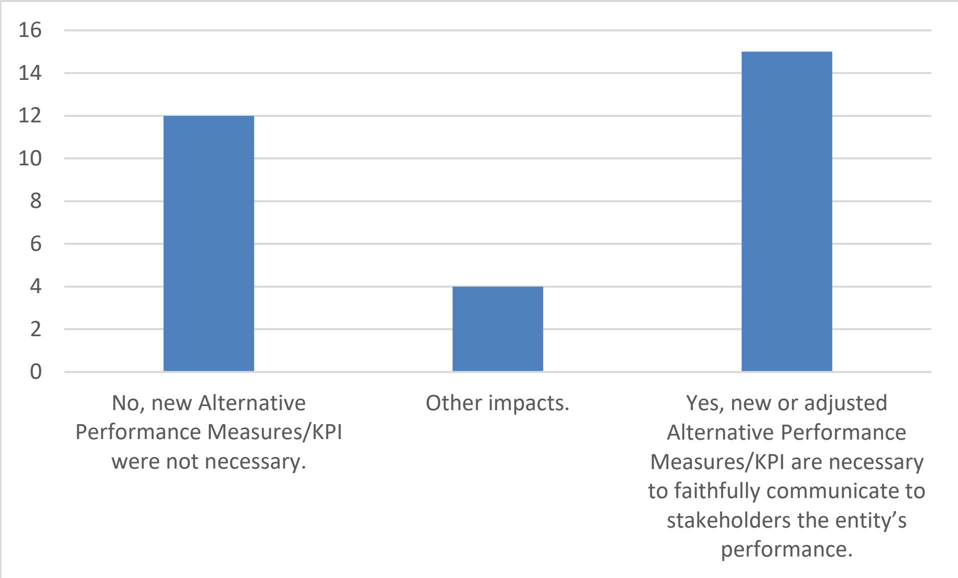
(v) *No benefits (two respondents):* The same objectives would have been achieved through enhanced disclosures without changing the accounting treatment of lease contracts. Also, for entities that do not have a material impact arising from lease contracts compared to total assets, implementing IFRS 16 does not result in any benefits.

Question on the effects of the implementation of IFRS 16 on the performance of stakeholder reporting (Question 6)

47 Respondents had mixed views on whether the implementation of IFRS 16 has reinforced the use of new or adjusted performance measures to stakeholders. 15 out of 31[1] respondents mentioned that new or adjusted performance measures were necessary to faithfully communicate the entity's performance to stakeholders, while 12 out of 31 thought it was not necessary. The remaining respondents (4 out of 31) reported other impacts from the implementation of IFRS 16.

[1] Two respondents did not complete question n.6

Figure 7: Impact of IFRS 16 on reporting



48 Respondents who provided reasons related to the need for new or adjusted performance measures reported the following.

(a) *Remove the impact of IFRS 16 (8 out of 15)*: Entities adjusted their KPIs to remove the impact of IFRS 16 (e.g., Free Cash Flow, Risk Weighted Assets, CAPEX, Net financial position, etc.).

(b) *Bank covenants (2 out of 15)*: Some entities adjusted their performance measures, since their bank covenants do not include the impact of IFRS 16.

(c) *Initial application* (*2 out of 15):* During the initial application of IFRS 16, entities had to report additional KPIs due to the comparative information already presented without the impact of IFRS 16.

(d) *Additional information* (*1 out of 15):* Entities considered it necessary to provide more detailed explanations in the notes.

(e) *Interaction with other Standards (1 out of 15):* IFRS 16 may result in different accounting compared to other standards (e.g., IFRS 15) and, therefore, some entities need to report adjusted performance measures.

Question on the effects of the implementation of IFRS 16 on the decision-making process for entering into lease contracts or purchases of assets (Question 7)

49 The majority of respondents (20 out of 32[2]) did not consider that the implementation of IFRS 16 had an impact on their decision-making process of signing lease contracts.

[2] One respondent did not complete question n.7

50 Many respondents (12 out of 32) reported an impact on their decision-making process due to the effects of IFRS 16, which resulted in:

(a) no significant effect on assets purchased (8 out of 12);

(b) more assets being purchased (2 out of 12); and

(c) less assets being purchased (2 out of 12).

51 For these respondents, the decision-making process has been affected by the impact of IFRS 16 for the following reasons.

(a) The on-balance sheet accounting for leases under IFRS 16 has made leasing less attractive (7 respondents).

(b) The effect of IFRS 16, which accounts for the presentation of cash flows, favours leasing over purchase of assets (1 respondent).

(c) The distinction between CAPEX and OPEX is distorted and is therefore less useful (1 respondent).

(d) Entities have introduced new control, investment appraisal and approval requirements, which have an impact on decision-making (2 respondents).

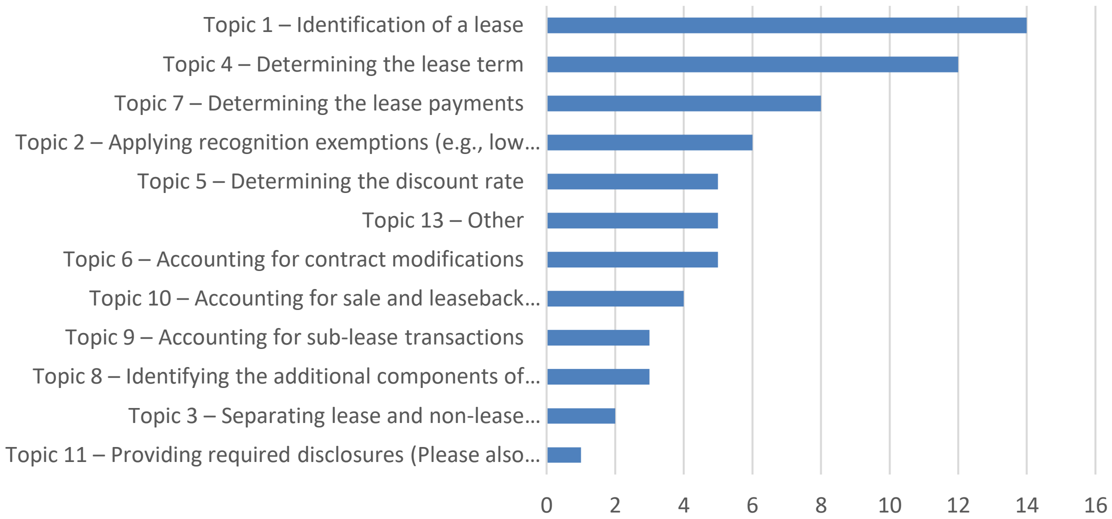
Application issues arising from the application of IFRS 16

Questions on the application issues arising from the application of IFRS 16 (Question 8)

52 8 out of 33 respondents did not identify application issues arising from the application of IFRS 16. These respondents mainly include preparers from the financial institution sector.

