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EFRAG Users' 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 users' 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 users of financial statements.

3 The purpose of the survey was to collect feedback on whether recognition, measurement, presentation and disclosure requirements in IFRS 16 result in useful information for entities, which helps users of financial statements assess the effect of leases on an entity's financial position, financial performance and cash flows. The input would complement the feedback received from preparers, auditors, regulators and national standard-setters.

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

Definition of terms

5 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

6 EFRAG received seven completed surveys from users, including three equity analysts, two credit rating agencies, one retail investor and one investors' organisation. The detailed breakdown by users' type and industry of focus is included in Figure 1 and 2.

Overall assessment of and experience with IFRS 16

7 The majority of respondents (57%) stated that IFRS is working as intended, some respondents (29%) stated that it is working well but that there is room for improvement and only one respondent (14%) stated that it is not working as intended (see Figure 3).

8 Improvements were suggested to limit the structuring opportunities that are still achievable under current IFRS 16 requirements, to reduce the existing diversity in practice in applying guidance to determine the lease term when the lease contract includes extension or termination options, and to reduce the lack of cash flows disclosures.

9 Compared to the corresponding topic under US GAAP[1], one respondent stated that IFRS 16 complicated users' understanding of financial results, given the absence of a distinction between operating and finance leases, which leads to the distortion of the cash flows and the leverage ratio.

10 On average, respondents confirmed that current disclosure requirements in IFRS 16:

(a) slightly increased (average rating between 3 and 4[2]) the relevance of information across the most impacted industries, especially in the airlines, retail, travel and leisure as well as industrial goods and service sectors (see Figure 4);

(b) improved information on entity's leverage and slightly improved other relevant aspects detailed in Figure 5, such as information transparency (e.g., better understanding of the contractual terms, total obligations and entity's risks exposure)

[1] Topic 842 – *Leases.*

[2] Proposed rating: 1 - Significantly decreased, 2 Decreased, 3 No changes, 4 Increased, 5 Significantly increased.

and users' ability to estimate future cash flows as well as information on the entity's profitability; and

(c) slightly increased information comparability between entities, between leased and purchased asset and between similar contracts (see Figure 6).

11 However, two respondents highlighted that comparability between entities and similar contracts, albeit improved, would remain an issue because structuring opportunities to avoid or limit IFRS 16 impact still exists (e.g., diversity in practice in determining the lease term).

12 Furthermore, the majority of respondents (four out of seven) observed a decrease in the users' cost for obtaining useful information as shown in Figure 7. Those respondents stated that the implementation of IFRS 16 has increased the quantity, the quality and the comparability of information about lease transactions in the statement of financial performance and in the notes. However, one respondent noted that this is an area where entities might improve further.

13 Finally, all the respondents experienced an increased use of adjusted alternative performance measures to neutralise IFRS 16 impacts (e.g., EBITDAL = EBITDA Before Leases) or because covenants are calculated on pre-IFRS 16 figures; however, two respondents explicitly stated that these alternative performance measures are not used for their analysis.

Overall assessment of the disclosure requirements in IFRS 16

14 The majority of respondents (57%) stated that IFRS 16 disclosure requirements provide useful information both from the lessee's and the lessor's perspectives (see Figure 8).

15 Respondents also indicated which disclosure requirements need to be improved, among which the maturity analysis of lease liabilities and total cash outflow for leases were the most cited (see Figure 9).

16 The most useful disclosure requirements were considered to be interest expense on lease liabilities, expenses related to variable lease payments not included in measurement of lease liabilities, and additional qualitative and quantitative information about the lessee's leasing and the lessor's disclosure of finance leases (see Figure 10).

Overall assessment of recognition, measurement and presentation requirements in IFRS 16

17 In general, the majority of respondents considered that the current recognition, measurement and presentation requirements under IFRS 16 result in faithful representation of lease transactions, both from the lessee's and the lessor's perspectives,

while providing mixed views on where there is room for improvement (see Figure 11). In particular, for each of the primary financial statements, respondents provided the following comments.

(a) Statement of financial position: diversity in practice in determining the lease term when extension/termination options exist might impair faithful leases' representation, and one respondent expressed a preference for operating and finance distinction of lease liabilities.

(b) Statement of profit or loss: interest expenses from leases might be understated compared to those from financing agreement, there is still room for improvement on disclosures related to management performance measures, and there should be better information related to the depreciation and interest expenses as well as a split between operating and finance leases.

(c) Statement of cash flows: there are concerns on the flexibility provided under current IAS 7 requirements, there is no clear distinction between capital and interest components related to leases, and restoring the distinction between operating and lease liability as under IAS 17 would be preferable.

18 Regarding variable lease payments' current accounting, the majority of respondents (57%) stated that, overall, current requirements do not provide a faithful representation in the financial statements (see Figure 12). A suggestion to improve related disclosures was made.

Impacts from interaction between IFRS 16 and other IFRS Accounting Standards and Interpretations

19 Almost none of the respondents identified application issues arising from the interaction between IFRS 16 and other IFRS Accounting Standards.

