IFRS® Accounting

# Staff paper

Agenda reference: 7B

**IASB® meeting**

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| Date | **March 2025** |
| Project | **Post-implementation Review of IFRS 16 *Leases*** |
| Topic | **Feedback analysis—Overall assessment of IFRS 16** |
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## Purpose and structure of this paper

1. This paper analyses feedback on IFRS 16 *Leases* as a whole, including the costs and benefits related to the implementation and application of the Standard, and provides staff recommendations on which matters to include in a request for information (RFI) on the Post-implementation Review (PIR) of IFRS 16.

2. This paper includes:

   (a) background (paragraphs 3–10);

   (b) feedback summary (paragraphs 11–34);

   (c) staff analysis (paragraphs 35–46);

   (d) summary of staff recommendations (paragraph 47); and

   (e) questions for the International Accounting Standards Board (IASB).

## Background

3. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective of the Standard is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions.

This information gives a basis for users of financial statements (users) to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.[1]

4. To meet the objective, the Standard introduces a single lessee accounting model (IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee) in which a lessee accounts for all leases as providing finance. For almost all leases, IFRS 16 requires a lessee:

   (a) to recognise lease assets (right-of-use assets) and lease liabilities in the balance sheet, initially measured at the present value of future lease payments;

   (b) to recognise depreciation of lease assets and interest on lease liabilities in the income statement over the lease term; and

   (c) to classify cash payments for the principal portion of lease liabilities within financing activities, and the interest portion of lease liabilities in accordance with the requirements in IAS 7 *Statement of Cash Flows*.

5. IFRS 16 did not change substantially how a lessor accounts for leases. Accordingly, a lessor continues to classify leases as either finance leases or operating leases applying IFRS 16, and accounting for those two types of leases differently.

6. The IASB considered the costs and benefits of the new requirements and discussed these in the *Effects Analysis* accompanying IFRS 16. The IASB expected IFRS 16 to improve the information available to *all* users. Specifically, the IASB expected IFRS 16:

   (a) to reduce the need for users to make adjustments to amounts reported on a lessee's balance sheet and income statement and reduce the need for entities to provide management-defined performance measures (sometimes called 'alternative performance measures (APMs)' or 'non-GAAP measures') about leases;

[1] Paragraph 1 of IFRS 16.

(b) to improve comparability between entities that lease assets and entities that borrow to buy assets; and

(c) to create a more level playing field by providing transparent information about leases to all market participants because entities would more accurately measure assets and liabilities arising from leases applying IFRS 16 as compared to the estimates made by only more sophisticated users when entities applied IAS 17 *Leases*.[2]

7. The IASB expected that entities with material off balance sheet leases would incur implementation costs:

(a) to set up systems and processes, including educating staff;

(b) to determine the discount rates used to measure lease assets and lease liabilities on a present value basis; and

(c) to communicate changes to reported information to external parties.

8. The IASB expected ongoing costs to be only marginally higher compared to those incurred when applying IAS 17.[3]

9. To provide cost relief for entities both when implementing IFRS 16 and on an ongoing basis, IFRS 16 includes some simplifications and practical expedients, such as:

(a) a lessee is permitted to elect not to recognise assets and liabilities for:

(i) short-term leases (that is, leases of 12 months or less); or

(ii) leases of low-value assets (such as personal computers);

(b) a lessee is permitted not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease component as a single lease component;

[2] See Section 4 *Benefits* of the *Effects Analysis* accompanying IFRS 16.
[3] See Section 5 *Costs* of the *Effects Analysis* accompanying IFRS 16.

(c) variable lease payments linked to future sales from, or use of, the leased item are excluded from the measurement of lease assets and lease liabilities;

(d) when first applying IFRS 16 entities were:

(i) not required to restate comparative information; and

(ii) permitted to choose how to measure lease assets relating to off balance sheet leases.

10. The IASB expected the benefits of the new requirements to be ongoing and to justify the costs of implementing the requirements (for example, costs to set up systems and processes), which would be incurred mainly in transitioning from the previous lease accounting requirements.