53 25 out of 33 respondents identified application issues arising from the application of IFRS 16 and they mainly referred to the following topics:

Figure 8 – Number of respondents who commented on each topic



54 Analysing the application issues identified by respondents, the following figures (Figure 9 and Figure 10) summarise the number of application issues connected to each topic and their related priority.

Figure 9 - Application issues by respondents' priority

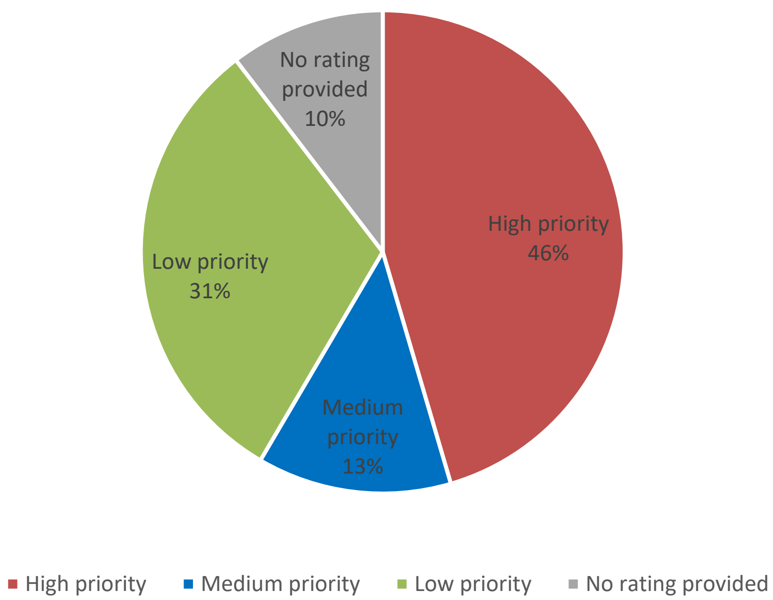
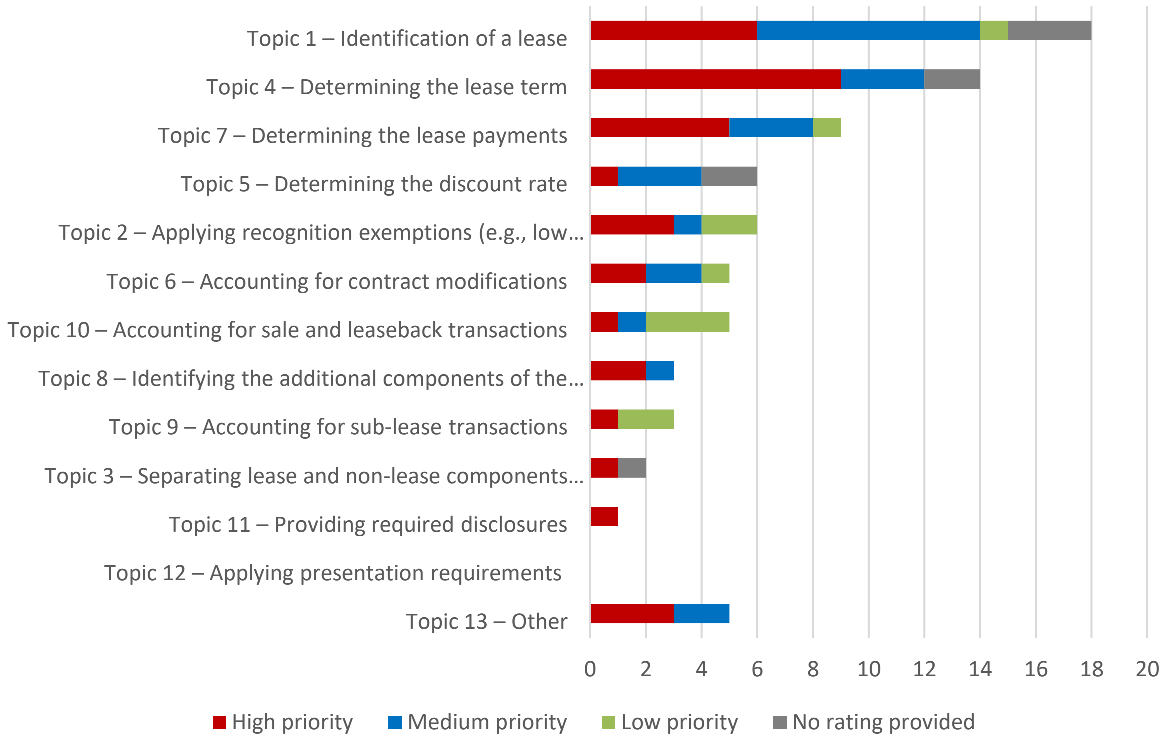


Figure 10 - Number of application issues by topic and priority



Identification of a lease

55 Respondents who identified application issues relating to this topic highlighted the complexity of current requirements in:

(a) identifying lease contracts embedded in service contracts;

(b) assessing whether a contract conveys the right to control the use of an identified asset; and

(c) assessing whether lessors' substitution rights are substantive.

Identifying lease contracts embedded in service contracts

56 Many respondents stated that assessing whether a service contract is or contains a lease (so-called 'embedded lease') might be complex and burdensome, especially in multi-component contracts which include a lease and other ancillary services, such as maintenance, and in subcontracting agreements. This would lead to diversity in practice (i.e., different conclusions for similar contracts) and offer entities the ability to structure such contracts so as to avoid or limit IFRS 16 impact (i.e., shifting from lease to service contract).

57 In the supply chain management business, sometimes dedicated warehouses are leased to render services to one specific customer, and all the costs are fully recharged to the customer. The warehouse is an identified asset in the head lease. Costs for the use of the

warehouse, where the service provider renders the warehousing service, are charged to the customer based on the service contract. Usually, no specific sublease contract is concluded. Therefore, the service contract might contain an embedded lease. This assessment requires judgment and might lead to diversity in practice as well as a distorted presentation of such a transaction in the financial statements.