20 However, one respondent stated that IFRS 16 might make it difficult to apply IAS 36 *Impairment of Assets* and IFRS 13 *Fair Value Measurement* because the leverage ratio is distorted along with the cash flows. In this respondent's view, the IASB should align IFRS 16 requirements with the corresponding US GAAP ones.

Other information

Almost none of the respondents identified issues in terms of the usefulness of the information provided by the entities when initially applying IFRS 16 despite the two transition methods allowed under IFRS 16. However, one respondent stated that the IASB should have not allowed entities with material lease contracts to apply the modified retrospective method.

General information

Figure 1: *Respondent type*

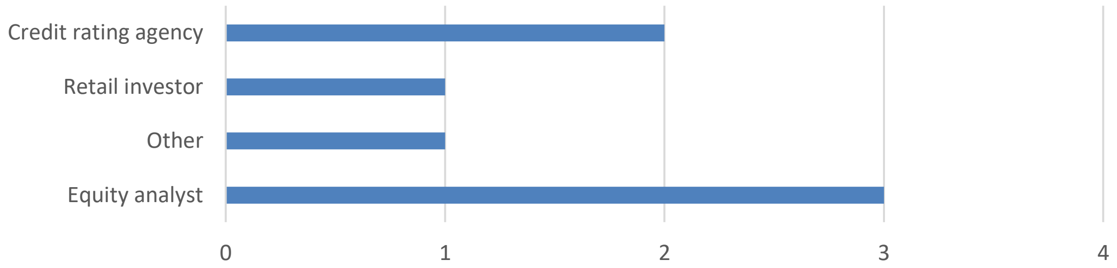
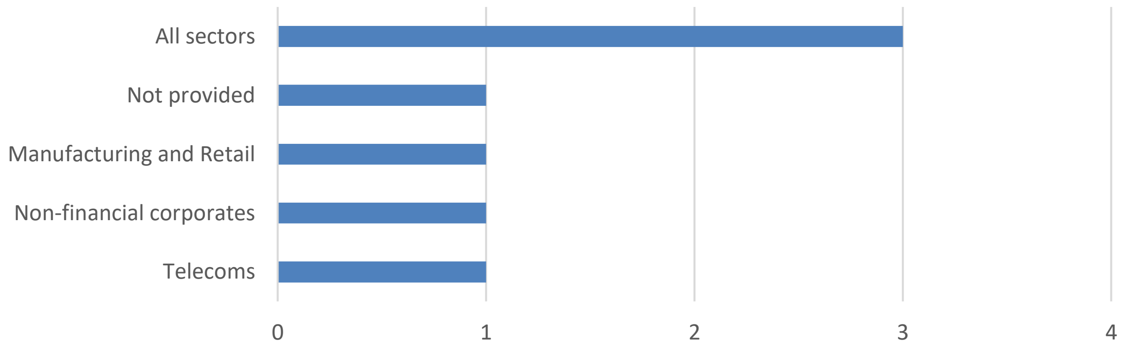


Figure 2: *Industry focus breakdown of respondents*



Structure of this paper

21 The rest of this paper is structured as follows:

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

(b) Overall assessment of the disclosure requirements in IFRS 16;

(c) Overall assessment of recognition, measurement and presentation requirements in IFRS 16;

(d) Impacts from interaction between IFRS 16 and other IFRS Accounting Standards and Interpretations; and

(e) Other information.

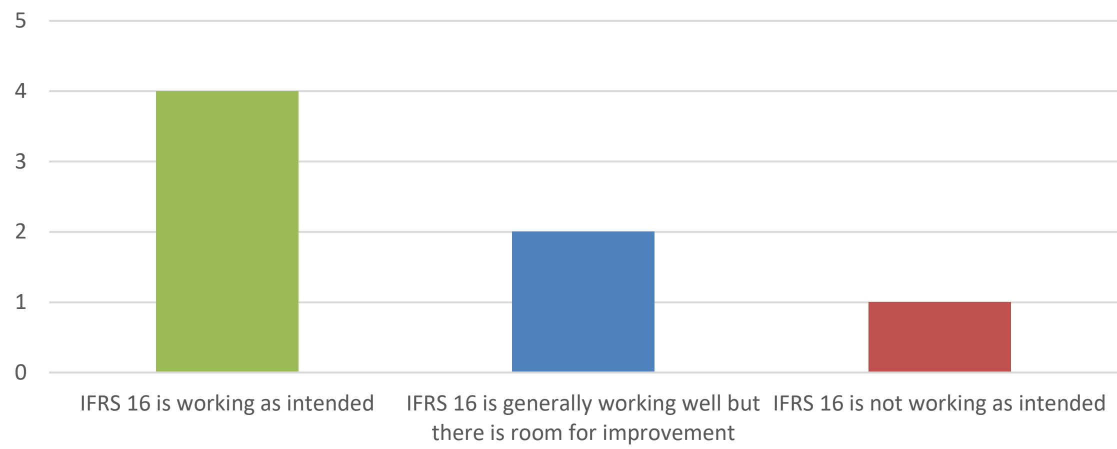
22 The structure follows the same structure (questions) as the survey.

