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Post-implementation review of IFRS 16 Leases ('PIR of IFRS 16')

Cover Note

Objective

- 1 The objectives of this session are to:
 - (a) Provide EFRAG FR TEG with an update of the EFRAG Secretariat preparatory work performed so far; and
 - (b) Seek EFRAG FR TEG members' views on the preliminary assessment, both in terms of prevalence and priority, of the IFRS 16 application challenges as suggested by the EFRAG Secretariat.

Structure of the session and the related agenda papers

- 2 For background purposes only, the agenda paper 03-02 contains a more detailed description of all application issues identified so far.
- 3 From paragraph 11 to 14 and in Appendix 1 – Table A, an overview of the application issues preliminarily assessed of High priority is provided.
- 4 In paragraph 15 and in Appendix 1 – Table B, an overview of the application issues for which we are seeking EFRAG FR TEG members' further input to assess their prevalence and priority is provided.
- 5 In Appendix 1 – Table C and D, an overview of the application issues preliminarily assessed, respectively, of Medium and Low/No priority is provided.

Background of the IASB project

- 6 In June 2024 the IASB started the PIR of IFRS 16 and is planning to conduct outreach with consultative groups and other stakeholders to inform a request for information, whose publication of the Request for Information ("RFI") is expected in the first half of 2025.
- 7 For further information about the project please refer to the IASB project page [here](#).

Overview of EFRAG Preparatory work

- 8 EFRAG's preparatory work started in February 2024 and is expected to continue until the issuance of the IASB RFI (H1 2025). It aims at developing a preliminary list of application challenges and proposed recommendations that will be further discussed, categorised and

prioritised by EFRAG FR TEG and EFRAG FRB in preparation of EFRAG comment letter in response to the IASB RFI.

- 9 At the Joint EFRAG FR TEG-User Panel meeting in May ([here](#)) and at the EFRAG FR TEG meeting in September ([here](#)), the EFRAG Secretariat provided members with a summary of:
- (a) the preliminary feedback collected through the online surveys to users, preparers, national standard setters and auditors launched in February;
 - (b) the preliminary application issues raised by stakeholders during different outreaches held with preparers, auditors and users the ad-hoc meeting held from February to July; and
 - (c) the key messages sought about the overall assessment of IFRS 16 and its cost-benefits analysis.
- 10 In addition, some other closed meetings took place with various stakeholders. Appendix 2 reflects the complete feedback collected so far through EFRAG's online surveys, at previous EFRAG FR TEG, CFSS and EFRAG Working Group meetings and other outreaches held with preparers, auditors and users as listed.
- 11 In order to prioritise the identified issues, in November the EFRAG Secretariat asked EFRAG FR TEG and CFSS members to complete an online survey to provide their input in term of prevalence, priority and proposed solution for each of the preliminary application issues detected so far and further detailed in agenda paper 03-02. Six responses were received. The limited feedback provides an indication for the categorisation of issues, but still requires further discussion with EFRAG FR TEG on the topic.

EFRAG Secretariat preliminary prioritisation of the issues arising from the application of IFRS 16

- 12 Based on the feedback collected during its preparatory work the EFRAG Secretariat identified:
- (a) No. 14 application issues arising from the application of IFRS 16; and
 - (b) No. 11 application issues arising from the interaction with other IFRS Accounting Standards.
- 13 The main sources of concern raised by stakeholders include:
- (a) *The high level of judgment which may lead to diversity in practice;*
 - (b) *Too complex and burdensome accounting requirements;*
 - (c) *Lack or limited guidance in IFRS 16;*
 - (d) *Substance of the transaction not properly reflected in the financial statements; and*
 - (e) *The interaction with other IFRS Accounting Standards.*
- 14 More detailed information about all these issues, is included in **agenda paper 03-02**.
- 15 Among them, the EFRAG Secretariat preliminarily identified **n.5 high priority issues**, which are those listed in the Appendix 1 - Table A. Such an assessment is mainly driven by the following factors:

