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STAFF PAPER

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IASB® Meeting

Project	**Comprehensive review of the *IFRS for SMEs*® Standard**
Paper topic	New IFRS Standards—IFRS 16 *Leases*

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Purpose

1. As outlined in agenda paper 30A of this meeting, the purpose of this paper is to demonstrate how the alignment principles would be applied when determining whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards.

2. This paper is for educational purposes only. At a future meeting, we will ask the International Accounting Standards Board (Board) if the Request for Information should seek views on a proposal to align the *IFRS for SMEs* Standard with IFRS 16 *Leases* and on the proposed simplifications to IFRS 16 for this purpose.

3. Agenda paper 30A of this meeting provides the background to the 2019 comprehensive review of the *IFRS for SMEs* Standard (2019 Review).

Structure of this paper

4. This paper is structured as follows:

   (a) background (paragraphs 5–9):

      (i) overview of IFRS 16 *Leases* (paragraphs 5–8);

      (ii) overview of Section 20 *Leases* (paragraph 9);

   (b) application of the alignment principles (paragraphs 10–59);

      (i) principle 1—Relevance to SMEs (paragraphs 12–17);

   (ii) principle 2—Simplicity (paragraphs 18–54);

   (iii) principle 3—Faithful representation (paragraphs 55–59);

(c) stakeholder views (paragraphs 60–67);

(d) other considerations (paragraphs 68 and 69);

(e) Appendix A—Summary of SMEIG members' views on whether to align the *IFRS for SMEs* Standard with IFRS 16 *Leases*; and

(f) Appendix B—Overview of Section 20 and differences between IAS 17 and Section 20.

Background

Overview of IFRS 16 Leases

5. In January 2016 the Board issued IFRS 16 and completed its project to improve financial reporting for leases. IFRS 16 superseded IAS 17 *Leases* and became effective on 1 January 2019.

6. IFRS 16 was issued after the 2012 Comprehensive Review of the *IFRS for SMEs* Standard was completed. The Board has not previously considered aligning the *IFRS for SMEs* Standard with IFRS 16.

7. IFRS 16 eliminates the requirement for lessees to classify leases as either operating leases or finance leases. Instead, IFRS 16 requires a single model for the accounting for leases and requires recognition of all lease obligations. There are some limited optional recognition exemptions for short-term leases and leases of low-value assets.

8. IFRS 16 retains the IAS 17 requirements for lessor accounting. However, there is new guidance for lessors on the definition of a lease, a sublease and on the accounting for sale and leaseback transactions.

Overview of Section 20 Leases

9. Section 20 of the *IFRS for SMEs* Standard is largely based on IAS 17, except for some minor differences. A list of these differences and an overview of the requirements of Section 20 are provided in Appendix B of this paper.

Application of the alignment principles

10. At its March 2019 Board meeting (Agenda Paper 30), the staff proposed that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, the Board could apply three principles:

    (a) Relevance;

    (b) Simplicity; and

    (c) Faithful representation.

11. The following paragraphs demonstrate how the alignment principles can be applied to IFRS 16 (paragraphs 12–59).

Principle 1—Relevance

12. Leasing is widely used by SMEs. The 2015 SAFE Report[1] ranked leasing as the third most important source of financing after lines of credit and bank loans to SMEs. Further, according to the 2015 report *The Use of Leasing Amongst European SMEs*, about 40% of SMEs use leases and about 17% of SMEs' total investment is financed by leasing.[2]

13. The Effects Analysis of IFRS 16 states that

> …the Standard is the Board's response to concerns about the lack of transparency of the information provided about lease obligations. That lack of transparency made it difficult for

[1] EU Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, *Survey on the access to finance of enterprises (SAFE)—Analytical Report 2015*.

[2] Leaseurope, *The Use of Leasing Amongst European SMEs*, 2015.

investors and others to obtain an accurate picture of a company's assets and financial leverage, and to properly compare companies that borrow to buy assets with those that lease assets. The Board concluded that IFRS 16 will result in a more faithful representation of a company's assets and liabilities and greater transparency about the company's financial leverage and capital employed. This is expected to:

(a) reduce the need:

(i) for investors and analysts to adjust amounts reported on a lessee's balance sheet and income statement; and

(ii) for companies to provide 'non-GAAP' information about leases. IFRS 16 provides a richer set of information than was available applying IAS 17, giving further insight into a company's operations.