58 In addition, in these situations assessing whether the entity is acting as a principal (i.e., there is a head lease and a sublease) or as an agent (i.e., there is not a lease and IFRS 15 would apply) is still difficult.

59 Respondents suggested the following solutions:

(a) providing more guidance to support an entity in assessing whether the lease identification criteria are met in the context of service contracts and considering in the scope of IFRS 16 only those contracts where the lessee has direct usage rights only; and

(b) providing more application guidance and/or examples to illustrate principal versus agent assessment in the context of potential embedded leases.

Assessing whether a contract conveys the right to control the use of an identified asset

60 Many respondents stated that assessing the right to obtain substantially all the economic benefits from the use of the underlying asset required judgment, and therefore diversity in practice might exist. They provided the following examples.

(a) IFRS 16 does not clearly define the term 'substantially all' in connection to the economic benefits, as required in IFRS 16.B9 and B21-23. This would allow entities to structure their contracts to avoid IFRS 16 accounting (e.g., a common practice is to refer to a threshold of 90% of the capacity of an asset to define substantially all the economic benefits). A suggestion to clarify or provide more examples to illustrate how to apply the 'substantially all' concept to reduce judgment and diversity in practice was made.

(b) Assessing how and for what purpose the underlying asset is used might be complex when the customer takes part to the design phase. A suggestion to provide for additional guidance was made.

61 Furthermore, it was noted that in the advertising industry it is a common practice when signing contracts with municipalities and transport companies ('the contractors') to use their spaces for a period of time ('core business contracts'). During the contract duration, the contractors have and continue to have all the rights on such spaces (e.g., they can ask

to remove entity's advertising space, to change the advertising space, etc.). Furthermore, when a contract includes suppliers' substitution rights, it is very often scoped out of IFRS 16. Hence, different assessments might lead to different accounting treatments, and consequently to different KPI performance, regardless of whether the contracts are similar. A suggestion to exclude from the scope of IFRS 16 such core business contracts was made to improve comparability between them.

Assessing whether the lessors' substitution rights are substantive

62 In assessing the lessor's substantive substitution right, the lessee has to assess whether the supplier would benefit economically from the exercise of its right to substitute the asset (i.e., substantive substitution rights). Some respondents noted that although assessing the cost might be feasible, from the lessee's perspective assessing the lessor's benefit might be difficult due to lack of insight into the supplier's business model and common practices. Hence, assessing whether lessor's substitution rights are substantive might be complex and might lead to diversity in practice.

63 This difficult assessment is common in those contracts related to the provisions of on-premises hardware servers and of several assets with identical characteristics (e.g., forklifts).

64 Respondents provided the following suggestions

(a) providing examples to illustrate such an assessment in contracts related to the provisions of on-premises hardware servers; this fact pattern would be helpful (e.g., similar to Illustrative Example 3 - Fibre-optic cable);

(b) providing additional guidance on how to assess whether the lessors' substitution rights are substantive; and

(c) linking such an assessment to the suppliers' historical practice experienced by the lessees.

Applying recognition exemptions

65 Many respondents stated that the current definition of low-value assets (IFRS 16.B3-B8) might lead to misunderstandings and misinterpretations and that, therefore, diversity in practice might exist. In particular, the following comments were provided.

(a) The threshold of $5,000 included in the BC might not reflect the materiality assessment under IAS 1; is not affected by the size, nature or circumstances of the lessee; and does not seem in line with a principle-based standard. A suggestion to align such an assessment with the materiality assessment in IAS 1 allowing an entity to define its own threshold based on its size was made.

(b) IFRS 16.B6, which specifically scopes cars out of this exemption, might be considered in contrast to a principle-based standard. A suggestion to consider the introduction of more general exemption criteria was made (e.g., if car leases were exempted as a general rule, this is likely to both improve comparability and reduce the administrative costs).

(c) The low-value asset exemption does not apply to sublease transactions; this might lead to the recognition of a lot of immaterial lease contracts in the balance sheet. A suggestion to extend such an exemption to the sublease contract was made.

Separating lease and non-lease components and allocating the consideration

66 It is difficult to separate lease and non-lease components when the contract includes a lease and a service component (e.g., maintenance services) and to allocate the consideration to be paid (e.g., when the two components have different duration or the lease contract can be extended) (IFRS 16.12-15).

67 It is unclear how to apply IFRS 16 in the leases of a business. In particular, in this type of contracts the distinction between lease and non-lease component might be complex (e.g., because a business is an integrated set of activities); hence, IFRS 16 does not seem to be the right standard to apply.

Determining the lease term

68 Respondents who identified application issues relating this topic highlighted the following aspects:

(a) complexity and existing diversity in practice in determining the lease term;

(b) depreciation period for leasehold improvements;

(c) application of a revised discount rate when changes in the lease term occurred; and

(d) determining the lease term considering the extension options might distort the entity's key ratio.

Complexity and existing diversity in practice in determining the lease term

69 IFRS 16 requires an entity to determine the lease term as the non-cancellable period of a lease together with periods covered by reasonably certain options to extend and/or to terminate the lease. In assessing whether a lessee is reasonably certain to exercise an option to extend a lease or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the

lessee to exercise the option to extend the lease or not to exercise the option to terminate the lease.

70 Some respondents stated that, because determining the lease term requires a high level of judgment, diversity in practice might exist. In particular, they provided the following comments.

(a) Determining the lease term might be complex when:

(i) a contract gives the cancellation right to the lessor, the lessee or both;

(ii) the possible exercise date of an option occurs long after the commencement date of the lease contract. Regarding the long-term horizon required for the lessee's judgment, one respondent noted that IAS 36.33(b) seems to refer to a reasonable and supportable time horizon for cash flow projections for a maximum period of five years unless a longer period can be justified;

(iii) a tacit annual renewal option exists (e.g., 'evergreen lease contract') or the contract has indefinite life. It was noted that in some contracts in this situation the only reasonable non-cancellable period might be the termination notice period, which is often below 12 months (e.g., three or six months).

(iv) A multinational company consolidates several lease contracts from different jurisdictions with different legal contexts. This would create operational difficulties in analysing each single contract and additional time-consuming activities.