- (a) Their prevalence and pervasiveness across industries and jurisdictions (i.e., widespread diversity in practice exists, (e.g. it affects transactions that occur frequently in various industries);
 - (b) Their relevance for EU stakeholders (i.e., the issue materially affects users of financial statements' ability to analyse trends and compare entities); and
 - (c) Whether the matter relates to an issue that can be addressed by the IASB or the IFRS Interpretation Committee on a timely manner.
- 16 Furthermore, the EFRAG Secretariat received mixed views in relation to the following application issues (see Appendix 1 – Table B) for which **we are seeking EFRAG FR TEG member additional input to assess their prevalence and priority:**
- (a) Determining the discount rate – Several stakeholders argued that current requirements are too theoretical, judgmental, and obtaining data on an ongoing basis could be costly for preparers. There is also diversity in practice in how entities define the methodology to calculate the IBR; this might lead to substantially different discount rates across entities, even for similar contracts. Therefore, some stakeholders called for additional guidance or simplifications to reduce, respectively, existing diversity in practice and costs for preparers. On the other hand, EFRAG observes that such a diversity reflects the different levels of creditworthiness assigned by financial institutions to each entity, thereby increasing comparability between leased and financed assets at the individual entity level.
 - (b) Determining the lease payments - Stakeholders from the retail industry questioned the overall outcome of IFRS 16 given the relevance of variable lease payments still not included in the lease liability calculation. In addition, some stakeholders noted that the accounting for variable lease payments in IFRS 16 is not consistent with that provided for other IFRS Accounting Standards (e.g., IFRS 9 and IFRS 15) and between leases and leaseback transactions with only variable payments within IFRS 16.
 - (c) Distinction between lease and in-substance purchase of assets – Several stakeholders noted that such a distinction may impact the entity's performance indicators, and it may not be substantial in those lease contracts whose term cover the entirety of the useful life of the underlying asset. A call for additional guidance to address such a diversity in practice was made.
 - (d) Contract modification - Stakeholders from the retail industry noted that the accounting is too complex and burdensome, especially when modifications occurred frequently. This would imply relevant on-going costs and frequent reassessment of the right of use assets and lease liabilities. Therefore, they called for simplifications to reduce on-going costs.
 - (e) Low-value asset lease exemption – Some stakeholders noted that the accounting of leases of low-value assets, or providing the related disclosure if the recognition exemption is applied, may be burdensome especially when, on an aggregate basis, these contracts are not material compared to total assets value. Moreover, stakeholders questioned the application of the 5,000\$ threshold (IFRS 16.BC100), as it may not be consistent with the materiality assessment in IAS 1.

- 17 The remaining application issues have been assessed of Medium, Low or no priority for the IASB's action. Please refer to Appendix 1 – Table C and D.

Questions for EFRAG FR TEG

- 18 Do EFRAG FR TEG members agree with the EFRAG Secretariat preliminary identification of issues of high priority as detailed in paragraph 15 (and as listed in table A of Appendix 1)?
- 19 Do EFRAG FR TEG members assess any of the application issues summarised in paragraph 16 as of high priority issues (as listed in table B of Appendix 1)? If yes, please explain why and how the IASB should address them.
- 20 Do EFRAG FR TEG members agree with the EFRAG Secretariat preliminary assessment - both in terms of the most affected industries prevalence, and priority - of the other issues listed in Table C (Medium Priority) and Table D (Low or not priority) of Appendix 1?
- 21 Are there other relevant application issues and interactions with other IFRS Accounting Standards besides those summarised in the agenda paper 03-02? If yes, please explain the issue and how the IASB should address them.

Next steps

- 22 The EFRAG Secretariat will continue to monitor the IASB project and to collect feedback from various stakeholders to assess to which extent the identified issues are widespread and relevant to the EU stakeholders.

Agenda Papers

- 23 In addition to this cover note, Agenda Paper 03-02 – PIR IFRS 16 – Description of the application issues – has been provided for this session.