(b) improve comparability between companies that lease assets and companies that borrow to buy assets.

(c) create a more level playing field for market participants by providing transparent information about leases. A company applying IFRS 16 will more accurately measure assets and liabilities arising from leases than estimates made by sophisticated investors and analysts for companies applying IAS 17. This information is helpful to users making lending and other credit decisions.

14. A lease conveys the right to control the use of an asset in exchange for a payment obligation. Applying IFRS 16, this right and the related liability are recognised in the statement of financial position whether the lease is an operating or finance lease.

15. Considering the prevalence and importance of lease financing to entities applying the *IFRS for SMEs* Standard, and given the benefits of IFRS 16 as set out in the Effects Analysis of that Standard, the staff is of the view that the benefits are relevant to users of financial statements prepared applying the *IFRS for SMEs* Standard.

16. Financial statements prepared using the aligned Standards would provide consistent, relevant and more accurate information about lease liabilities and financial leverage.

17. The staff therefore believes that IFRS 16 is relevant to entities applying the *IFRS for SMEs* Standard.

The Board will be asked to affirm staff's recommendation in a future Board meeting.

Principle 2—Simplicity

18. Requiring a single lessee accounting model could be viewed as a simplification as users of SMEs' financial statements will no longer have to analyse two separate accounting treatments for operating and finance leases (except where exemptions apply).

Implementation costs

19. The Effects Analysis of IFRS 16 states that implementation costs will depend on:
    (a) the size of a company's portfolio of leases;
    (b) the terms and conditions of its leases; and
    (c) the systems it already has in place to account for leases.

20. The Effect Analysis also states:

> …The IASB expects that companies with material off balance sheet leases will incur costs to (a) set up systems and processes, including educating staff; (b) determine the discount rates used to measure lease assets and lease liabilities on a present value basis; and (c) communicate changes to reported information to external parties. Once a company has updated its systems to provide the information required by IFRS 16, the IASB expects costs to be only marginally higher compared to those incurred when applying IAS 17. The data required to apply IFRS 16 is similar to that needed to apply IAS 17, with the exception of discount rates that are required for all leases when applying IFRS 16.

21. Given what the Board has said in the Effect Analysis of IFRS 16, staff do not expect the costs of implementation of a simplified version of IFRS 16 to be significant for entities applying the *IFRS for SMEs* Standard.

Simplifications in IFRS 16

22. IFRS 16 already permits some simplifications, including:

    (a) specific recognition exemptions for:

        (i) leases of 12 months or less (short-term leases); and

        (ii) leases of low-value assets.[3]

    (b) other simplifications and practical expedients, such as:

        (i) exempting entities from the requirement to separate a lease component from any associated non-lease components[4],

        (ii) simplifying measurement requirements for some variable lease payments, and for optional payments, such as those relating to extension options.

23. The Board stated in the Effect Analysis that these exemptions, simplifications and practical expedients would provide substantial cost relief for potentially high volumes of leases without any significant effect on the improvements introduced by IFRS 16.

24. The staff notes that the simplifications already included in IFRS 16 can be included in the *IFRS for SMEs* Standard and provide cost reliefs to entities applying the Standard.

The Board will be asked in a future Board meeting if they agree to include the simplifications in IFRS 16 into the *IFRS for SMEs* Standard.

[3] IFRS 16 paragraph 5.

[4] IFRS 16 paragraphs 12 and 15.

Additional simplifications to IFRS 16 for the IFRS for SMEs Standard

25. The staff proposes that the following additional simplifications can be introduced into the *IFRS for SMEs* Standard, when aligning with IFRS 16:

   (a) removing the quantitative threshold for low value assets and introducing a list of examples to assist companies identifying such assets (paragraphs 27–34);

   (b) providing additional relief to assist entities with identifying the discount rate to be applied when determining the liability (paragraphs 35–39);

   (c) providing additional relief to assist entities with determining and reassessing the lease term (paragraphs 40–44);

   (d) simplifying the requirements for subsequent measurement (reassessment) of lease liability (paragraphs 45–48);

   (e) retaining the existing finance lease disclosures applying the *IFRS for SMEs* Standard (paragraphs 49–52); and

   (f) simplifying the language of the Standard (paragraph 53).

