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The Chair
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Dr Wolf Klinz
EFRAG FRB Chair
European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: EFRAG's due process on the IASB's Request for Information on the Post Implementation Review of IFRS 16

Dear Dr Klinz,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process with regards to the IASB's Post Implementation Review (PIR) of IFRS 16 *Leases*. We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRS in the European Union.

ESMA strongly supports PIRs as an opportunity to assess how issuers apply in their financial statements the IFRS requirements and how these can be further improved to address any issues that may challenge consistent application, enforceability and usefulness to users of financial statements.

Our responses to the IASB's Request for Information (IASB/RFI/2025/1) are based on the evidence from supervision and enforcement activities undertaken by European enforcers on financial statements, as well as on discussions with preparers of financial statements, users, academics and auditors.

ESMA considers that the application of IFRS 16 has led to improved transparency by providing more relevant and comparable information about lease contracts. By requiring the recognition of assets and liabilities arising from all lease contracts (except for short-term leases) the standard enhanced the usefulness of financial statements as a basis for investor decision-making. ESMA, like EFRAG, finds that the standard met, to a large extent, its objective to ensure that lessees and lessors provide relevant information about their leases in a manner that faithfully represents those transactions. ESMA also heard from stakeholders that implementing the requirements of IFRS 16 entailed significant implementation costs and efforts, and, for this reason, many would prefer to avoid significant changes to the standard.

Nevertheless, there are still some limited areas where improvements of the financial reporting of leases are expected to reduce diversity in practice and improve comparability of financial statements and enforceability of IFRS standards. This applies notably to the following high-priority areas:

- accounting treatment of transactions involving single underlying assets held within a legal entity (corporate wrapper);
- clarification as to whether a lessor's forgiveness of lease payments contractually due with no other modifications to the lease term should be treated by lessees as an

extinguishment of a liability under IFRS 9 *Financial Instruments* or accounted for as a modification in accordance with the requirements of IFRS 16;

- accounting for major maintenance costs incurred by companies that lease transportation assets, such as aircraft;
- the distinction between a lease and an in-substance purchase as well as the transfer of control of an asset in the context of a sale and leaseback transaction.

Our detailed responses are included in the Appendix to this letter.

In case you have any questions or comments please do not hesitate to contact me or Isabelle Grauer-Gaynor, Head of the Corporate Finance and Reporting Unit (Isabelle.Grauer-Gaynor@esma.europa.eu).

Yours sincerely,

[signed]

Verena Ross

Appendix

1 Overall assessment of IFRS 16

Question 1 – Overall assessment of IFRS 16
(a) In your view, is IFRS 16 meeting its objective (see page 9) and are its core principles clear? If not, please explain why not.
(b) In your view, are the overall improvements to the quality and comparability of financial information about leases largely as the IASB expected? If your view is that the overall improvements are significantly lower than expected, please explain why.
(c) In your view, are the overall ongoing costs of applying the requirements and auditing and enforcing their application largely as the IASB expected? If your view is that the overall ongoing costs are significantly higher than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.

1. ESMA considers that the application of IFRS 16 requirements resulted in the overall improvement of relevance and comparability of financial information about lease contracts and the standard met its objective to a large extent. Elimination of the off-balance-sheet financing and shifting the P&L presentation to depreciation and interest recognition rather than a single lease expense, improved analysis of lessees' EBITDA and debt service capabilities, even if ESMA notes that some issuers continue to make use of pre-IFRS 16 metrics. ESMA agrees with EFRAG that one of the reasons contributing to this development appears to be the significant discretion applied in determining the lease term under IFRS 16 (see also our response to Question 2). Market participants are relying on adjusted performance measures to better isolate the effects of this discretion and improve the comparability across entities.

2. However, discussions among national enforcers and feedback from constituents[1] indicate that there are still some areas where improvements of the financial reporting of leases can be achieved. This relates in particular to interactions of IFRS 16 with some other standards (e.g. IFRS 10 *Consolidated Financial Statements*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 9 *Financial Instruments* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) and to the application of judgement in connection with the transfer of control.

3. When answering the subsequent questions, ESMA focused on the areas where the current requirements in IFRS 16 or the absence of specific guidance pose significant challenges for enforcement and supervision, significantly impair the comparability of the information provided to users of financial statements or lead to diversity in practice.

[1] Consultative Working Group for Corporate Reporting of the ESMA Issuers Standing Committee.

2 Usefulness of information resulting from lessees' application of judgement

Question 2 – Usefulness of information resulting from lessees' application of judgement
(a) Do you agree that the usefulness of financial information resulting from lessees' application of judgement is largely as the IASB expected? If your view is that lessees' application of judgement has a significant negative effect on the usefulness of financial information, please explain why. **(b) Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.** **(c) If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain:** **(i) what amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or** **(ii) what additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs).**

4. While ESMA does not consider that the exercise of judgement by lessees generally undermines the usefulness of financial information (especially when there is an appropriate level of transparency on how such judgement was exercised), it is of the view that additional guidance could be useful in the assessment of the lease term to provide a better basis for entities to make appropriate judgements. This relates, for example, to determining whether the exercise of options to extend/terminate the lease is reasonably certain. ESMA also considers that additional requirements/examples could help improve transparency and comparability of lessee reporting.