Overall assessment of and experience with IFRS 16

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

23 As shown in Figure 3, the majority of respondents (57%) stated that IFRS is working as intended, some respondents (29%) stated that it is working well but that there is room for improvement and only one respondent (14%) stated that it is not working as intended.

Figure 3 – Overall assessment of IFRS 16



24 Those respondents who highlighted that there is room for improvement mainly referred to the following aspects:

(a) limiting the structuring opportunities that are still achievable under current IFRS 16 requirements;

(b) reducing the existing diversity in practice in applying guidance to determine the lease term when the lease contract includes extension or termination options; and

(c) improving disclosures related to cash flows.

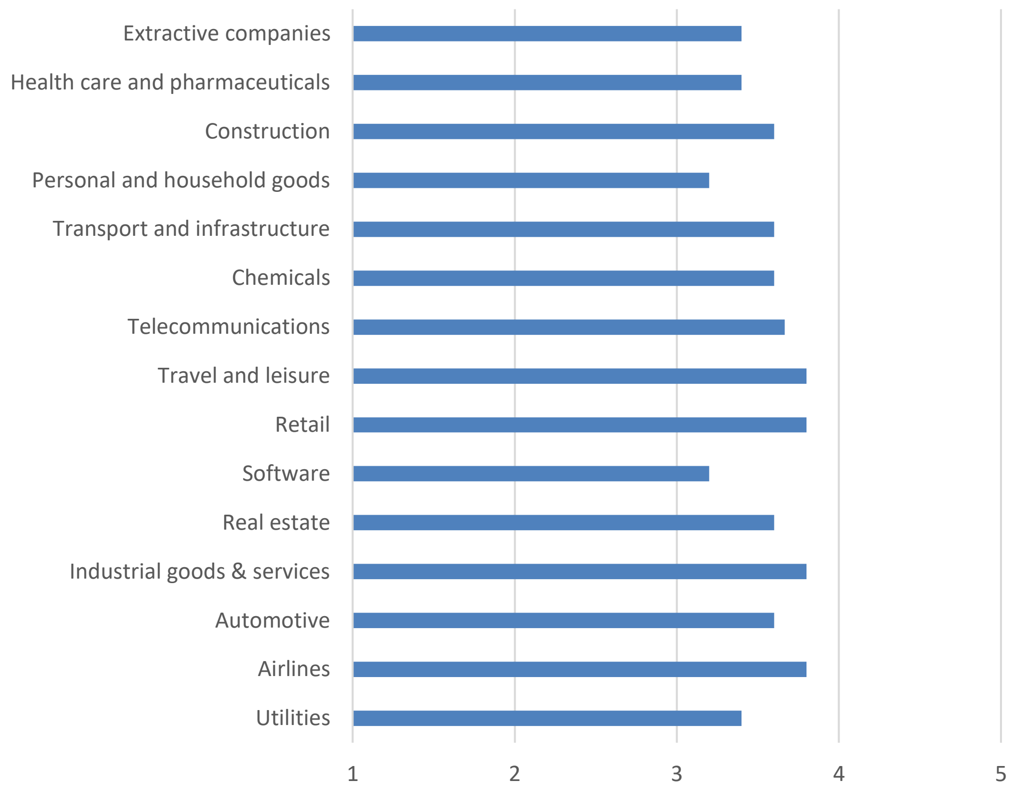
25 The respondent who stated that IFRS 16 is not working as intended noted that it complicates users' understanding of financial results and cash flows and the calculation of the leverage ratio due to the absence of a clear identification of pure financial leases. In this respondent's view, the corresponding standard under US GAAP is working better.

Question on the relevance of information arising from the implementation of IFRS 16 across industries (Question 3)

26 Based on the feedback provided, the implementation of IFRS 16 slightly increased (average rating between 3 and 4) on average the relevance of information about lease transactions in all the industries although to a different extent, as shown in Figure 4.

Figure 4 – To what extent the implementation of IFRS 16 has decreased/increased the relevance of information?

1 - Significantly decreased, 2 Decreased, 3 No changes, 4 Increased, 5 Significantly increased

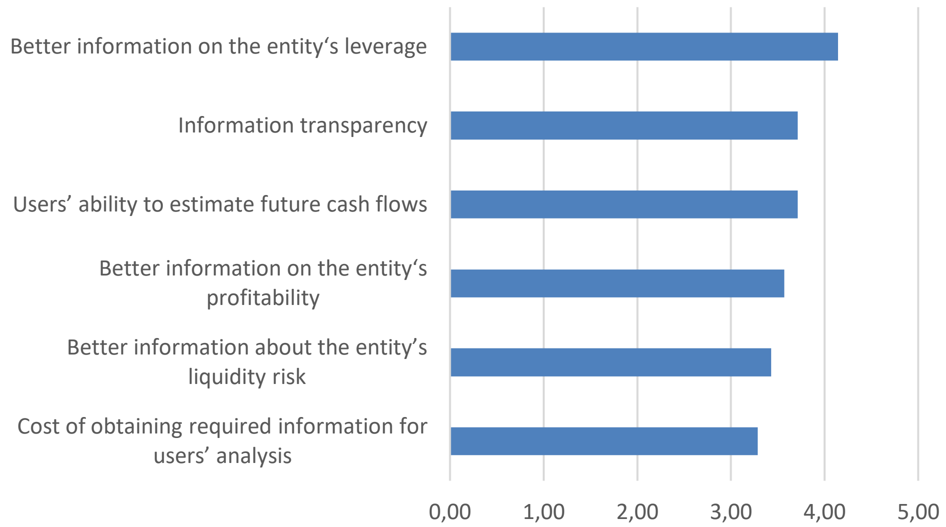


27 It was noted that industries which manage a large number of leases (that under the previous standard were off-balance) now provide better and more transparent information, both in the primary financial statements and in the notes. However, the transition to IFRS 16 raised a lot of questions that were only partially addressed.