26. The staff believes that these additional simplifications to IFRS 16 will significantly reduce complexity.

Removing the quantitative threshold for low value assets

27. The Board explained in the Basis for Conclusions to IFRS 16 that in deciding on the exemption

> …the IASB had in mind leases of underlying assets with a value, when new, in the order of magnitude of US$5,000 or less.[5]

28. The reference to a quantitative amount in the Basis for Conclusions is intended to help companies identify leased assets that might be captured by the exemption.

29. Furthermore, the quantitative threshold addressed some of the operationality concerns raised by outreach participants when the Board developed the

[5] IFRS 16, Basis for Conclusions paragraph BC100.

exemptions. It is intended to provide context for the Board's decision at the time that it was made.

30. The staff believes there are three options the Board could consider in aligning the *IFRS for SMEs* Standard with IFRS 16:

    (a) retaining the quantitative threshold either at the IFRS 16 level, or set a lower level;

    (b) retaining the principle of low-value assets and provide an indicative list of assets that are typically expected to qualify as low-value assets. The list of low-value assets could include items such as tablets and personal computers, small items of office furniture and telephones; or

    (c) eliminating the relief.

31. The staff does not believe a quantitative threshold is appropriate for entities applying the *IFRS for SMEs* Standard, given the diversity in the size of entities eligible to apply the Standard. The existing threshold of US$5,000 is more likely to be considered material for smaller entities applying the *IFRS for SMEs* Standard that entities applying full IFRS Standards, whilst an alternative threshold will be arbitrary. Arguably, the exemption is already familiar to entities applying full IFRS Standards, therefore, the threshold is no longer needed.

32. The staff also believes that the same concerns that arose during the development of IFRS 16 with regard to the costs of capitalising low-value assets are relevant for entities applying the *IFRS for SMEs* Standard, and consequently does not support eliminating the relief. Accordingly, providing relief for these leases has the potential to provide significant cost relief whilst not losing a significant amount of useful information.

33. The staff therefore supports option (b)—retaining the exemption and providing an indicative list of assets. This option simplifies the application of the low-value assets exemption. Staff believe most items that would qualify for the low-value assets exemption can be covered by the list. Consequently, entities applying the *IFRS for SMEs* Standard would have to assess materiality only for the few items not included in the list.

34. As noted in paragraph 22, staff also support retaining the IFRS 16 exemption for short-term leases unmodified in the *IFRS for SMEs* Standard.

Determining the discount rate

35. IFRS 16 requires lease payments to be discounted using the interest rate implicit in the lease, if that can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.[6]

36. The Board explained in the Basis for Conclusions to IFRS 16:

> … the IASB noted that it is likely to be difficult for lessees to determine the interest rate implicit in the lease for many leases, particularly those for which the underlying asset has a significant residual value at the end of the lease, for example, property leases.[7]

37. The Effects Analysis of IFRS 16 acknowledge that companies with material off-balance sheet leases are expected to incur costs to measure lease assets and lease liabilities at the present value of future lease payments mainly due to the need to determine a discount rate for each lease (other than short-term leases and leases of low-value assets).

38. To address concerns about the cost to entities applying the *IFRS for SMEs* Standard in determining discount rates, staff proposes the *IFRS for SMEs* Standards to require:

    (a) lease payments to be discounted using the interest rate implicit in the lease, if that can be readily determined; or

    (b) use the lessee's incremental borrowing rate.

    If (a) and (b) cannot be readily determined, the lessee shall determine the rate used to discount lease payments by reference to market yields at the end of the reporting period on high quality corporate bonds.

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[6] IFRS 16 paragraph 26.

[7] IFRS 16 Basis for Conclusions paragraph BC161

39. Staff recommend the option to use a discount rate by reference to market yields on high quality corporate bonds because such a rate reflects the time value of money and includes a risk allowance for the risk associated with the liability and hence such a discount rate is appropriate to discount the lease liability.

Lease term

40. IFRS 16 states:

> …the lease term is the non-cancellable period of a lease, together with both:
>
> (i) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
>
> (ii) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.[8]
>
> In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease...[9]

41. There is no definition of lease term currently in Section 20 of the *IFRS for SMEs* Standard. Two possible approaches are:

(a) retain the current approach of Section 20 of not defining the lease term; or

(b) simplify the IFRS 16 definition of lease term.