3 Usefulness of information about lessees' lease-related cash flows

Question 3 – Usefulness of information about lessees' lease-related cash flows
Do you agree that the improvements to the quality and comparability of financial information about lease-related cash flows that lessees present and disclose are largely as the IASB expected? If your view is that the improvements are significantly lower than expected, please explain why.

5. ESMA reiterates the importance of better transparency about the effect of non-cash movements arising from transactions such as leases as previously highlighted in its comment letter on the IASB's Third Agenda Consultation[2]. ESMA therefore supports the suggestions made by other stakeholders to require entities to provide information about

[2] esma32-61-457_third_agenda_consultation_letter_to_the_iasb.pdf

non-cash transactions related to the initial recognition of leases to improve comparability between entities that lease assets and entities that borrow funds to buy assets.

6. ESMA acknowledges that it can be questioned whether the classification of certain lease-related cash flows, in particular reimbursement of the principal portion of lease liabilities by lessees in situations where assets can only be leased and not purchased, as cash flows from financing activities (and not as operating cash flows) truly reflects the substance of these transactions. However, in many other situations, presenting these payments as financing cash flows ensures comparability between entities that lease assets and those entities that finance the purchase of similar assets. Consequently, ESMA has reservations about whether amending the existing IFRS requirements to allow the presentation of all repayments of the principal of lease liabilities as cash flows from operating activities would increase the quality and usefulness of financial reporting. By contrast, requiring different presentation of cash flows based on the specific characteristics of lease transactions would result in reduced comparability and, depending on how the criteria are defined, may lead to enforcement challenges and increased diversity in practice. Finally, ESMA considers that these questions would be better addressed within the IASB's ongoing project "Statement of Cash Flows and Related Matters".

4 Ongoing costs for lessees of applying the measurement requirements

Question 4 – Ongoing costs for lessees of applying the measurement requirements
(a) Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected? If your view is that the ongoing costs are significantly higher than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.
(b) If your view is that the ongoing costs are significantly higher than expected, please explain how you propose the IASB reduce these costs without a significant negative effect on the usefulness of financial information about leases.

7. ESMA does not have any comments on this question and expects that preparers would be in a better position to provide information about ongoing costs of applying the measurement requirements in IFRS 16.

5 Potential improvements to future transition requirements

Question 5 – Potential improvements to future transition requirements
Based on your experience with the transition to IFRS 16, would you recommend the IASB does anything differently when developing transition requirements in future standard-setting projects? If so, please explain how your idea would ensure:

(a)	**users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows; and**
(b)	**preparers can appropriately reduce their transition costs when implementing new requirements for the first time.**

8. ESMA acknowledges that rigorous application of the full retrospective approach prescribed for the new IFRS requirements in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* could, in certain cases, be impracticable or entail significant costs. At the same time, ESMA notes that the availability of multiple transition options and practical expedients may also undermine comparability across entities and periods and may impair users' ability to fully understand the impact of new accounting requirements on the financial statements.

9. Therefore, ESMA urges the IASB to carefully evaluate, in the context of future standard-setting projects, whether granting exemptions from the full retrospective approach is justified by placing emphasis on the consistency, transparency, and comparability of financial information for users.

6 Other matters relevant to the assessment of the effects of IFRS 16

Question 6.1 – Applying IFRS 16 with IFRS 9 to rent concessions	
(a)	**How often have you observed the type of rent concession described in Spotlight 6.1?**
(b)	**Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?**
(c)	**If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.**

10. ESMA has observed several instances in the past where rent concessions involved solely the lessor's forgiveness of lease payments contractually due from the lessee, with no other modifications to the lease term. While such concessions were predominantly granted during periods of economic stress (e.g. the COVID-19 pandemic) and appear to be less common during normal economic conditions, ESMA considers that clarity should be provided by the IASB as to whether these rent concessions should be treated by lessees as an extinguishment of a liability under IFRS 9 or accounted for as a modification in accordance with the requirements of IFRS 16[3]. Having this clarity is important as during periods of economic turbulence, which tend to recur, consistent and comparable financial reporting becomes especially important to investors and creditors.

[3] See also ESMA's comment letter on the IASB's ED Annual Improvements – Volume 11.

Question 6.2 – Applying IFRS 16 with IFRS 15 when assessing whether the transfer of an asset in a sale and leaseback transaction is a sale

(a) How often have you observed difficulties in assessing whether the transfer of an asset in a sale and leaseback transaction is a sale?

(b) Have you observed diversity in seller–lessees' assessments of the transfer of control that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

(c) If your view is that the IASB should act to help seller–lessees determine whether the transfer of an asset is a sale, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs

11. ESMA and enforcers discussed cases where significant judgement was required to assess whether control of an asset (e.g. land and buildings) was transferred in the context of a sale and leaseback transaction. ESMA observed that this assessment is particularly difficult when the contractual terms of the lease cover a substantial portion of the economic life of the asset and the legal lessee retains significant risks and rewards associated with ownership of the asset. Therefore, ESMA would consider additional guidance or/and examples from the IASB on how to assess whether the transfer of an asset in a sale and leaseback transaction qualifies as a sale to be very useful.