## Feedback summary

### *Overall assessment*

11. Overall, most users and almost all standard-setters, regulators and members of the IFRS Interpretations Committee (Interpretations Committee) said IFRS 16 is working as intended, has achieved its objectives and improved financial reporting. However, almost all preparers said they incurred high initial costs, and many said they continue to incur high ongoing costs of applying IFRS 16 but see limited or no benefits.

### *Detailed feedback*

#### *User feedback*

12. Most users said IFRS 16 has *improved transparency* and the *quality of financial information*. In their view, IFRS 16 provides useful information that helps them assess capital employed by, and financial leverage of, lessees, in particular in industries that use leases extensively (such as retail, airlines and telecommunications). Users said recognition of leases on entities' balance sheets reflects their view that leases are debt-like transactions, and this is an improvement compared to the previous model. These

users said they generally receive (or can obtain) the information they need for their analyses.

13. Most users said they find the *more detailed information disclosed* in the notes to the financial statements to be a great improvement compared to the information disclosed under the previous requirements for leases. However, a few users expressed concerns that lessees *do not disclose information* about leases in a single note (or a separate section) in their financial statements, contrary to what paragraph 52 of IFRS 16 requires (see also paragraph 28(c) of Agenda Paper 7A).

14. On the other hand, a few users said IFRS 16 solved a *problem that did not need to be solved*. In these users' view, improving disclosure requirements about previous operating leases would have improved financial reporting. However, these users generally expressed *no appetite for any substantial changes* to the requirements of IFRS 16 to avoid further disruption to their models and time series.

15. Many users said different lessee accounting models in IFRS 16 and US GAAP hinder comparability between entities, generate costs and add complexity.[4] Users generally agree that the IFRS 16 lessee accounting model is conceptually correct, but some users would prefer presentation of leases in the income statement and statement of cash flows as operating activities, which would be more aligned with the US GAAP presentation.

16. Some users expressed concerns about *lack of comparability of cash flows* of entities that lease assets (non-cash movements related to the initial recognition of leases are not presented in the statement of cash flows) and entities that borrow funds to buy assets (proceeds from borrowings are presented in financing activities; cash payments to acquire assets are presented as investing cash outflows).[5] Users said presentation of non-cash movements in lessees' statements of cash flows or additional disclosures about non-cash movements would be helpful. A few users acknowledged that the information about additions to right-of-use assets, that is required to be disclosed in

[4] Appendix B to Agenda Paper 7A for the June 2024 FASB-IASB joint educational meeting summarises key differences between the requirements in IFRS 16 and in Topic 842.

[5] See The Essentials February 2019 for more details.

accordance with IFRS 16, might serve as a proxy for capital expenditure (investing cash outflows).

17. Some users said the *significant judgement* required to determine *lease term and discount rates* negatively affects comparability. But some others said IFRS 16 provides more accurate information than previous methods they used to estimate lease liabilities based on rent expense multiples or the present value of future minimum lease payments that lessees disclosed under IAS 17.

18. A few users expressed concerns about the accounting for *lease renewals* that might cause *volatility* in the balance sheet. In these users' view, the accounting for lease renewals impairs comparability of financial information, even between entities from the same industry with similar business models (for example, airlines—see the preparer feedback in paragraph 27).

19. A few users raised concerns about potential *structuring opportunities* in identifying a contract as a lease versus a service or in having shorter lease terms to reduce on-balance-sheet accounting by lessees. A few users also said entities might include variable lease payments (that do not depend on an index or a rate) in contracts instead of fixed payments to avoid recognition of lease liability or recognise lower amounts of lease liabilities on the balance sheet than they would otherwise have.[6]

20. Users expressed mixed views about the accounting for *variable lease payments* that are not included in the measurement of lease liability (such as those that depend on future sales or use of the underlying asset). See more details in paragraphs 51–53 of Agenda Paper 7C.