42. The staff do not recommend approach (a) as incorporating IFRS 16 into the *IFRS for SMEs* Standard is expected to result in an increase in lease assets and financial liabilities. Staff think this will include property leases, where the underlying asset will have a high residual value and lease agreements may include more complex terms regarding the lease term. Consequently, it would

[8] IFRS 16 paragraph 18.

[9] IFRS 16 paragraph 19.

help preparers to apply the *IFRS for SMEs* Standard if there is a definition of lease term.

43. The staff recommend simplifying the definition of lease term by changing it to 'the non-cancellable period for which an entity is required to comply with the lease'. Any subsequent extension to the lease term shall be accounted for as a new lease.

44. This simplification will make it simple and easy for entities applying *the IFRS for SMEs* Standard to determine the lease term. Staff think determining the lease term using the simplified definition will not likely to result in a significantly different lease term applying IFRS 16 in most cases.

Subsequent measurement (reassessment) of the lease liability

45. IFRS 16 requires a lessee to remeasure the lease liability if there is a change in:[10]

    (a) the lease term (using a revised discount rate);[11]

    (b) the assessment of a purchase option (using a revised discount rate);[12]

    (c) the amounts expected to be payable under residual value guarantees (using an unchanged discount rate);[13] and

    (d) future lease payments resulting from a change in an index or rate used to determine those payments (using an unchanged discount rate).[14]

46. The Effects Analysis noted that the Board simplified the reassessment requirements and, consequently, concluded that the entity would be unlikely to need to reassess many lease liabilities. Nonetheless, because some lease liabilities would be reassessed, the Board expected some companies to incur costs to remeasure lease liabilities.

[10] IFRS 16 paragraph 39.

[11] IFRS 16 paragraph 40(a).

[12] IFRS 16 paragraph 40(b).

[13] IFRS 16 paragraph 42(a).

[14] IFRS 16 paragraph 42(b).

47. The Board formed the view that, even when a lease contains options for extension or termination, remeasurement of the lease liability is unlikely to be onerous because the threshold for reassessment is high. In essence, IFRS 16 requires reassessment of the lease term after its initial determination only when the company takes actions that could significantly affect the lease term. Accordingly, changes to the lease term—and thereby a reassessment of the discount rate and lease payments—are expected only in a small number of cases.

48. The staff thinks IFRS 16 requirements for subsequent measurement (reassessment) of the lease liability could be simplified by requiring a lease to be remeasured in the event of a substantive change in the expected term of the contract. For any other change, the effect of the change must be reflected in the income statement for the period in which it is recognised. Consequently, the staff do not propose the *IFRS for SMEs* Standard to include guidance on paragraph 45(b) to 45(d) above.

Disclosure for lessees

49. The objective of IFRS 16's disclosure requirements is that the notes to the financial statements—together with the statement of financial position, statement of profit or loss and statement of cash flows—provide users with a basis for assessing the effects leases have on the financial position, financial performance and cash flows of lessees.

50. The disclosure requirements applying IFRS 16 are significantly more onerous than those applying Section 20.[15] Further, IFRS 16 specifies an overall objective for lessee disclosures.[16]

51. Staff have identified two possible approaches for disclosures:

    (a) substantially reduce the disclosure requirements of IFRS 16 for inclusion in the *IFRS for SMEs* Standard to take account of users' needs and cost-benefit considerations; or

[15] Compare IFRS 16 paragraphs 51–60 to Section 20 paragraph 20.13 on disclosure requirements.

[16] IFRS 16 Basis for Conclusions paragraph BC215.

(b) retain the current disclosure requirement in Section 20 for finance leases for lessee only.

52. Staff is of the view that the current disclosure for finance leases as set out in Section 20 for lessee is not 'broken'. Consequently, staff supports retaining the current, rule-based approach to disclosure in Section 20, which is working well in practice.

