

This paper has been prepared by the EFRAG Secretariat to supplement EFRAG's Preliminary Consultation Document regarding the endorsement of IFRS 16. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG.

IFRS 16 Leases: Fieldwork on the definition of a lease EFRAG Secretariat paper

Background

Objective of the fieldwork

- 1 EFRAG Secretariat initiated a fieldwork to identify whether the criteria in IFRS 16 as to whether a contract is, or contains, a lease are understandable and do not require excessive application of professional judgement.
- 2 EFRAG Secretariat considered that outreach was needed based on the feedback received by EFRAG at previous stages of its due process and the extent to which differences were introduced by IFRS 16 to the accounting for lease and non-lease contracts.
- 3 The importance of the topic was iterated in the European Commission's letter requesting an advice on the definition of a lease for the purposes of IFRS 16 endorsement.

Modalities of the fieldwork

- 4 Participants in the fieldwork were asked to select existing contracts where they believed the determination as to whether a contract is, or contains, a lease is likely to be complex. Then they were asked to apply the requirements in IFRS 16 to those contracts in order to determine whether they found difficulties in identifying whether those contracts were, or contained, a lease and, if such difficulties existed, the features of those contracts that created those difficulties.
- 5 To ensure an appropriate focus for the fieldwork, EFRAG Secretariat selected entities that were considered to have the potential to enter into contracts where the identification of a lease might be problematic based on the magnitude of reported operating lease commitments, past participation in consultation on leases and affiliation to a sector where potential issues could be expected to arise.
- 6 Physical meetings or conference calls were held with each entity that agreed to participate to discuss how they would apply the requirements in IFRS 16 to the contracts they had selected.

Feedback report

- 7 EFRAG Secretariat initially selected 59 entities from 9 European countries. Details of the country and industry of the 22 companies that agreed to participate are provided in the Appendix to this paper. The relevant National Standard Setter was invited to participate in the process and some chose to do so.
- 8 The feedback received from all participants did not identify that the application of the definition of a lease as defined in IFRS 16 would involve excessive judgment. However, participants noted the following were areas where the assessment might be more complex:

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- (a) Determining which party has the right to direct the use: two participants identified areas of judgement when assessing which party has the right to direct the use of a drilling rig. Factors driving the assessment would include which party decides where to drill, at what depth and for how long; which party decides when to stop drilling and which party operates the rig.
- (b) Determining 'how and for what purpose' an asset was designed (for assets that are not controlled by either the supplier or the customer): how much involvement when designing the asset is needed.
- (c) Right to obtain economic benefit by substituting the asset: a participant in the fieldwork considered a contract for fleet of trucks at a remote location. In participant's view, the site is remote and it seems unlikely that the supplier will benefit from substituting the asset even when the truck is not for specialised use. The judgement relates to assessing the existence of economic benefits to replace the asset which may be affected by the existing customer.

Appendix: Information on participants by country and industry

Country	Number of participants	Industry	Number of participants
Denmark	1	Energy	4
France	3	Telecom	3
Germany	4	Construction	2
Italy	5	Media	2
The Netherlands	1	Manufacturing	2
Spain	2	Pharmaceutical	2
Sweden	1	Aviation	1
Switzerland	1	Chemicals	1
United Kingdom	4	Courier Services	1
		Distribution	1
		Mining	1
		Retail	1
		Transportation	1
Total	22	Total	22