21. The IASB expected IFRS 16 to reduce the need for investors and analysts to make adjustments to amounts reported on a lessee's balance sheet and income statement. During outreach, we asked users whether they continue to make adjustments, and if so, what types of adjustments they make. Some users said they continue to adjust

[6] Although there is no similar evidence for entities applying IFRS 16, the academic literature review provides evidence that entities applying Topic 842 increased the use of variable lease payments after the new leases standard became effective (see paragraph 39 of Agenda Paper 7F).

amounts reported in accordance with IFRS 16 for various reasons. Their comments included:

(a) some users make their own estimates of lease liabilities based on the useful life of the asset (whole asset model), rather than the lease term determined applying IFRS 16, to compare economic returns on invested capital. Accordingly, some users suggested the IASB add a requirement to disclose information about the useful life of leased assets (paragraphs 90–92 of Agenda Paper 7C summarise feedback on the disclosure requirements).

(b) lease liabilities are not viewed as debt by all users and some users also disagree with how IFRS 16 changed entities' risk profile from 'operational' to 'financial', hence the need for adjustments to meet users' specific information needs.

(c) many entities have financial covenants (including for new debt issues) based on pre-IFRS 16 metrics, so analysts must adjust figures to align with these covenants, which adds another layer of complexity to financial modelling.

(d) EBITDA is no longer useful as a proxy for cash flows, because it does not include lease expenses. As a result, some users include lease expenses in EBITDA to use it as a proxy for cash flow in their models to value entities.[7]

(e) users need to adjust their models because, in their view, the presentation of leases in the statement of cash flows of entities operating in some industry sectors (such as retail or telecommunications) does not faithfully represent the underlying economics of leases.

(f) IFRS 16 is still a relatively recent Standard. Users need to adjust their models to enable time-series comparisons—for example, if they analyse 10-year time series to compare margins and leverage with the pre-pandemic levels. However, these adjustments will eventually fade away.

[7] However, we also heard comments that there is no longer a need to calculate EBITDAR (Earnings Before Interest, Tax, Depreciation, Amortisation and Rent Expense) because lease expense is already excluded from EBITDA calculations (for those users that consider leases to be a financing transaction).

(g) users need to adjust either information prepared in accordance with IFRS 16 or FASB ASC Topic 842, Leases (Topic 842) to compare entities that apply IFRS Accounting Standards with those that apply US GAAP.

22. In relation to the *costs* of applying IFRS 16, feedback received from users indicates that they were largely as expected when the IASB issued IFRS 16. Many users said differences between IFRS 16 and US GAAP requirements complicate their analyses and comparisons between entities (see paragraphs 15 and 21(g)). Many users commented on initial costs to update their methodologies and models to analyse and compare entities. They said distortion to historical trends required significant effort to analyse financial statements, adjust their models and present the financial information on a comparable basis. The analyses were further complicated because IFRS 16 permits lessees to use different transition options, practical expedients and choices of how to measure lease assets relating to off balance sheet leases when first implementing IFRS 16.

### *Feedback from other stakeholders*

23. Almost all standard-setters, regulators and members of the Interpretations Committee said IFRS 16 is generally *working as intended*, has achieved its objectives and improved the quality of information.

24. However, many preparers said it is *unclear whether IFRS 16 has achieved its objectives* because *for internal management* purposes they need to adjust financial information (in particular presentation of leases in the statement of cash flows and in the income statement) to *reverse the effects of IFRS 16* and they observe that some users of their financial statements also reverse the effects of IFRS 16 in their models. Accordingly, these preparers view the application of IFRS 16 as a compliance exercise with very little to no benefits.

25. On the other hand, some stakeholders (mostly preparers) said IFRS 16 has improved internal controls and coordination between the accounting and business functions. One preparer said the benefits of IFRS 16 outweighed the costs because the entity's

finance function took over controls concerning leases from the operational functions and now maintains registers for leases similar to fixed assets registers.