Simplifying the language of the Standard

53. Simplifying the language used in the *IFRS for SMEs* Standard can make the Standard easier for entities applying the *IFRS for SMEs* Standard to understand and apply. For example, IFRS 16 mentions variable lease payments in several places and uses quite complex definitions and explanations of how to measure variable lease payments. The Standard includes a whole section on in-substance fixed lease payments.[17] In contrast, Section 20 requires a lessee to charge contingent rents as expenses in the periods in which they are incurred.[18]

Recommendation

54. The staff think the above simplifications to IFRS 16 are needed for entities applying the *IFRS for SMEs* Standard. The staff recommend the simplifications in paragraph 25 to be incorporated into the *IFRS for SMEs* Standard.

The Board will be asked if it agrees with the simplifications proposed by staff in this paper at a future Board meeting.

Principle 3—Faithful representation

55. The analysis relating to principle 1 in this paper sets out the staff's view that the transparency and comparability provided by IFRS 16 is relevant to entities applying the *IFRS for SMEs* Standard. In applying principle 2, the staff proposed simplifications to be introduced if Section 20 and IFRS 16 are aligned. In this

[17] IFRS 16 paragraph B42.

[18] Section 20 paragraph 20.11.

section, the staff analyses whether financial statements prepared applying the proposed simplifications would provide information that faithfully represents a lessee's assets and liabilities.

56. At the commencement date, a lessee obtains the right to use an underlying asset for a period of time, and the lessor delivers that right by making the asset available for use by the lessee.

57. Aligning the *IFRS for SMEs* Standard with IFRS 16 after incorporating the additional simplifications proposed in this paper will require a lessee to recognise assets and liabilities for the rights and obligations created by leases (with limited exceptions).

58. This approach will provide useful information to users of the entity's financial statements and will result in a more faithful representation of a lessee's assets and liabilities than the current Section 20.

59. The staff believes the additional simplifications proposed in this paper will not reduce faithful representation as outlined below:

	Proposed additional simplifications	Impact on faithful representation
(a)	Low value assets (paragraphs 27–34)	The cost of recognising the right-of-use assets and lease obligations of low-value assets exceeds the benefits with potentially little effect on reported information. Providing an indicative list of assets which would qualify for the low value exemption would make application of the exemption easier for entities applying the *IFRS for SMEs* Standard and will still capture the items intended by IFRS 16 and therefore will still provide a faithful representation.
(b)	Discount rate (paragraphs 35–39)	The objective in specifying the discount rate to apply to a lease is to specify a rate that reflects how the contract

		is priced.[19] The discount rate should reflect the time value of money and the risk associated with the liability. The rate of return for high quality corporate bond reflects the time value of money and a small premium for risk. Hence, such a rate is a proxy of the average borrowing rate. Consequently, it provides a faithful representation of the lease liability.
(c)	Lease term (paragraphs 40–44)	Staff think simplifying the lease term to 'the non-cancellable period for which an entity is required to comply with the lease' in the *IFRS for SMEs* Standard will not likely to result in a significantly different lease term applying IFRS 16 in most cases.
(d)	Disclosure (paragraphs 49–52)	The existing disclosure requirement of finance leases for lessees is not broken. Therefore, the staff's proposal to substantially carry forward the Section 20 finance lease disclosure requirements for lessee will provide relevant information to users of SMEs' financial statements.
(e)	Simplifying language (paragraph 53)	Simplified redrafting will not change the principles of IFRS 16.

The Board will be asked at a future Board meeting if it agrees that the outcome of the simplifications still provide faithful representation.

[19] IFRS 16 Basis for Conclusions paragraph 160

Stakeholder views

60. In February 2019 the staff asked members of the Small and Medium-sized Entities Implementation Group (SMEIG) for their views on whether to align the *IFRS for SMEs* Standard with IFRS 16.

61. A summary of their responses is set out in Appendix A. SMEIG members were not asked whether they support or object to aligning the *IFRS for SMEs* Standard with IFRS 16.

62. The main objection raised by SMEIG members against incorporating IFRS 16 into the *IFRS for SMEs* Standard relates to the complexity of IFRS 16.