Question on the effects of the implementation of IFRS 16 on information relevance and comparability

Figure 5 – To what extent has the implementation of IFRS 16 decreased or increased the following aspects? (Question 4)

1 - Significantly decreased, 2 Decreased, 3 No changes, 4 Increased, 5 Significantly increased



28 On average, the implementation of IFRS 16 improved the information on entities' leverage (average rating of 4,14) and slightly improved (average rating between 3 and 4) all of the other aspects listed in Figure 5 above. In particular, respondents provided the following comments.

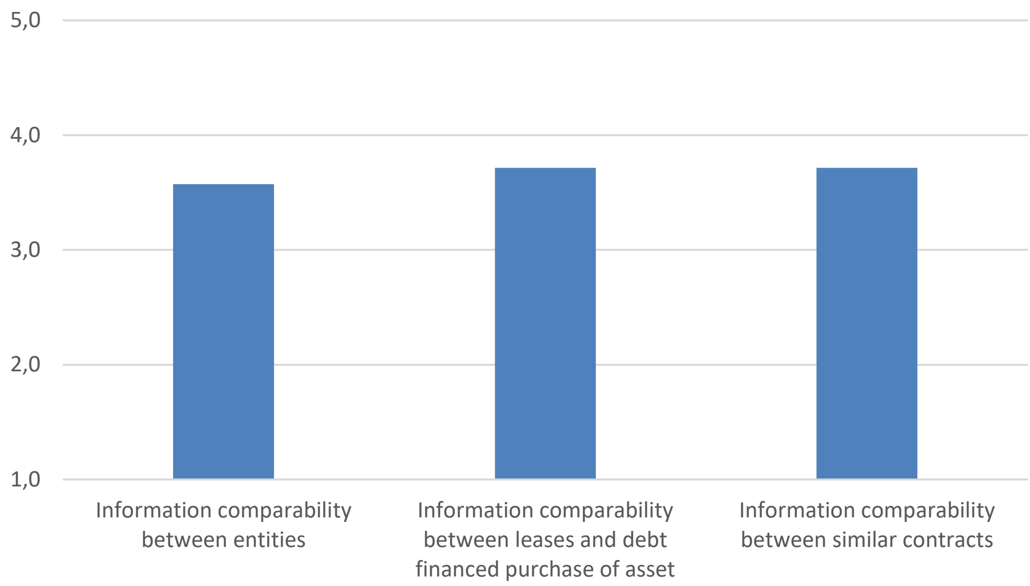
(a) Information transparency is materially improved with a better understanding of the contractual terms and total obligations, which are useful to calculate the entity's leverage position. Having such an information in the primary financial statement and in the notes, rather than only in the notes, should also improve its reliability.

(b) IFRS 16 solved users' need for estimating lease liability for operating leases that under IAS 17 were off-balance, and it therefore reduced users' costs for obtaining information.

29 However, one respondent stated that IFRS 16 complicates the calculation of the leverage ratio because it reduces users' understanding of the financial results and cash flows and does not clearly identify financial leasing. In this respondent's view, the corresponding standard under US GAAP would provide better information.

Figure 6 – To what extent has the implementation of IFRS 16 decreased or increased the information comparability? (Question 5)

1 - Significantly decreased, 2 Decreased, 3 No changes, 4 Increased, 5 Significantly increased



30 As shown in Figure 6 above, on average IFRS 16 slightly increased (average rating between 3 and 4) information comparability between entities, between leased and purchased asset and between similar contracts.

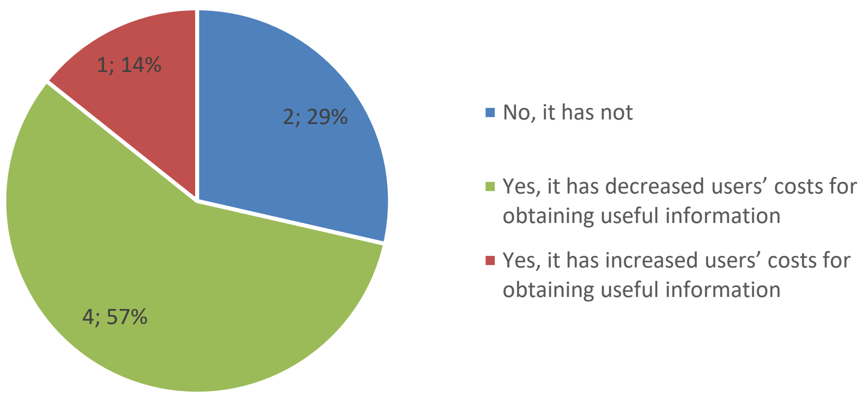
31 One respondent stated that having all leases on-balance sheet led to more comparable information. Furthermore, disclosures are important to better understand the risks to which an entity might be exposed. Overall, IFRS 16 improves comparability and therefore facilitates an entity's valuation within the sector.