26. One standard-setter, as well as some preparers from the retail and telecommunications sectors, said the requirement to present lease repayments as *cash outflows* in financing activities does not faithfully represent the substance of leases. In these stakeholders' view, the decision to lease is not a financing decision (or a decision between buying or leasing an asset) but a necessity because certain assets (for example, retail space in a shopping mall or part of a roof leased to install telecommunications equipment) cannot be purchased. Therefore, in their view, lease payments should be presented as cash outflows in operating activities. As a result, these entities adjust IFRS 16 amounts and present APMs. Retailers from Latin America also said in their jurisdiction leases provide operational and legal flexibility—renting retail space is a simple process, and retailers have flexibility to unilaterally terminate a lease contract with a 30-day notice period and an insignificant penalty, such as 3-month rent payments, even if a contract is for a period of 10 years. Because of this flexibility management considers lease payments to be operational expenses and does not consider recognising large lease liabilities on the balance sheet to result in faithful representation of its contractual obligations.

27. A few airlines said they observe *diversity in practice* relating to *discount rates*, *lease terms* and accounting for *sale and leaseback transactions*. In their view, inconsistent accounting for economically similar contracts makes financial statements of peer entities difficult to analyse and compare and might indicate that some aspects of the Standard are not working as intended (see also paragraph 27 in Agenda Paper 7F).

28. A few preparers said that differences between IFRS 16 and Topic 842 significantly reduce comparability and, as a result, increase costs. A few preparers said that, in their view, reporting some leases (for example, leases of office space) as operating leases (similar to the US GAAP model) would be more meaningful.

29. However, despite these comments, most preparers expressed *no appetite for significant changes* to the requirements in IFRS 16. They said, despite the initial challenges, for most matters entities have now developed accounting policies and

processes that work well in practice and any fundamental changes to the Standard could result in further disruption that would not justify the benefits of changes. However, a few other preparers (in particular some retailers from Europe and Latin America) said they would support making substantial changes to the lessee accounting model for the various reasons that we summarise in this section.

30. Almost all preparers we met with from industry sectors that the IASB expected to be among those most affected by IFRS 16 (retail, airlines, telecommunications) said they incurred *high initial costs*, and many said they continue to incur *high ongoing costs* of applying IFRS 16 and see limited benefits from application of IFRS 16 (see also paragraph 24).

31. Many preparers said the *cost of implementation of IFRS 16 was high* (as expected) mainly because they needed:

    (a) to apply the new accounting model to many contracts.

    (b) to apply significant judgement to determine discount rates and lease term.

    (c) to implement expensive IT solutions. Some preparers said there was a lack of fully developed IT solutions when IFRS 16 was being implemented. Some preparers developed their own short-term solutions or workarounds based on Excel spreadsheets. Some others needed to make significant investments in terms of money and other resources to customise software purchased from external suppliers.

32. Some preparers said *ongoing costs* are reasonable. A few preparers said the *elimination of the requirement to determine whether a lease is a finance or an operating lease* has been beneficial as it reduced workload and costs of making, documenting and auditing management judgements.

33. However, many other preparers said that the *ongoing costs* are higher than was expected. Preparers said they incur high ongoing costs:

    (a) to determine lease term and discount rates for each new lease contract.

(b) to apply lease modifications (that both increase and decrease the scope of the lease) in each interim period to thousands of complex lease contracts, which requires determining multiple revised discount rates for many jurisdictions.

(c) to remeasure the lease liability to reflect changes in future variable lease payments resulting from a change in an index or a rate used to determine those payments.

(d) to maintain dual intragroup leases accounting records for separate (or individual) financial statements prepared in accordance with IFRS Accounting Standards and to eliminate intragroup leases in consolidated financial statements at each reporting date, which is complex.

(e) to maintain internal controls over lease accounting processes, including Sarbanes-Oxley controls for entities listed in the US that apply IFRS Accounting Standards (foreign private issuers).

(f) to incur audit costs because auditors need to verify controls, processes and the areas of significant management judgement.