63. Other stakeholders' views on whether to align the *IFRS for SMEs* Standard with IFRS 16 are mixed. An Asian-Oceanian Standard-Setters Group (AOSSG) survey on the *IFRS for SMEs* Standard found that:

    (a) three jurisdictions, Cambodia[20], Nepal[21] and Syria[22], were in favour of aligning the *IFRS for SMEs* Standard with IFRS 16 because for many entities, leasing is an important means of gaining access to assets, of obtaining finance and of reducing an entity's exposure to the risks of asset ownership.[23]

    (b) eight jurisdictions, China, India, Korea, Thailand, Pakistan[24], Malaysia, Sri Lanka and the Philippines[25], opposed aligning the *IFRS for SMEs* Standard with IFRS 16. In their view, because SMEs have limited resources, it is particularly important that there is sufficient implementation experience of

[20] Cambodia allow SMEs to use the *IFRS for SMEs* Standard which is adopted without modification.

[21] Nepal does not use the *IFRS for SMEs* Standard.

[22] No information is available about the use of the *IFRS for SMEs* Standard in Syria.

[23] AOSSG, *Report of AOSSG Survey on the IFRS for SMEs Standard*, 2018.

[24] China, India, Korea, Thailand, Pakistan do not use the *IFRS for SMEs* Standard.

[25] Malaysia, Sri Lanka and the Philippines accounting standard for SMEs is substantively identical to the *IFRS for SMEs* Standard.

IFRS 16 before introducing its requirements. Some SMEIG members shared this view.[26]

64. The UK Financial Reporting Council (FRC) proposed incorporating IFRS 16 into *FRS 102—The Financial Reporting Standard applicable in the UK and Republic of Ireland*.[27] A small majority agreed with the proposal. Most opponents of the proposal were concerned about the proposed timetable rather than the principle of aligning requirements from IFRS 16. In general, respondents thought the FRC should wait until entities have more implementation experience.[28]

65. From the evidence above it appears that the main objections to aligning the Standards relate to the limited resources of SMEs, lack of implementation experience, and complexity.

66. In developing their draft endorsement advice on IFRS 16, the European Financial Reporting Advisory Group (EFRAG) considered whether aligning the *IFRS for SMEs* Standard with IFRS 16 would be proportional considering the needs of users of SMEs' financial statements and cost-benefit implications. They found no evidence that the administrative and accounting impact of implementing the requirements of IFRS 16 would be unduly burdensome to SMEs.[29]

67. In the light of the above analysis, if the Standards were to be aligned, the Board would allow a period of at least one year between the issue date of any amendments to the *IFRS for SMEs* Standard and its effective date.[30] The proposed timetable for the 2019 Review would mean any amendment to the *IFRS for SMEs* Standard would not be effective before 1 January 2022. The staff believes that from the date IFRS 16 was issued in January 2016 to the proposed effective date of any amendments to the *IFRS for SMEs* Standard, entities would

[26] Appendix A paragraph A4(a).

[27] FRS 102 is a Standard based on the *IFRS for SMEs* Standard.

[28] FRC, *Feedback Statement: Consultation Document—Triennial review of UK and Ireland accounting standards—Approach to changes in IFRS*, June 2017.

[29] EFRAG, *Paper 09-03: Application of IFRS 16 Leases by SMEs*, *EFRAG Board meeting of 12 January 2017*.

[30] Preface to the *IFRS for SMEs* Standard paragraph P18.

have sufficient implementation experience of IFRS 16 to inform SMEs' application of the amendments.

Other considerations

68. As noted, IFRS 16 did not make significant changes to lessor accounting. The staff proposes making no significant changes to the lessor accounting model in the *IFRS for SMEs* Standard.

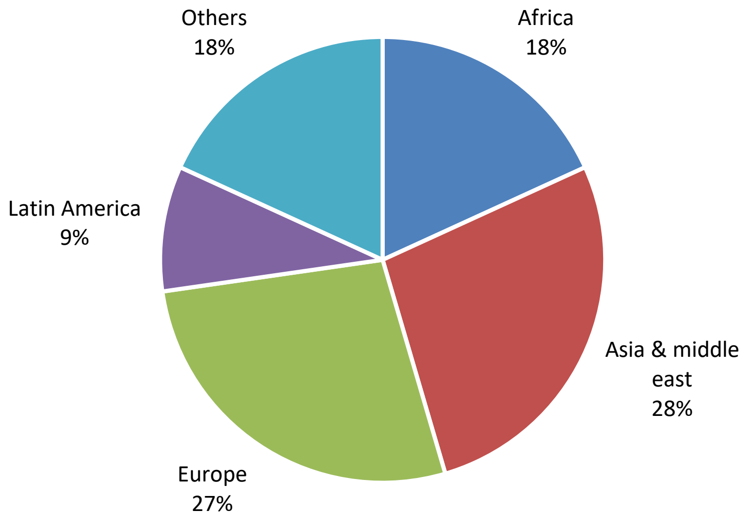
69. The Board allows IFRS 16 to be adopted if a company has already adopted IFRS 15 *Revenue from Contracts with Customers*. It is therefore important that IFRS 15 and IFRS 16 are considered for alignment at the same time.[31]

[31] IFRS 16 paragraph C1.