32 Commenting on information comparability between leased and purchased assets, many respondents recognised that, overall, it has improved. One respondent stated that, given the absence of repayment risk as the leased asset itself is returned at the end of the contract, IFRS 16 approach (i.e., "right of use approach" rather than the "whole asset approach") better reflects the true financial liability. However, the split between depreciation and interest expenses arising from leased assets is still not fully comparable with that one arising from owned assets, but it has improved.

33 However, two respondents highlighted that comparability between entities and similar contracts, albeit improved, would remain an issue because structuring opportunities to avoid or limit IFRS 16 impact still exist (e.g., diversity in practice in determining the lease term when an extension or termination option exists).

Question on the effects of IFRS 16's implementation on how users use the entity's financial statements (Question 6) and on the use of alternative performance measures (Question 7)

Figure 7 Has the adoption of IFRS 16 impacted how you use the entity's financial statements to obtain useful information for your analysis?



34 The majority of respondents (four out of seven) observed a decrease in the users' costs for obtaining useful information as shown in Figure 7. Those respondents stated that the implementation of IFRS 16 has increased the quantity, the quality and the comparability of information about lease transactions in the financial statements and in the notes. However, one respondent noted that this is an area where entities might improve further.

35 The respondent who observed an increase in the users' costs for obtaining useful information stated that IFRS 16 has introduced confusion regarding debts and that, therefore, users might require additional explanations from the entities.

36 Regarding the use of alternative performance measures by some preparers, all the respondents experienced an increased use of adjusted alternative performance measures. In particular, they provided the following comments.

(a) They are mainly used to neutralise or limit the effects of IFRS 16 on the entity's key ratios (e.g., EBITDAL = EBITDA Before Leases); however, two respondents explicitly stated that these alternative performance measures are not used in their analyses.

(b) Pre-IFRS 16 measures might be provided because covenants are calculated on that basis.

(c) Some entities tend to provide performance measures based on their internal reporting purposes (e.g., 'directional accounting') with more prominence than IFRS measures and with much more information being provided in the explanatory notes. This might lead to a transparency issue for investors.

Overall assessment of the disclosure requirements in IFRS 16

Questions on the usefulness of information from the disclosure requirements in IFRS 16 (Question 8, 9 and 10)

Figure 8 – Do IFRS 16 disclosures provide useful information?

(number of responses)

37 The majority of respondents (four out of seven) stated that IFRS 16 disclosure requirements provide useful information, both from the lessee's and the lessor's perspective.

38 Regarding the lessee's accounting, the respondent who did not consider that current IFRS 16 disclosures provide useful information highlighted that they create confusion between information relating operating and finance leases.

39 The respondents who stated that there is room for improvement provided the following comments.

(a) There is a need to reduce structuring opportunities related to the distinction between lease and service contract.

(b) Disclosure about leases cash flows should be improved (e.g., there should be a clear identification of capital and interest cash flows).

(c) Addressing existing diversity in practice when determining the lease term (e.g., different assessment about the exercise of an extension option) might be helpful.