(b) Lease contracts with similar economic substance but with different contractual terms might be accounted for by considering different lease terms (e.g., contracts with an indefinite lease term versus contracts with a definite lease term without renewal option when the underlying asset is expected to be used for the same period of time). For example:

(i) Entity A (the lessee) enters into a lease contract with Entity B (the lessor) for a lease of rail cargo wagons;

(ii) the lessee knows it will need the wagons for at least three years, given the expected demand for its services. The lessor does not have any economic incentive to terminate the contract within three years; then,

(iii) depending on the contractual terms, the lessee might determine the following different lease terms:

- contract with an indefinite lease term: the lessee determines a non-cancellable period of three years based on the period of time in which the lessee expects to use it; or
- contract with a definite lease term of one year without renewal option: because of the absence of an extension option, the lessee determines a non-cancellable period of one year only, although the lessee's historical experience shows that the contract is usually extended beyond the original lease term through contract modification at a later stage.

(c) Entities developed their own accounting policies to determine the lease term at the inception of the contract and at an ongoing basis. This might impair comparability between entities.

(d) Entities seem to be reluctant to determine long lease terms for indefinite life contracts.

(e) Current requirements would allow for opportunities to structure lease contracts to determine a non-cancellable period shorter than 12 months and, therefore, to apply the short-term exemption.

71 These respondents suggested that the IASB should:

(a) provide illustrative examples and additional application guidance to support the lessee's assessment of the lease term; and

(b) exclude from the scope of IFRS 16 those contracts which include a tacit renewal option or with indefinite life.

72 Furthermore, to address the issue described in paragraph 70(b)(iii) above, a respondent suggested that the IASB should consider amending current requirements in IFRS 16 to clarify how past practice and entities' expectations should or should not impact the determination of the lease term. In particular, to reflect similar contracts consistently in the financial statements, the lessee's past practice should be considered in assessing whether the lessee is reasonably certain to extend the lease term through a contract modification when an extension option does not exist (i.e., besides the situation described in IFRS 16.B40).

Depreciation period for leasehold improvements

73 One respondent stated that assessing the depreciation period for leasehold improvements consistently with the lease term (as clarified by the IFRS IC in November 2019) might not be aligned with the tax treatment of such depreciation expenses and could create some

distortions in the financial statements. Indeed, it might happen that at the end of the original lease term the lessee exercises an extension option and, although the lessee will continue to benefit from them, the leasehold improvements are fully depreciated at that date. A suggestion was made to allow for the possibility of not aligning the depreciation period of the leasehold improvements with the lease term when the former are not significant and are not considered to assess whether an extension option is to be exercised.

Application of a revised discount rate when changes in the lease term occurred

74 A preparer operating in the retail industry questioned current requirements in IFRS16.40 related to the revision of the discount rate when there is a change in the assessment to exercise an extension option provided for in the original lease contract. In this preparer's view, extending the application of IFRS 16.42-43 (i.e., using an unchanged discount rate) to this situation would be more appropriate.

Determining the lease term by considering the extension options might distort an entity's key ratio

75 A preparer stated that in some jurisdictions (e.g., the Netherlands) applying current requirements to determine the lease term considering the renewal options (IFRS16.18) has a negative impact on the entity's debt position and leverage ratio and that, therefore, it makes it more difficult for the entity to access the capital market. A suggestion to require more qualitative and quantitative disclosure regarding the potential impacts arising from the renewal options rather than to include renewal options for the measurement of the lease liability was made.

76 Another preparer highlighted that the entity's financial performance (e.g., profitability and operating efficiency) might affect how an entity determines the lease term and therefore the amount of financial liabilities to be recognised. In this respondent's view, this approach would lead to a counterintuitive outcome. Indeed, an entity with better financial performance would recognise higher lease liabilities than less profitable entities would.

Determining the discount rate

77 Some respondents stated that current requirements for determining the discount rate are too theoretical and judgmental and that obtaining data might be costly for preparers.

78 Therefore, in determining the incremental borrowing rates (or IBR), diversity in practice was noted. Indeed, entities might refer to different methods such as:

(a) parent company's interest rate on its borrowings;

(b) adjusted free-risk rates to reflect an entity's credit risk, country risk, etc. (entity's own model); or

(c) using interest rates quoted by a bank.

79 This results in estimation uncertainties which would impact all other aspects of the lease accounting (e.g., the amount of the lease liability and interest expenses) and might impair information comparability.

80 However, it was also noted that over the last years some standardised practices have also been set up with the support of external consultants/auditors; in some cases, these methods still reflect highly generalised assumptions rather than entity-specific parameters.

81 A respondent also noted that, conversely to the other financing decisions, the focus is at the single entity level rather than the group level although in many groups financing decisions are centralised. This approach might impair comparability between leases and financing arrangements.

82 Regarding the subsequent measurement of the lease liability, IFRS 16.39-43 specify how the lessee has to reassess the lease liability and whether an uncharged or a revised discount rate has to be used. However, one respondent noted that sometimes it might be difficult to clearly distinguish changes in the lease payment that would require a revised discount rate from those limited changes that would not (IFRS 16.42-43). To reduce such complexity, a suggestion to require an entity to always apply a revised discount rate was made.

Accounting for contract modification

83 Some respondents stated that accounting for contract modifications might be very complex and burdensome for the following reasons.

(a) It is difficult to assess whether a contract modification is or is not a separate lease (IFRS 16.44), especially when a modification would both increase and decrease the scope of the lease.

(b) Managing the calculation and the consequential entries to be posted without the support of specific IT tools is complex.

(c) Some preparers struggle to manage many contract modifications throughout the lease term.

84 In addition, one respondent noted that some small entities often use the reassessment requirements (i.e., to remeasure the lease liability and to make a corresponding adjustment to the right of use asset in accordance with IFRS 16.39-43), which are considered easier than the ones related to modification (IFRS 16.44-46).

85 To reduce such complexity, these respondents suggested to include practical expedient to assess multiple contract modifications as a whole and to extend the application of IFRS 16.46(b) to all contract modifications (i.e., to remeasure the lease liability and to make a corresponding adjustment to the right of use asset).

86 Furthermore, one respondent noted that, when a contract modification both extends the lease term and reduces the rent fee, the impact accounted for in the income statement for the first year might be distorted. Indeed, while the rent fee has been revised downward, the total IFRS 16 charge for the first year of the renewed contract might increase compared to the last year of the initial contract, due to the interest and depreciation expenses. As a result, it would not reflect the real operating performance of an entity and, therefore, it would not be easily understandable for the management.