12. ESMA considers, however, that the most pertinent accounting issue related to sale and leaseback transactions – one that results in significant diversity in practice – is the accounting treatment of transactions involving single underlying assets held within a legal entity (single asset entity or corporate wrapper). While some entities recognise the gain from the transaction in full applying IFRS 10, others apply IFRS 16 requirements and recognise only the amount of the gain that relates to the rights transferred to the buyer of the asset[4]. This impairs transparency and leads to a lack of comparability.

13. ESMA is aware that this issue has previously been discussed by the IFRS Interpretation Committee and referred to the IASB, which has not yet decided whether to add a project on the accounting for sale and leaseback of an asset in a single-asset entity to its work plan. ESMA reiterates its view expressed in the past[5] that the interplay between IFRS 10 and IFRS 16 as well as some other IFRS standards (e.g., IFRS 15, IAS 40) in the context of various types of construction projects and contracts, where the asset (real estate or other types of assets such as wind power plants, solar panels, or product rights in the pharmaceutical industry) is packaged in companies for tax-free disposal, should be addressed by the IASB in a timely manner either as part of the PIR of IFRS 16 or as an separate project.

[4] See Decision ref EECS/0123-01 in ESMA's 27th Extract from the EECS's Database of Enforcement.
[5] See ESMA's comment letter on the Request for Information on the PIR IFRS 15 and ESMA's report On the application of IFRS 10, IFRS 11 and IFRS 12.

Question 6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction
(a) Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information? **(b) What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ significantly from those expected?** **(c) If your view is that the IASB should improve the cost–benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution**

14. ESMA does not have any comments on this question.

Question 6.4 – Other matters relevant to the assessment of the effects of IFRS 16
Are there any further matters the IASB should examine as part of the postimplementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

Accounting for major maintenance costs incurred by companies using transportation assets under lease contracts

15. ESMA notes that significant diversity in practice exists regarding the accounting treatment of major maintenance costs incurred by companies that lease transportation assets, such as aircraft. The differences primarily relate to substantial components of leased assets (e.g. engines) that must meet specified minimum performance conditions and to maintenance costs assessed as avoidable on inception of the lease (these costs are deemed avoidable because, in the absence of transportation activity, there is no obligation to undertake such maintenance).

16. In practice, some issuers use the 'provision approach' and build up the provision until the next maintenance event with a corresponding charge to the income statement. When the maintenance or overhaul event occur, the associated provision is derecognised. Other issuers apply the 'components approach', whereby the maintenance costs are recognised when the obligation for those costs is incurred applying paragraphs 24(d) and 25 of IFRS 16 as part of the cost of the right-of-use asset. Under this approach, the expense is recorded through depreciation of the right-of-use asset over the period to the next maintenance or the end of the lease.

17. ESMA considers it important to clarify which of the two approaches is appropriate under IFRS 16, in order achieve consistent application and enhance comparability of financial statements.

Distinction between a lease and an in-substance purchase of an asset

18. ESMA has been informed that the distinction between a lease and an in-substance purchase of an asset (a contract that transfers control over the underlying asset) often poses difficulties in practice. Assessing control over the underlying asset can be particularly challenging in cases where the lease term approximates the asset's useful life and renewal options exist.

19. ESMA acknowledges that the IASB discussed this issue during the development of IFRS 16 (as mentioned in the Basis for Conclusions of IFRS 16) and noted that the accounting for leases that are similar to the sale or purchase of the underlying asset would be similar to that for sales and purchases applying the respective requirements of IFRS 15 and IAS 16. However, ESMA notes that qualifying contracts as in-substance purchases may affect the classification of the lease-related cash flows (investing cash flows vs. financing cash flows). In addition, ESMA notes that, unlike IFRS 16, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* do not specify how to measure the cost of an asset acquired through a contract that includes variable payments.

20. Against this background, ESMA suggests that the IASB clarifies the distinction between a lease and an in-substance purchase of an asset.

Interaction with the impairment requirements

21. In relation to the interaction between IFRS 16 and the impairment requirements in IAS 36 *Impairment of Assets*, ESMA observed uncertainty regarding the treatment of lease liabilities when right-of-use assets are included in the carrying amount of a cash-generating unit, which can lead to inconsistent impairment assessments[6]. Additionally, ESMA notes that the different discount rate concepts under IFRS 16 and IAS 36 can result in mismatches that affect the reliability of impairment evaluations. Even though these issues may not be considered a high-priority area given that practical solutions have emerged in practice (e.g., guidance from audit firms), ESMA encourages the IASB to develop clearer requirements and/or examples to address these issues and promote consistency in application.

[6] See Decision ref EECS/0122-07 in ESMA's 26th Extract from the EECS's Database of Enforcement.