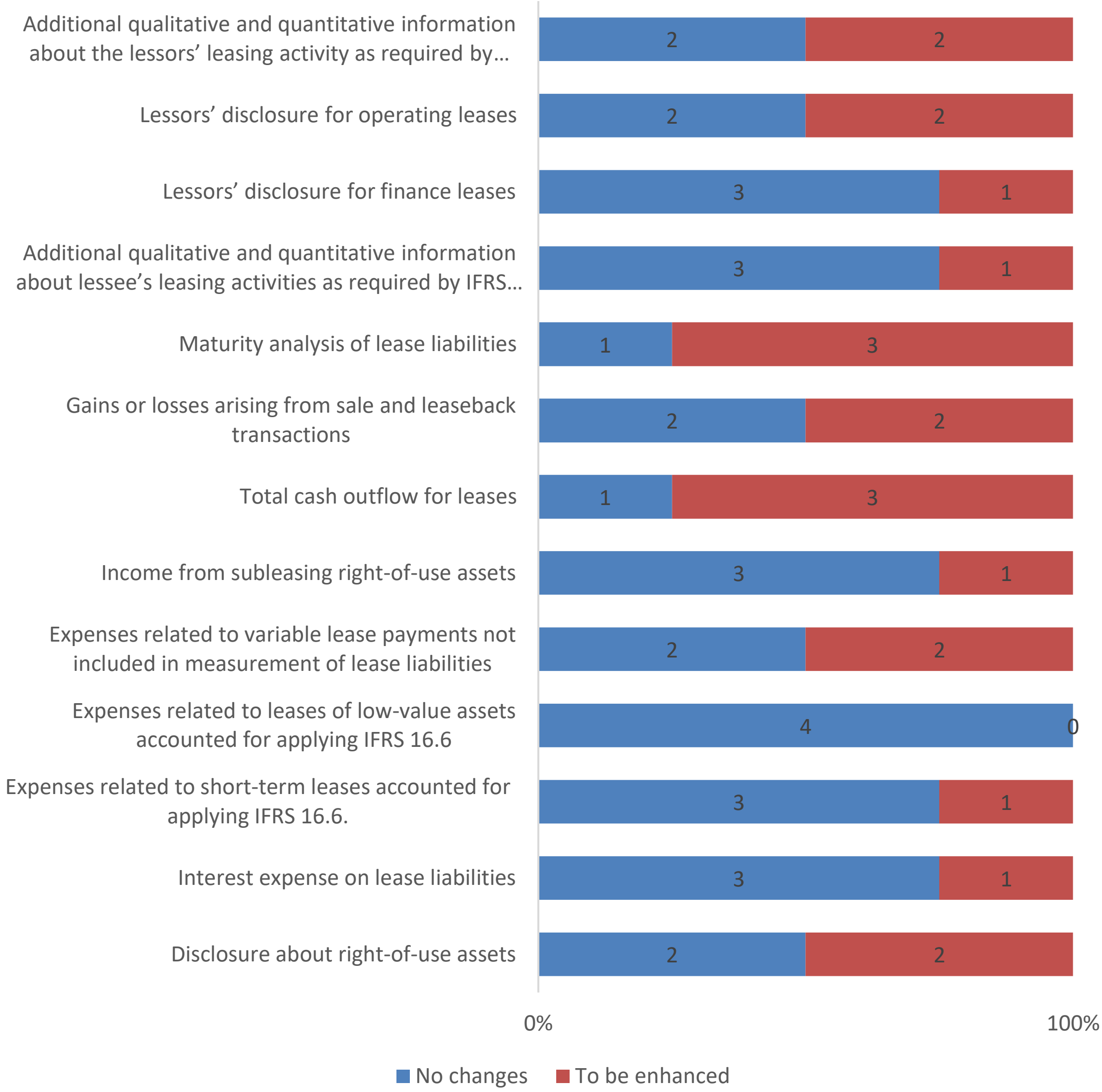
40 Regarding the lessor's accounting, the respondent who stated that there is a room for improvement questioned the IASB's decision to retain the distinction between operating and finance leases for lessors. However, this respondent acknowledged the positive impact, albeit limited, arising from IFRS 16 enhanced disclosures.

41 Those respondents who did not consider that current IFRS 16 lessors' disclosures provide useful information highlighted that current requirements create confusion between information relating operating and finance leases.

Question on the disclosure requirements that should be enhanced/improved or reduced/limited

42 Respondents were asked to indicate any of the current IFRS disclosure requirements (both for lessees and lessors) should be enhanced/improved or reduced/limited. Figure 9 shows the results obtained.

Figure 9 – Which of the following disclosure requirements, if any, should the IASB enhance/improve or reduce/limit? (Number of respondents)



43 Respondents did not identify disclosure requirements to be limited or reduced. However, they suggested to enhance/improve some disclosures, including those related to:

(a) the total cash outflow for leases – e.g., cash outflow for leases should clearly identify the capital and interest elements;

(b) the maturity analysis of lease liabilities – e.g., key assumptions to determine the lease term, including information about potential extension options, should be provided; and

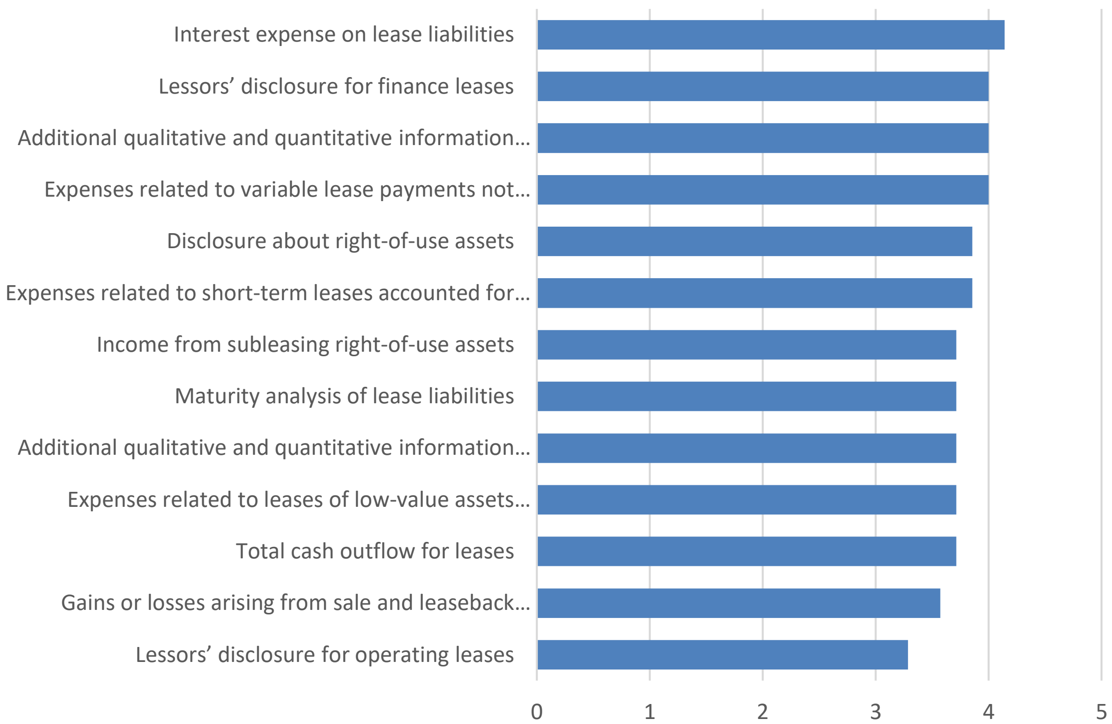
(c) lessors' disclosure for operating leases – e.g., disclosure about the operating lease schedule.

