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The European Federation
of Financial Analysts Societies

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Contact: Muriel Balda

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Re: EFRAG DCL-
Request for Information – Post-implementation Review IFRS 16 Leases.

Dear Mr. Klinz,

The EFFAS Commission on Financial Reporting (“Commission”, “We”) would like to express its general views on EFRAG’s DCL on the IASB’s – ***Post-implementation Review IFRS 16 Leases.***

We continue to support EFRAG’s comprehensive and high-quality documents albeit we emphasize the need for conciseness and simplicity in the documents.

The Commission’s comments on EFRAG’s DCL are primarily focused on users-related issues and are as follows:

1.- Overall Assessment

The Commission agrees with EFRAG that the standard is generally working well and has largely achieved its objective of improving lease-related financial reporting.

For users, a major milestone of the standard is the requirement for lessees to recognise most leases on the statement of financial position. This requirement provides greater transparency and comparability and is a major improvement compared to the previous off-balance sheet reporting practice. For preparers, we think that the improvement of internal controls and lease monitoring outweighs some higher costs.

In our opinion, some further steps should be considered to (1) clarify the interaction between IFRS 9 and IFRS 15 and to (2) improve guidance on discount rates to simplify lease modification accounting to reduce costs while maintaining transparency.

2.- Usefulness of information resulting from lessees’ application of judgment

We agree that in certain cases determining the lease term, the discount rates and the type of variable lease to be included in the measurement of the lease liability can be challenging.

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***Lease Term***

We agree with EFRAG that the determination of a lease term is in general clearly defined in a lease contract. An entity determines the term of a lease contract based on the length that it considers it will have the rights-of-use to develop its business.

Customarily, entities reassess their option to extend or terminate a lease based on their business model and the given circumstances to meet an expected level of activity. The Commission understands this situation and the need for an entity to adjust the length of the lease. This implies a significant level of judgment. An example of these situations could be the length of mobile phone tower leases, typically about 5 years capitalized, whereas the mobile phone operator is buying government mobile phone licenses of about 20 years.

Nonetheless, we consider that in certain cases entities determining the length of a lease is not consistent with the expectation of the future level of activity. In these cases which might involve a high level of judgment the Commission suggests entities providing additional disclosures. For instance, disclosing the basis for expectations to meet the foreseen level of activity and if this is comparable with their peers' activity. This particular situation of undisclosed key assumptions reduces the comparability of the financial information and makes it difficult for users to assess the completion of the lease term.

Discount Rates

The Commission agrees with EFRAG's comments, paragraph 38, that determining the discount rate or the interest rates implicit in leases can be a main judgmental exercise for preparers. However, even using judgment to determine an entity's borrowing costs IFRS-16 is more accurate than the estimates reported when leases were off-balance-sheet. Since the discount rate determination can be highly judgmental, reducing peer comparability, more disclosures are needed to provide a clearer picture for the users.

In this particular issue, we suggest that (1) the IASB provides guidance related to the type of rate to be used –risk-free rate or borrowing rate- and (2) requires enhanced qualitative and quantitative disclosures and the assumptions and methodology being used in application of the discount rate.

Variable Lease Payments

As noted in EFRAG's DCL, paragraph 46, the Commission agrees that the diversity of variable lease contracts affects the comparability and impacts on entities' results and cash flows.

As proposed by EFRAG, enhanced guidance and examples can mitigate the impact in comparability. Guidance should be provided to distinguish in-substance fixed from variable payments and the alignment of IFRS 9 and IFRS 15 on variable consideration should also be considered. We support additional disclosures about the areas subject to judgment, as indicated in paragraph 48. Moreover, developing an overarching concept of the discount rate across IFRS 16, IFRS 9, and IAS 36 would be helpful.

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Also, material information should be provided when actual leases are treated as services contracts. IFRS 16 provides helpful disclosure on variable leases while there are no disclosures for services contracts. In this regard, the Commission suggests certain points for consideration. See below⁽¹⁾

3.- Information about lessees' lease-related cash flows

As EFRAG points out in paragraphs 55 (b) and (c), we think that additional disclosure enhancement should be required. In certain cases, entities present information on leases in a way that makes it difficult to reconcile the statement of cash flows to the other primary financial statements. Further disaggregation of cash flows and additional disclosures clarifying the difference between the classification of capital and interest related to cash flows should be provided, as this would also improve comparability.

Additionally, providing total lease cash outflow information -currently optional and inconsistently applied-, will give users information that could be reconciled with MPM such as net debt. Providing forward-looking information like expected lease outflows for the next one to five years aligned with the maturity analysis of lease liabilities would also be very helpful

Regarding paragraph 55 (d), we think that reintroducing the distinction between operating and financing leases would be an unnecessary and costly process.

4.- Potential improvements to future transition requirements

Although restating retrospectively information could be useful for comparative purposes, the Commission considers that the information provided by entities is adequate and generally allows to understand the impacts of the implementation of IFRS 16. As noted in paragraph 69 of EFRAG's DCL we find*useful the requirement for lessees to reconcile lease liabilities recognized in accordance with IFRS 16.....*

5.- Other comments

For leases related to technology such as software and cloud services, we think that providing examples, guidance and alignment between IAS 38 and IFRS 15 would be helpful.

If you would like to discuss the views expressed in this letter further, please contact us.

Javier de Frutos, Chair

EFFAS Commission on Financial Reporting

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Note (1)

As reference, we are indicating certain disclosures related to services contracts under IFRS 16 that could be useful for discussion.

(1) Expanded guidance on separating lease vs. service components:

Adding illustrative examples for industries particularly related to technology and define “substantive substitution rights” and “substantially all economic benefits” more clearly.

(2) Specific disclosure requirements for service elements in contracts:

- a) Disclose the accounting policy applied to the separation of components.*
- b) Present quantitative information: total service expenses linked to lease arrangements.*
- c) Provide qualitative disclosures: rationale for classification as service vs. lease.*

(3) Disclosure of material judgments

- d) Require disclosure of key judgments in classifying contracts.*
- e) For example, why a PPA is considered a lease vs. service contract.*

(4) Comparability with IFRS 15

- a) Link service contract disclosures under IFRS 16 with performance obligation disclosures under IFRS 15, so users can reconcile them.*

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