Determining the lease payments

87 Respondents who identified application issues relating to this topic highlighted the following aspects:

(a) the distinction between variable and in-substance fixed payments;

(b) inconsistent accounting treatments of variable lease payments across IFRS Accounting Standards;

(c) accounting for lease payments linked to index or rate; and

(d) the distinction between lease payments and other payments related to the lease contract.

Distinction between variable and in-substance fixed payments

88 Some respondents noted a lack of clarity in the distinction between variable payments and in-substance fixed payments. In particular, one auditor stated that current interpretation of 'unavoidable payments' might limit the identification of in-substance fixed payments to very limited circumstances.

89 These respondents suggested that the IASB should:

(a) provide more guidance and more illustrative examples on variable lease payments that become in-substance fixed payments for the remainder of the lease term; and

(b) consider all in-substance fixed payments as variable payments to reduce diversity in practice.

90 Furthermore, another respondent noted that IFRS 16.B42 provides some examples of in-substance fixed payments, including those situations where there are more than one set of

realistic payments that a lessee might find helpful. In this situation, IFRS 16 requires an entity to consider the set of payments that would result in the lowest amount. This approach may not reflect the economic substance of the contract, as the lease liability will be determined at the lowest amount rather than the more probable, though still realistic, amount. In this respondent's view, the IASB should reconsider such a requirement, including the probability criterion.

Inconsistent accounting treatment of variable lease payments across IFRS Accounting Standards

91 The accounting treatment of variable lease payments under IFRS 16 seems not to be consistent with the one required under IFRS 9, IFRS 15 and IFRIC 12. This could lead to structuring opportunities to avoid IFRS 16 impacts on financial statements.

Accounting for lease payments linked to index or rate

92 In the case of variable lease payments linked to an index (e.g., Consumer Price Index), it might happen that the updated index becomes available only at a later stage (e.g., after the expected payment date). One respondent noted that IFRS 16 is silent on how to account for revised lease payments when such an adjustment applies retrospectively. In this respondent's view, the IASB should clarify whether these retrospective impacts should be recognised in the statement of profit or loss or as an adjustment of the right of use.

Distinction between lease payments and other payments related to the lease contract

93 IFRS 16.B44 requires that if a lessee incurs in costs relating to the construction or design of an underlying asset, the lessee has to account for those costs applying other applicable Standards, such as IAS 16. One respondent stated that in practice, especially in real estate leases, these additional costs are sometimes included in the lease contract and that, therefore, the distinction between lease and other payments might be difficult to make. These additional costs might include deposits, reimbursements from the landlord to the tenant for removable and non-removable leasehold improvements, and improvements made by the lessor on behalf of the lessee as well as corresponding reimbursements. A suggestion to provide more examples to illustrate how to account for such additional payments was made.

Identifying the additional components of the right-of-use asset

94 A few respondents raised some application issues relating this topic. In particular, they provided the following comments.

(a) IFRS 16 is silent on how to account for costs other than 'initial direct costs' (e.g., costs incurred to bring the underlying asset to the lessee's location). A suggestion to align guidance and requirements with those included in IAS 16 was made.

(b) The definition of 'initial direct costs' in IFRS 16 is not consistent with those costs directly attributable to an asset as defined in IAS 16.17, even if the underlying assets are the same. A suggestion to align the IFRS 16 accounting treatment with the one defined under IAS 16 for those costs incurred to bring the underlying leased asset into its working condition (e.g., transportation, setting up, testing, etc.) was made.

(c) Estimating the costs to be incurred by the lessee in restoring the site in which the underlying asset is located or restoring the underlying asset to the condition required by the terms and conditions of the lease might be complex, especially at the contract's inception and for long-term leases. In addition, it was noted that sometimes the lessee has the possibility to negotiate with the lessor these costs at the end of the contract in order to reduce or cancel them. Consequently, at the inception of the contract such an estimate might not be accurate. A suggestion was made to limit the recognition of restoring costs only when the amounts are significant and reliably estimated.

Accounting for sublease transactions

95 One respondent noted a presentation mismatch in the statement of profit or loss of gains and losses arising from the head lease and the related sublease, the latter of which normally reflects the same condition of the head lease. For example, in the case of a financial sublease (i.e., from the lessor's perspective, the right-of-use asset is replaced by the financial lease receivable), a modification of the head lease (e.g., rent increase) would have the following impact on the statement of profit or loss:

(a) the increase due to higher lease payments is to be presented in the financial result of the income statement in accordance with IFRS 16.80(b) based on which financial lease receivable is accounted for in accordance with IFRS 9; and,

(b) in contrast, there is no further guidance in IFRS 16 on how to reflect the lease payment increase in the head lease liability. Usually, such an increase would be presented as loss in the operating result.

96 In this respondent's view, especially in the case of an embedded lease where conditions in the head lease and in the sublease are very often identical, this leads to distortions in the statement of profit or loss.

97 Other respondents highlighted that:

(a) IFRS 16 is silent on how to account for an exchange of lease contracts/assets. A suggestion to include guidance similar to that included in IAS 16 was made; and

(b) entities could structure sublease contracts to limit/avoid IFRS 16 impacts (e.g., in the shipping industry).

Accounting for sale and leaseback transactions ('SLB')

98 Some respondents raised application issues regarding this topic, which can be summarised as follows.

(a) Lack of specific guidance in IFRS 16 – when compared to other general guidance in IFRS 16, the one related to SLB transaction is limited. However, these transactions could be much more complex and detailed guidance would be beneficial.

(b) Lack of clarity on the relationship between the sold asset and the leased back one – it is not clear whether they have to be identical or not (e.g., the sold asset has a colour that differs from the leased back one). In this regard, it was noted that US GAAP literatures provide some insights that the IASB might want to consider.

(c) Identification of a SLB transaction and accounting for gain or loss – IFRS 16 requirements for SLB transaction and for the recognition of gain or loss from this transaction seem more complex than those defined under US GAAP, especially assessing whether the transfer of the asset is a sale (e.g., under US GAAP, a fair value purchase option does not trigger a failed sale when an asset that is substantially the same is readily available). A suggestion to reduce the complexity of current requirements in IFRS 16 while considering current requirements under US GAAP was made.

(d) Existing structuring opportunities – Under IFRS 16, entities might enter into SLB contract with variable lease payments to limit/avoid IFRS 16 impacts.