Question on the disclosure requirements that result in entities providing useful information to users for assessing the effect of leases on the financial position, financial performance and cash flows of an entity

44 Respondents were asked to indicate to what degree the following disclosure requirements result in entities providing useful information to users of financial statements to assess the effects that leases have on the financial position, financial performance and cash flows of an entity. Figure 10 shows the average rating that was provided.

Figure 10 – To what degree do the following disclosure requirements result in entities providing useful information to users of financial statements to assess the effects that leases have on the financial position, financial performance and cash flows of an entity? (Average rating)

(1 – Not useful, 2 – Slightly useful, 3 – Moderately useful, 4 – Useful, 5 – Very useful)



45 On average, disclosures about (i) interest expenses on lease liabilities, (ii) expenses related to variable lease payments not included in the measurement of lease liabilities, (iii) additional qualitative and quantitative information about the lessee's leasing and (iv) the lessor's disclosure of finance leases are considered useful (with the average rating between 4,0 and 4,1). All the other disclosure requirements are considered moderately useful (with the average rating between three and four).

46 Furthermore, some respondents provided the following qualitative comments.

(a) Overall, all disclosures are helpful; however, one respondent stated that reduced disclosures would be acceptable if they did not provide material information.

(b) All the information that is necessary to distinguish between operating and financial leases is very useful (applicable to lessees).

(c) Even if it is currently not required, annual information on the lessee's future lease charges would be very helpful for users.

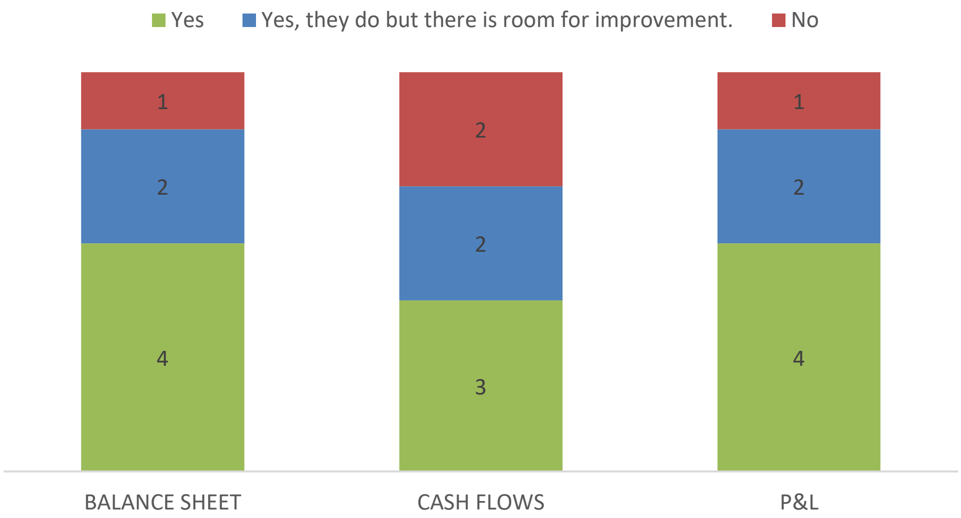
(d) Disclosures that provide additional information particularly related to lease expenses add value to the information and allow for gauging of the impact on cashflows.

(e) Cash outflow for leases should clearly identify the capital and interest elements.

Overall assessment of recognition, measurement and presentation requirements in IFRS 16

Questions on whether the recognition, measurement and presentation requirements in IFRS 16 result in more faithful representation of lease transactions in the primary financial statements (Question 11, 12 and 13)

Figure 11 – Do the recognition, measurement and presentation requirements in IFRS 16 result in a more faithful representation of lease transactions in the statement of financial position, of profit or loss and of cash flows?



Statement of financial position

47 Those respondents who expressed concerns about the representation of lease transactions in the statement of financial position provided the following comments.

(a) One respondent would have preferred a 'whole asset approach', which would have required the return of the leased asset to be recognised as an obligation. However, this respondent acknowledged that considering this alternative approach would go beyond the scope of this PIR.

(b) One respondent stated that existing diversity in practice in determining the lease term when an extension or termination option exists might impair the faithful representation of the lease transaction in the financial statements.

