

Mr Jean-Paul Gauzès
President of the Board
European Financial Reporting
Advisory Group (EFRAG)
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**Ref: Preliminary Consultation Document regarding the endorsement of IFRS 16
Leases**

Dear Mr Gauzès,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to the development of EFRAG's endorsement advice on adoption of IFRS 16 *Leases*.

On 12 October 2016 EFRAG published its Preliminary Consultation Document regarding the endorsement of IFRS 16 *Leases*, which included preliminary conclusions on whether IFRS 16 complies with requirements of Article 3 of the IAS Regulation¹. In particular, EFRAG concluded that IFRS 16 meets the technical endorsement criteria (understandability, relevance, reliability and comparability) required for financial information in order to make economic decisions and to assess the stewardship of management. EFRAG also concluded that IFRS 16 is not contrary to the true and fair view principle of Article 4(3) of the Accounting Directive². Furthermore, EFRAG seeks input from stakeholders to underpin its assessment whether IFRS 16 is conducive to the European public good.

ESMA concurs with EFRAG's conclusion that IFRS 16 meets all the technical endorsement criteria and is not contrary to the true and fair view principle as defined in the Accounting Directive.

ESMA agrees with EFRAG's assessment that IFRS 16 brings a significant improvement to the reporting of leases by lessees compared to the existing model in IAS 17 *Leases*. ESMA strongly believes that IFRS 16 will result in more and transparent information being reported

¹ Regulation (EC) no 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

² Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.



on leasing arrangements with a positive impact on investors' protection. For this reason, ESMA believes that the endorsement of the new standard should be completed swiftly.

Particularly, ESMA is of the view that increased transparency will arise from the recognition of a right-to-use asset and a lease liability for all leases (except for short-term leases or leases of low-value assets) in a lessee's balance sheet and from the introduction of more objective-based disclosures. ESMA believes that the increased level of transparency will help promoting long term financial stability in the EU. ESMA also supports EFRAG's approach to gather evidence and to specifically consult with the ECB as to whether IFRS 16 supports financial stability, before concluding whether the adoption of IFRS 16 is conducive to the European public good.

ESMA expects that the significant improvements provided for by IFRS 16, namely, the introduction of a single model for lessee accounting, the revised disclosure framework and the expanded guidance on lease definition based on a control concept that is consistent with other recent standards (i.e. IFRS 10 and IFRS 15), will have a largely positive impact on enforcement compared to the current situation. Notwithstanding this fact, ESMA also believes that the new model in IFRS 16 might require a significant degree of judgment in some areas. For instance, implementation and enforcement issues may arise in the assessment whether or not a contract qualifies as a lease or in defining the eligibility to the recognition exemption for leases of 'low value'. However, ESMA strongly believes that, on balance, IFRS 16 will result in an improvement of the enforceability of lease accounting requirements.

Finally, ESMA believes that the potential of IFRS 16 for improving investor protection and promoting financial stability can only be achieved when all listed issuers on a regulated market, including SMEs, are subject to the same requirements. In this respect, ESMA highlights that EFRAG's quantitative evidence shows that for SMEs the application of the new requirements would result in some cases in a higher proportion of lease leverage as a share of total debt compared to other issuers. Therefore, in ESMA's view it is important that SMEs that are listed on a regulated market fully apply IFRS 16.

Please do not hesitate to contact us should you wish to discuss all or any of our comments.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'S. Maijoor', written over a light blue horizontal line.

Steven Maijoor

cc: Erik Nooteboom, Head of Unit B3 FISMA, European Commission