Providing required disclosures

99 One respondent questioned the costs associated with providing the following disclosures requirements mainly due to the extreme high manual workload for preparers:

(a) expenses relating to short-term leases, to leases of low-value assets and to variable lease payments not included in the measurement of lease liabilities as required by IFRS 16.53(c), (d) and (e). In this respondent's view, such disclosure requirements reduce the real cost relief that the IASB aimed for when it decided on the related accounting treatments; and

(b) additional qualitative and quantitative information to disclose the lessee's potential exposure to future cash flows related to extension and termination options as required by IFRS 16.59(b)(ii). In this respondent's view, this information sometimes is not easily available because it is not integrated in the IT tools. In addition, it would be conceptually questionable since for other long-term contracts (e.g., contracts for the purchase of raw materials) this information would not be required.

100 Therefore, a suggestion to remove these disclosure requirements was made.

Other

101 In addition to the main topics listed above, some respondents provided the following comments:

(a) <u>Structuring opportunities</u> – IFRS 16 still allows entities to structure their contracts to limit/avoid IFRS 16 impact, especially within the intercompany leases, by acting on the lease term (e.g., short-term lease contracts without renewal option) and/or on the lease payments (e.g., including only variable lease payments).

(b) <u>Intercompany lease contract</u> – At a subsidiary level, IFRS 16 accounting would distort its financial position from the group perspective. This issue would be relevant for those groups which have centralised real estate companies that lease or hold the asset and then sublease the asset within the group. In addition, intercompany leases might make the consolidation process more complex, which could also require new IT system investments. A suggestion was made to allow subsidiaries to account for intercompany lease contracts as operating leases (off-balance sheet accounting model) to facilitate the consolidation process and to limit financial position distortion.

(c) <u>Lack of faithful representation of lease transactions</u> – Users of the entity's internal and external financial information would be more focused on the financial information based on the actual cash flows rather than on the expenses accounted for in the statement of profit or loss under IFRS 16 (i.e., depreciation and interest expenses). A suggestion to consider the application of a single and straight-line lease expense model more aligned with actual cash flows was made in order to improve the usefulness of the information.

(d) <u>Accounting for lease payments during the negotiation period</u> (i.e., payments made in absence of a valid contract) – IFRS 16 does not provide guidance on how to account for an asset that is used when a valid lease contract is not yet in place (e.g., during the renegotiation period). A suggestion to include additional guidance on how to account for those lease payments was made (e.g., as an expense in the statement of profit or loss or as right-of-use asset).

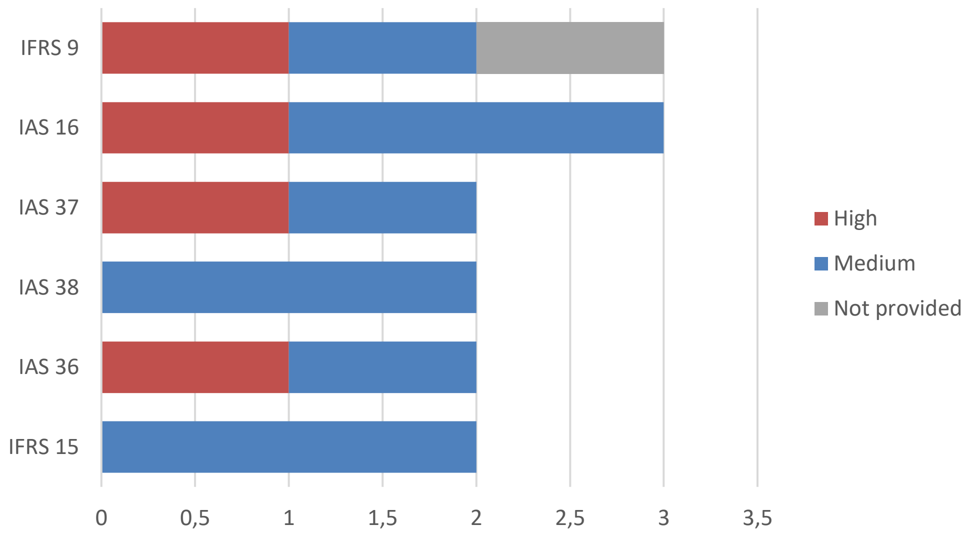
Application issues arising from the interaction with other IFRS Accounting Standards and Interpretations

Questions on the application issues arising from the interaction with other IFRS Accounting Standards and Interpretations (Question 9)

102 19 out of 33 respondents did not identify application issues arising from the interaction with other IFRS Accounting Standards and Interpretations.

103 However, the remaining respondents mainly provided feedback about the interaction between IFRS 16 and other IFRS Accounting Standards as follows:

Figure 11 - Number of respondents for IFRS Accounting Standard and priority



104 Furthermore, a few respondents provided limited feedback about the interaction between IFRS 16 and IFRS 5, IFRS 17, IAS 40 and European Sustainability Reporting Standards (ESRS).

105 Finally, some respondents provided the following general comments.

(a) <u>Lack of consistency across IFRS Accounting Standards</u> – Current IFRS 16 requirements for variable payments do not seem in line with those included in IFRS 9 and IFRS 15.

(b) <u>Need to clarify boundaries among IFRS Accounting Standards</u> – To reduce diversity in practice and structuring opportunities, the IASB should clarify the boundaries between IFRS 16 and the following standards:

(i) IFRS 3 when there is a business lease and a business combination by contract alone; and

(ii) IFRS 15 and IFRS 9 for entities that are both lessees and lessors. Indeed, application issues in relation to the existing distinction between finance and operating leases on the lessor's side were detected.

(c) <u>Variety of discount rates across IFRS Accounting Standards</u> – Although the respondent acknowledged that different transactions might require different discount rate components, it was noted a low level of standardisation which might reduce effort (both in terms of manpower and timing) for preparers. This respondent would encourage the IASB to develop an overarching concept of discount rate as far as possible, which would lead to a more efficient approach for preparers.

Interaction between IFRS 16 and IFRS 9

106 Some respondents considered the lack of clarity about the distinction between contract modification under IFRS 16 and lease liability extinguishment under IFRS 9 a critical issue that the IASB should address.

107 Furthermore, one respondent operating in the banking industry stated that the application of IFRS 9 and IFRS 16 requirements to lease receivables from a lessor perspective is not clear. In particular, in this respondent's view it is not clear what the fair value of a lease receivable at initial recognition is (i.e., how this relates to the contractual rate of the contract) and how to determine the credit-adjusted effective interest rate for purchased and originated credit-impaired receivables ('POCI receivables').

Interaction between IFRS 16 and IFRS 15

108 One respondent stated that, in the context of contracts for the construction of an asset at the customer's site, it is not clear which standard has to be applied first.