(c) One respondent would prefer to have the distinction between operating lease liabilities and financial lease liabilities.

Statement of profit or loss

48 Those respondents who expressed concerns about the representation of lease transactions in the statement of profit or loss provided the following comments.

(a) Interest expense is understated when compared to the actual cost of financing from purchasing the asset.

(b) One respondent stated that there is still room to improve an entity's disclosures about management performance measures.

(c) One respondent noted the lack of information on depreciation expenses related to right-of-use assets and on interest expenses related to lease liabilities. Furthermore, a breakdown of the expenses between those arising from operating leases and those arising from financial leases would be useful.

Statement of cash flows

49 Those respondents who expressed concerns about the representation of lease transactions in the statement of cash flows provided the following comments.

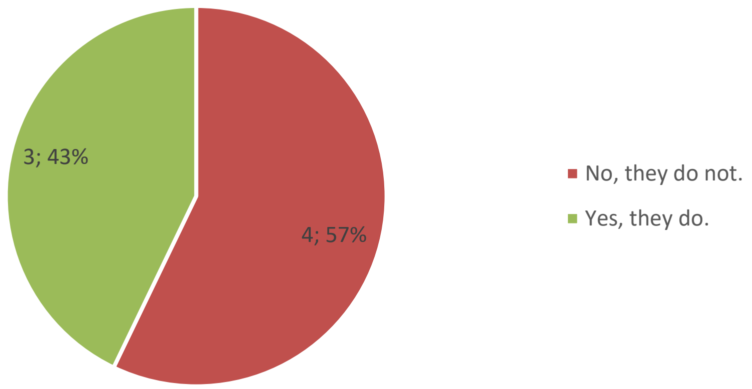
(a) One respondent suggested restoring the distinction between financial and operating leases.

(b) One respondent expressed general concerns about current requirements in IAS 7 (e.g., presentation requirements and flexibility).

(c) One respondent noted that the cash flows statement should clearly identify the capital and interest components related to leases.

Question on whether the accounting treatment of variable lease payments provides faithful representation in the financial statements (Question 14)

Figure 12 - Do current accounting requirements for variable lease payments provide a faithful representation in the financial statements that is useful for users of financial information?



50 The majority of respondents (four out of seven) stated that current accounting requirements for variable lease payments do not provide a faithful representation in the financial statements that is useful for users of financial information. In particular, they provided the following comments.

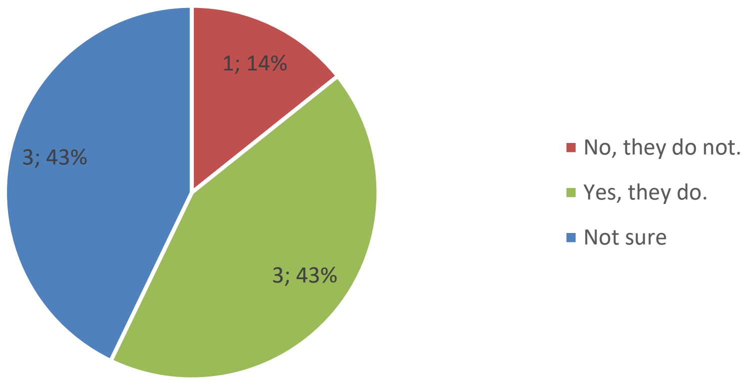
(a) IFRS 16 requirements did not explicitly consider those sectors with a material amount of variable lease payments, and it was suggested to improve disclosures rather than revising current accounting requirements.

(b) There are structuring opportunities and, therefore, it was suggested to perform a detailed analysis to understand whether entities are abusing the current requirements under variable leases.

(c) Disclosures on variable lease payments are still not provided consistently by the entities.

Question on whether the accounting treatment of sale and leaseback transactions provides faithful representation in the financial statements (Question 15)

Figure 13 - Do current accounting requirements for sale and leaseback transactions provide a faithful representation in the financial statements that is useful for users of financial information?



51 Almost none of the respondents (only one out of seven) questioned current accounting requirements for sale and leaseback transactions.

Impacts resulting from the interaction between IFRS 16 and other IFRS Accounting Standards and Interpretations

Question on whether there any interactions between IFRS 16 and other IFRS Accounting Standards and Interpretations that reduce the usefulness and comparability of information (Question 16)

52 Almost none of the respondents (only one out of seven) identified application issues arising from the interaction between IFRS 16 and other IFRS Accounting Standards.

53 However, one respondent stated that IFRS 16 might make it difficult to apply IAS 36 *Impairment of Assets* and IFRS 13 *Fair Value Measurement* because the leverage ratio is distorted along with the cash flows. In this respondent's view, the IASB should align IFRS 16 requirements with US GAAP requirements.

Other information

Question on the usefulness of the information provided by the entities when initially applying IFRS 16 (Question 17)

54 Almost none of the respondents (only one out of seven) identified issues in terms of usefulness of the information provided by entities when initially applying IFRS 16 despite the two transition methods allowed under IFRS 16.

55 Conversely, one respondent stated that the IASB should have not allowed entities with material lease contracts to apply the modified retrospective method.