Appendix 1 – Preliminary prioritisation of the application issues arising from the application of IFRS 16

Table A - Application Issues preliminary assessed as of HIGH PRIORITY by the EFRAG Secretariat

#	Description of the issue	Type of issue	Industry affected	Prevalence & Priority for EU stakeholders	EFRAG Secretariat preliminary view on priority for IASB action	EFRAG Secretariat preliminary recommendation for IASB action
1	Sale and leaseback transaction	Lack of guidance is leading to diversity in practice	Across industries	Prevalent	High	To explore whether standard-setter activity might reduce existing diversity in practice
2	Presentation requirement in the CF statement	Substance of the transaction not properly reflected in the FS	Across industries	Prevalent	High	To explore whether standard-setting activity is needed within the IAS 7 Cash flow statements project
3	IFRS 9 - Distinction between a lease modification (IFRS 16) and extinguishment of a lease liability (IFRS 9) arising from a rent concession	Lack of guidance in the standard	Across industries	Prevalent	High	To explore standard setting activity
4	IFRS 15 - Sale and leaseback transaction	Application difficulties and lack of consistent application	Real estate and retail industry	Prevalent	High	To explore standard setting activity
5	IFRS 10 - Sale and leaseback of a single asset entity through corporate wrapper	Lack of consistent application	Across industries	Prevalent	High	To explore standard setting activity

Post-implementation review of IFRS 16 Leases ('PIR of IFRS 16') - Cover Note

Table B - Application Issues to be further discussed

#	Description of the issue	Type of issue	Industry affected	Prevalence & Priority for EU stakeholders	EFRAG Secretariat preliminary view on priority for IASB action	EFRAG Secretariat preliminary recommendation for IASB action
1	Determining the discount rate	Application difficulties and lack of consistent application	Retail industry	Some prevalence	To be discussed	Additional guidance and to explore whether current accounting treatment for variable lease payments might be reconsidered
2	Determining the lease payments	Lack of guidance is leading to diversity in practice	Across industries	Some prevalence	To be discussed	To obtain more information in next agenda consultation
3	Distinction between lease and in-substance purchase of assets:	Lack of guidance is leading to diversity in practice	Retail industry	Some prevalence	To be discussed	To explore whether additional guidance or simplifications might reduce existing diversity in practice and costs
4	Contract modification	Too complex and burdensome accounting requirements	Across industries	Prevalent	To be discussed	To explore whether additional guidance or simplifications might reduce existing diversity in practice and costs
5	Low-value asset lease exemption	Too complex and burdensome accounting requirements	Retail industry	Some prevalence	To be discussed	Additional guidance and to explore whether current accounting treatment for variable lease payments might be reconsidered

Post-implementation review of IFRS 16 Leases ('PIR of IFRS 16') - Cover Note

Table C - Application Issues preliminary assessed as of **MEDIUM PRIORITY** by the EFRAG Secretariat

#	Description of the issue	Type of issue	Industry affected	Prevalence & Priority for EU stakeholders	EFRAG Secretariat preliminary view on priority for IASB action	EFRAG Secretariat preliminary recommendation for IASB action
1	Determining the lease term	Application difficulties and lack of consistent application	Across industries	Some prevalence	Medium	Additional guidance, including incorporation of IFRS IC Agenda decision within the standard
2	IFRS 15 - Identifying components in lease contracts and scope	Application difficulties and lack of consistent application; Lack of guidance in the standard	Across industries	Some prevalence	Medium	Additional guidance and/or educational material
3	IAS 16 - Different level of certainty in assessing optional periods to define the depreciation period	Inconsistency across standards	Across industries	Some prevalence	Medium	To obtain more information in next agenda consultation
4	IAS 36 - Application of the impairment test requirements	Lack of consistent application	Across industries	Some prevalence	Medium	Additional guidance and/or educational material

Post-implementation review of IFRS 16 Leases ('PIR of IFRS 16') - Cover Note

Table D - Application Issues preliminary assessed as of **LOW or NO PRIORITY** by the EFRAG Secretariat