(g) to apply IFRS 3 *Business Combinations*, which is onerous because that Standard requires the acquirer to measure the lease liability (for leases in which the acquiree is the lessee) at the present value of the remaining lease payments as if the acquired lease was a new lease at the acquisition date. Entities might also need to maintain two sets of accounting records, for example, if the acquiree is required to prepare individual financial statements, in which leases would be reported as if the acquisition had not happened (see also paragraphs 3–9 of Agenda Paper 7E).

34. Some preparers said *simplifications* to the requirements in the Standard *might improve financial reporting* and the cost-benefit balance (for example, in relation to accounting for lease modifications and determination of discount rates or lease term—see feedback on these matters discussed in Agenda Paper 7C).

## Staff analysis

35. Overall, most users and almost all standard-setters, regulators and members of the Interpretations Committee said IFRS 16 is working as intended, has achieved its objectives and improved financial reporting. However, almost all preparers said they incurred high initial costs, and many said they continue to incur high ongoing costs of applying IFRS 16 but see limited or no benefits.

36. The actual quantitative effects of changes to lessee accounting were broadly in line with those expected in the Effects Analysis accompanying IFRS 16 (see paragraphs 37–40 of Agenda Paper 7A).

37. The analysts' reports and investor presentations published around the time IFRS 16 was issued (see paragraphs 21–24 of Agenda Paper 7A) discuss expected effects of the application of the Standard and include messages that are similar to the user feedback that we received, for example:

    (a) entities need to exercise judgement to apply IFRS 16, in particular in relation to determining lease term and discount rates, and this makes the analysis of information that entities provide about leases complex and hinders comparability of financial information; or

    (b) mixed views about the usefulness of information about leases presented in statements of cash flows or income statement.

38. Our review of APMs (see paragraphs 30–36 of Agenda Paper 7A) used by FTSE 100 entities highlighted that most entities use APMs that contain lease-related adjustments. The review highlighted that there were different views on whether lease liabilities are financing in nature and these differing views affected how entities defined their net debt measures. Some entities adjusted particular measures of cash flows (the second most commonly used lease-related APM category). Our research also revealed that a few entities use APMs that reverse effects of IFRS 16 and, conversely, a few other entities discontinued the use of APMs that they used in 2018 applying IAS 17, because the application of IFRS 16 rendered the adjustments they were making redundant.

39. Most of the key messages from our review of academic literature relating to the overall assessment of IFRS 16 (see paragraphs 4–10 of Agenda Paper 7F) were rather mixed but, to a varying degree, were in line with the feedback from stakeholders. For example, our academic literature review provides evidence that:

(a) IFRS 16 had a significant effect on entities' financial statements and some performance measures;

(b) transparency of information about leases improved with on-balance-sheet presentation of former operating leases and better disclosures, which also improved the accuracy of analysts' forecasts;

(c) there are mixed views on the effect of IFRS 16 on the comparability of information about leases, with some research reporting improved comparability and some reporting reduced comparability because of significant judgements, such as in determining lease term or discount rates; and

(d) business decisions of some entities were significantly affected by IFRS 16, for example, some entities:

(i) updated their internal controls, IT systems and staffing;

(ii) improved management and investment efficiency for their leases;

(iii) increased the use of variable lease payments in lease contracts and the use of short-term leases; and

(iv) shifted from leasing to purchasing assets.

40. The objective of a PIR is to assess whether the effects of applying the new requirements on users, preparers, auditors and regulators are as intended when the IASB developed those new requirements. The PIR will conclude with the IASB assessing whether the new requirements are overall working as intended, with the benefits to users of information prepared in accordance with IFRS 16 *not significantly* lower than was expected, and the costs of applying the requirements and auditing and enforcing their application *not significantly* greater than was expected.

41. Although most stakeholders said IFRS 16 is generally working as intended, considering the significant effect of IFRS 16 on entities' financial statements, as well as the variety of messages received in our outreach, review of academic literature and additional research, we think asking a broad range of stakeholders for their overall assessment of the Standard in a public consultation would be helpful. Therefore, the staff recommend the IASB ask in the RFI whether the overall objective of IFRS 16 is being met, whether the core principles of the Standard are clear and whether the benefits to users and the costs of applying the requirements are not significantly different than was expected.