109 One respondent highlighted the lack of clarity on the distinction between a lease and an in-substance sale transaction.

Interaction between IFRS 16 and IAS 16

<u>In-substance purchased versus leased asset</u>

110 One respondent stated that the distinction between lease and in-substance purchase contract is not clear under IFRS 16. Indeed, a lease contract which includes a purchase option at the end of the contract might be classified as a lease contract or as an in-substance purchase contract regardless of whether the purchase option is at a fair market value or at a lower value. In this respondent's view, the IASB should clearly explain how to distinguish between in-substance purchase and lease transaction (in addition to the consideration included in IFRS 16.BC138-140).

Depreciation of leasehold improvements

111 One respondent noted that the level of certainty involved in assessing optional periods ('reasonably certain to exercise an extension option' applying IFRS 16) and the level of certainty involved in determining the useful life ('expected to be available for use by an entity' applying IAS 16.6) are different (i.e., IAS 16 requires a lower level of certainty than IFRS 16)[3]. A suggestion to align how to assess the lease term with the depreciation period for leasehold improvement was made.

Interaction between IFRS 16 and IAS 36

112 Some respondents noted that applying IAS 36 requirements to CGU, which contains a right-of-use asset, is complex (e.g., there is an increased need for coordination between the local and central departments within a group) and requires judgment. In particular, they provided the following comments.

(a) Identifying the cash-generating unit to which an asset belongs (i.e., the asset's CGU) became more complex under IFRS 16 than under IAS 17. Indeed, under IAS 17 a provision for onerous contracts was required, and this approach allowed local entities to account for individual provision when needed.

(b) Different business models in each operating segment within a group might lead to diversity in practice on how the asset's CGU is determined.

(c) Applying the discounted cash flow model under IFRS 16 is more complex than under the previous standard.

113 These respondents suggested that the IASB should:

(a) provide more guidance on how an impairment test for a right-of-use asset has to be conducted and on how the value-in-use model has to be applied consistently with the carrying amount of the CGU; or

(b) allow for the estimation of the value in use under the previous IAS 17 model on a consistent way when comparing the resulting value in use with the carrying amount of the CGU.

[3] This approach is consistent with that one discussed by the IFRS IC in November 2019 here.

Interaction between IFRS 16 and IAS 37 (and IFRIC 1)

<u>Cost for dismantling, removing and restoring the leased assets</u>

114 One respondent noted that applying IFRS 16.24(d) to recognise the estimated costs to dismantle, remove and restore the site and/or the leased asset as part of the right-of-use asset might be complex. In particular, the following practical difficulties were noted.

(a) At initial recognition, such expenses might be accounted for in different expense accounts and, therefore, their capitalisation might be complex for the accounting department.

(b) It is difficult to distinguish between restoring cost and wear and tear.

(c) Frequent reassessments of such provisions are required in accordance with IFRIC 1.

(d) All of these actions are often performed manually, which might mean relevant effort from preparers and risk of potential mistakes.

(e) Volatility in the right-of-use assets and the KPI 'Capital Expenditure' may arise.

115 A suggestion was made to simplify current requirements in IFRIC 1 to reduce accounting effort and volatility in the right-of-use asset as well as in the related KPI was made.

<u>IAS 37 - Onerous contracts</u>

116 One respondent stated that the IASB should better clarify the interaction between IAS 37.66 and IFRS 16 in case of onerous lease contracts.

Interaction between IFRS 16 and IAS 38

117 Some respondents stated that IFRS 16.3(e) and IFRS 16.4 would create a distinction between some intangible assets based on which IFRS 16 shall be applied or might be applied. In these respondents' view, it is challenging to apply this distinction due to the lack of clear guidance.

118 Furthermore, it was noted that in the case of software licences granted for limited periods of time, the underlying asset is not unique. Indeed, it is just a copy of the underling software code. Therefore, lease recognition criteria would not be met.

119 These respondents suggested that the IASB should clarify which standard has to be applied for software leases.

Other minor interactions

120 Finally, a few respondents also mentioned further application issues arising from the interaction between IFRS 16 and the following IFRS Accounting Standards:

(a) IFRS 5 – IFRS 16 does not include any guidance in relation to the presentation and subsequent measurement (e.g., depreciation period) of any right-of-use asset held for sale. A suggestion to include some guidance consistently with those already provided for other non-current assets was made.

(b) IFRS 17 – Applying scope, presentation and disclosure requirements to leases for which related expenses fall within the scope of IFRS 17 might be challenging. A suggestion was made to scope out such leases from IFRS 16.

(c) IAS 40 – Application challenges were noted in case of leased investment properties.

(d) European Sustainability Reporting Standards (ESRS) – This respondent did not provide further information.

IFRS 16 presentation and disclosure requirements

Question on whether the presentation requirements in IFRS 16 result in a more faithful representation of lease transactions in the primary financial statements (Question 10)

121 The majority of respondents (23 out of 33) considered that IFRS 16 results in a more faithful representation of lease transactions in all three primary financial statements, with 4 out of 23 noting that there is room for improvement. Notably, most preparers (16 out of 23) supported that lease transactions are faithfully represented in the financial statements, as per IFRS 16 requirements.

122 The areas in which room for improvement was suggested have been highlighted as follows.

(a) Structuring opportunities has been moved from finance versus operating leases to low-value assets, variable payments only and service contracts.

(b) In some contract models, the transaction is not faithfully represented.

(c) Users still do not fully understand the accounting of leases (e.g., how a right-of-use asset is amortised), especially on the P&L and cash flow statement.

(d) Comparability issues in the classification across categories in the cash flow statement.

123 The remainder of respondents (10 out of 33) considered that the IFRS 16 accounting treatment does not faithfully represent lease transactions for the following reasons:

(a) it might impair comparability due to the structuring opportunities;

(b) the accounting treatment under IAS 17 was considered to be more appropriate;

(c) the effects of IFRS 16 distort operating profit due to the classification of part of the lease cost in the financing category;

(d) the impact of IFRS 16 impact may be immaterial compared to the balance sheet size;

(e) it involves a significant use of judgement and estimations;

(f) entities that apply IFRS 16 are disadvantaged in the capital markets; and

(g) management/stakeholders use performance measures without the impact of IFRS 16.