#	Description of the issue	Type of issue	Industry affected	Prevalence & Priority for EU stakeholders	EFRAG Secretariat preliminary view on priority for IASB action	EFRAG Secretariat preliminary recommendation for IASB action
1	Non-monetary consideration	Lack of guidance is leading to diversity in practice	Real estate?	Limited prevalence	Low	To obtain more information in next agenda consultation
2	Accounting for expenditures incurred before the leased assets became operational	Lack of guidance is leading to diversity in practice	Across industries	Limited prevalence	Low	To obtain more information in next agenda consultation
3	Accounting for leases with non-consecutive lease periods	Lack of guidance is leading to diversity in practice	Retail industry	Limited prevalence	Low	To address any specific issue consulting IFRS IC
4	Determination of the appropriate ROU asset depreciation period	Substance of the transaction not properly reflected in the FS	Retail industry	Some prevalence	Low	To address any specific issue consulting IFRS IC
5	IAS 16 - Definition of initial direct costs	Inconsistency across standards	Across industries	Some prevalence	Low	To obtain more information in next agenda consultation (e.g. to discuss the capitalisation of non-deductible VAT to RoU).
6	IAS 37 - Accounting for onerous lease contracts	Lack of guidance in the standard	Across industries	Limited prevalence	Low	To obtain more information in next agenda consultation
7	IFRS 11 - Accounting for leases in context of joint operations	Lack of consistent application	Oil&Gas	Limited prevalence	Low	To obtain more information in next agenda consultation

Post-implementation review of IFRS 16 Leases ('PIR of IFRS 16') - Cover Note

#	Description of the issue	Type of issue	Industry affected	Prevalence & Priority for EU stakeholders	EFRAG Secretariat preliminary view on priority for IASB action	EFRAG Secretariat preliminary recommendation for IASB action
8	Identifying lease contracts	Application difficulties and lack of consistent application	Across industries	Some prevalence	No further action	
9	Separating lease and non-lease components	Application difficulties and lack of consistent application	Across industries	Some prevalence	No further action	
10	IFRS 9 - Application of the ECLs model under IFRS 9 to lease liabilities from the lessor's perspective	Lack of guidance in the standard	Across industries	Limited prevalence	No further action	
11	IFRS 3 - Accounting for lease contracts in the context of a business combination	Lack of consistent application	Across industries	Some prevalence	No further action	

Appendix 2 – Detailed list of outreach activities

- 1 Since January 2024, the EFRAG Secretariat conducted several outreaches that can be summarised as follows:
 - (a) French preparers operating in the retail industry (January 2024)
 - (b) Meeting with EFRAG FR TEG-CFSS (March 2024)
 - (c) Italian preparers operating in the retail industry (July 2024)
 - (d) German preparers operating in the automotive industry (April and May 2024)
 - (e) Members of the International Valuation Standards Council (March 2024)
 - (f) Meeting with representatives of large audit firms (March-April 2024)
 - (g) Meeting with the European Public Real Estate Association (EPRA) (July 2024)
 - (h) Meeting with Leaseurope (April 2024)
 - (i) Meeting with National Standard Setters (NSS) (April-May 2024)
 - (j) Meeting with EFRAG FR TEG and User Panel (May 2024)
 - (k) Meeting with EFRAG FIWG, EFRAG Academic Panel and EFRAG IAWG (May 2024)
 - (l) Meeting with Italian National Standard Setter (OIC)' working groups (June – July 2024)
 - (m) Meeting with French National Standard Setter (ANC)' working groups (June – July 2024)
 - (n) Meeting with EFRAG RRAWG (July 2024)
- 2 Furthermore, EFRAG got input during the following external meetings:
 - (a) April 2024 International Forum of Standard-setters (IFASS) meeting (see meeting report [here](#) - Item 15 from page 61).
 - (b) Meeting with German CFO – (October 2024)