42. We note concerns of the many preparers about high ongoing costs of applying some of the requirements in IFRS 16 (paragraph 33). In developing IFRS 16 the IASB expected ongoing costs to be only marginally higher compared to those incurred when applying IAS 17 (see paragraph 8). To help the IASB determine whether the actual effects (costs and benefits) of applying the requirements differ *significantly* from those expected when the IASB issued the requirements, we recommend including in the RFI a specific question on ongoing costs of applying the requirements in IFRS 16. This will help the IASB determine which requirements might give rise to high ongoing costs, the causes of those high costs and possible simplifications that might alleviate those costs together with the potential effects of those simplifications on the benefits of IFRS 16.

43. In relation to user feedback (paragraph 22) and preparer feedback (paragraph 28) relating to differences between IFRS 16 and US GAAP requirements for leases, we note that the IASB and the FASB reached the same conclusions in many areas, including requiring leases to be reported on the balance sheet, how to define a lease and how lease liabilities are measured.[8] However, the IASB and the FASB reached different decisions about the lessee accounting model.[9]

[8] Except that variable lease payments depending on an index or rate are reassessed when those payments change applying IFRS 16, but are not when applying the FASB model.

[9] There are a number of other differences between IFRS 16 and the decisions made by the FASB, primarily because of the different decisions reached on the lessee accounting model. See pages 65–70 of the *Effects Analysis* for the analysis of the effects of differences between IFRS and US GAAP.

44. IFRS 16 applies a single lessee accounting model, which views all leases recognised on the balance sheet as providing finance. The FASB decided upon a dual lessee accounting model, under which a lessee:

    (a) accounts for finance leases (that is, leases previously classified as capital leases) similarly to the IASB model; and

    (b) accounts for operating leases by:

        (i) recognising right-of-use assets and lease liabilities;

        (ii) measuring lease liabilities in the same way as they would be measured applying IFRS 16, but without a requirement to reassess variable lease payments subject to an index or rate;

        (iii) recognising a single lease expense typically on a straight-line basis over the lease term; and

        (iv) presenting total cash paid within operating activities in the statement of cash flows.

45. Because of the different decisions the boards reached, differences arise between IFRS 16 and the FASB model in measuring lease assets, and presenting expenses and cash flows related to leases in the income statement and cash flow statement, which hinders comparability as many users said. The IASB's reasons for requiring a single lessee accounting model are explained in paragraphs BC41–BC56 of the Basis for Conclusions on IFRS 16. In our outreach, stakeholders have not challenged or questioned the validity of these reasons.

46. However, considering the prevalence of comments about comparability and the importance of comparability to users, we think the IASB should seek broader feedback in its public consultation to determine whether there are any potential improvements to the disclosure requirements in IFRS 16 that would help users analyse and make comparisons between entities that apply IFRS 16 and entities that apply Topic 842. To elicit more focused feedback, we think the IASB could explore if users would find useful any of the lessee disclosure requirements in Topic 842 (for example, the requirement to disclose weighted-average discount rate) that are not included in IFRS 16.

## Summary of staff recommendations

47. The staff recommend the IASB include questions in the RFI to assess whether:

    (a) IFRS 16 is meeting its objective and whether its core principles are clear;

    (b) the benefits to users of the information reported in accordance with IFRS 16 and the costs of applying the requirements and auditing and enforcing their application are *not* significantly different than was expected, in particular the ongoing costs; and

    (c) the IASB could make any improvements to the disclosure requirements in IFRS 16 that would help users analyse and compare entities that apply IFRS 16 and entities that apply Topic 842.

## Questions for the IASB

| Questions for the IASB |
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| 1. Do IASB members agree with the staff recommendations in paragraph 47 of this paper? |
| 2. Are there any additional matters related to IFRS 16 as a whole that the IASB should seek feedback on in the request for information? |