Question on whether there is any new evidence/element that the IASB should consider when assessing whether the current accounting of variable leases results in faithful representation

124 Most respondents (27 out of 32[4]) did not think that there is new evidence for reconsidering the accounting treatment of variable leases, among which there were mixed views on whether the current requirements should be improved. In particular, 15 out of 27 respondents supported improvements, and 12 out of 27 did not think that improvements were necessary.

125 The respondents who stated that there is new evidence highlighted the following points that the IASB should take into account:

(a) the need to further reduce structuring opportunities; and

(b) the incoherent accounting treatment for variable payments across IFRS Accounting Standards.;

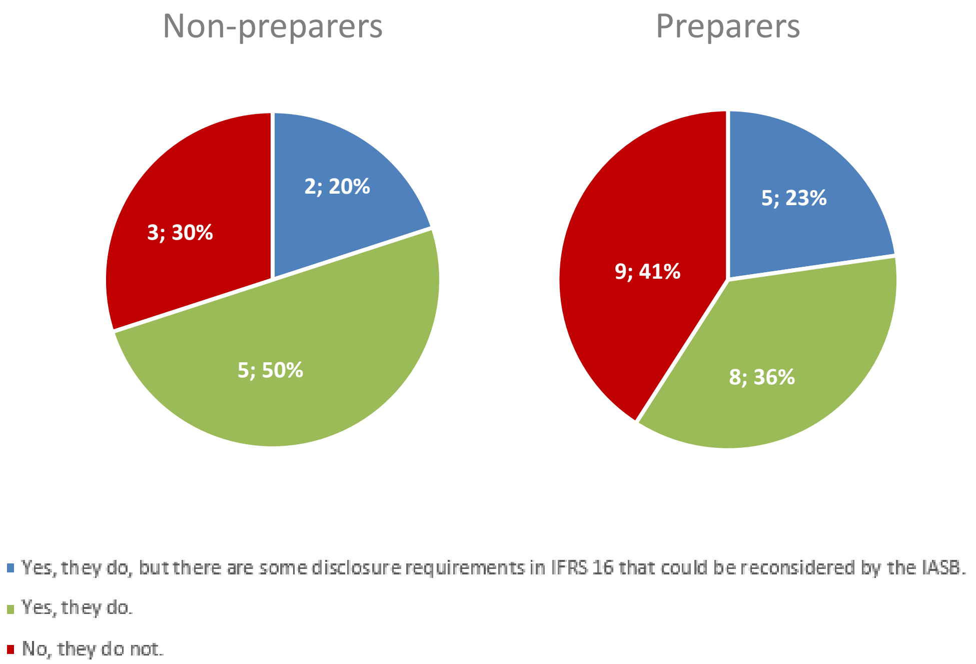
Questions on the cost-benefit analysis of the presentation and disclosure requirements in IFRS 16 (Question 12, 13 and 14)

126 Overall, the majority of respondents (20 out of 32[5]) noted that presentation and disclosure requirements result in useful information to users and achieve a balance between the costs and benefits, among which 7 out of 20 considered that there were some disclosure requirements in IFRS 16 that could be reconsidered by the IASB. However, among preparers and non-preparers the resulting level of agreement is different, 59% and 70%, respectively, as showed in Figure 12 below.

[4] One respondent did not complete question n.11

[5] One respondent did not complete question n.12

Figure 12 - Do the presentation and disclosure requirements in IFRS 16 result in entities providing useful information to users of financial statements and achieve a balance between costs and benefits?



127 The most costly disclosure requirements were considered to be:

(a) disclosures related to variable lease payments (IFRS 16.53(e));

(b) breakdown of lease payments across maturity buckets; and

(c) income from subleasing right-of-use assets (IFRS 16.53(f)).

128 However, two preparers stated that disclosure requirements are not particularly costly (e.g., the lease software can provide all disclosures automatically).

129 To address these concerns, respondents suggested that the IASB should simplify disclosure requirements (especially for variable leases, as the information is not readily available).

130 The disclosure requirements that some respondents considered should be reduced are the following:

(a) Expenses related to leases of low-value assets; Expenses related to variable lease payments; Interest expense on lease liabilities; and Expenses related to short-term leases. These disclosures are considered costly since they might not be integrated in the IT tools, and they involve a high level of manual workload (two respondents);

(b) Maturity analysis of lease liabilities, because the requirement is too wide and the data collection burdensome. In particular, one respondent stated that it may be difficult to decide what to disclose (e.g., whether future payments of leases that have not commenced at the reporting date have to be disclosed) (two respondents); and

(c) Gains or losses arising from sale and leaseback transactions, since there are no benefits stemming from this disclosure (1 respondent).

131 One respondent (a professional organisation) suggested to improve current disclosure requirements on right-of-use assets requiring an entity to provide a full reconciliation of the carrying amount at the beginning and at end of the period, as required by IAS 16.73(e).

Lessor Accounting

Question on the application issues arising from the application of IFRS 16 related to lessor accounting (Question 15)

132 Most respondents (27 out of 31[6]) considered that current requirements in IFRS 16 for lessor accounting are overall working as intended.

133 The respondents who faced application issues related to the requirements on lessors reported the following.

(a) There are questions arising from the definition of a lease.

(b) There are some issues with the application of the impairment requirements to lease receivables.

(c) For entities that are both lessors and lessees, there are application issues related to finance/operating lease concepts that create confusion.

Transition requirements (optional)

Question on the cost-benefit analysis of the transition requirements (Question 16)

134 The majority of respondents (19 out of 26[7]) considered that the transition requirements achieved a cost-benefit balance.

135 The options provided under the transition requirements (e.g., modified retrospective approach) and some simplifications (e.g., in determining discount rates) helped preparers in reducing workload and complexity that would be otherwise needed under the full retrospective initial application.

136 The respondents (seven out of 26) who considered that the transition requirements did not achieve a cost-benefit balance found the implementation of the Standard too costly,

[6] Two respondents did not complete question n.15

[7] As this section was only optional, 26 respondents out of 33 completed question n.16.

burdensome and enjoying limited benefits. One respondent noted that the tools for supporting IFRS 16 application were not available at the time of implementation.

Question on the transition methods applied

137 Almost all the preparers who responded to this question (20 out of 21) applied the modified retrospective method, including practical expedients, mainly because it was less costly and complex to apply.

138 For non-preparers, seven out of nine respondents stated that the majority of entities in their jurisdictions have applied the modified retrospective approach, too, for the same reasons listed above. Those who applied the full retrospective method did so for liquidity and 'going concern' matters.