Appendix A—Summary of SMEIG members' views on whether to align the *IFRS for SMEs* Standard with IFRS 16 *Leases*

A1. On 29 January 2019 a questionnaire was sent to SME Implementation Group (SMEIG) members to seek their views on whether to align the *IFRS for SMEs* Standard with IFRS 16 *Leases*.

A2. 11 SMEIG members (42%) responded to the survey. The geographical distribution of the responses received is shown in the chart below.



A3. The main reasons given by SMEIG members for aligning the *IFRS for SMEs* Standard with IFRS 16 are:

(a) standardisation—the *IFRS for SMEs* Standard should follow the same underlying principles as IFRS Standards. Benefits include:

i. less confusion for preparers and users;

ii. education and training in accountancy will be more effective and efficient as there are fewer differences; and

iii. maintenance of the reputation of the *IFRS for SMEs* Standard.

(b) this is a significantly important standard; and

(c) improving comparability for users, in particular credit providers such as banks—many larger entities applying the *IFRS for SMEs* Standard compete for financing with publicly accountable entities; and

A4. The main reasons given by SMEIG members for not aligning the *IFRS for SMEs* Standard with IFRS 16 are:

(a) the lack of implementation experience to date;

(b) the complexity of IFRS 16 e.g reasonably certain lease terms and discounting future lease payments-including the rate of interest;

(c) concerns that the right-of use assets and lease liability introduced by IFRS 16 may not provide material information to users of SMEs' financial statements; and

(d) involve a lot of work and can get similar information by disclosing lease commitments in the current bands.

Appendix B—Overview of Section 20 and differences between IAS 17 and Section 20

Overview of Section 20

Introduction to the requirements

B1. The objective of Section 20 is to prescribe the accounting and disclosure requirements for leases in the financial statements of lessees and lessors.

B2. A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time.

Lease classification

B3. A primary issue in accounting for leases is the classification of the lease as either a finance lease or an operating lease. A finance lease transfers substantially all the risks and rewards incidental to ownership. An operating lease does not.

Finance leases

B4. A lessee accounts for a finance lease as a purchase of an asset on credit (that is, at the commencement of the lease the lessee recognises the rights and obligations arising from the lease at amounts equal to the fair value of the leased asset or, if lower, the present value of the minimum lease payments). Conversely, a lessor (including a manufacturer or dealer lessor) that has previously recognised the asset accounts for a finance lease as the sale of an asset on credit. The future amounts receivable under the terms of lease are recognised by any lessor as a receivable.

B5. After initial recognition of a finance lease the lessee accounts for the leased asset in accordance with other sections of the *IFRS for SMEs* Standard (for example, Section 17 *Property, Plant and Equipment*). The lessee apportions the minimum lease payments between the finance charge (interest expense) and repayment of the finance lease liability using the effective interest method. The lessor apportions the minimum lease payments between finance income on the receivable and repayment of the finance lease receivable using the effective interest method.

Operating leases

B6. The lessee and the lessor recognise lease payments under operating leases in profit or loss on the straight-line basis over the lease term unless specific exceptions apply (for example, unless another systematic basis is representative of the time pattern of the user's benefit).

Sale and leaseback transactions

B7. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease (that is, whether the lease is a finance lease or operating lease).

Differences between IAS 17 and Section 20

The main differences between the requirements of IAS 17 and Section 20 are as follows:

B8. certain terms defined in IAS 17 are not defined in Section 20, for example, non-cancellable lease, inception of the lease, commencement of the lease term, lease term, economic life, useful life (in the context of leased assets), guaranteed residual value, unguaranteed residual value and contingent rent.

B9. when payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate the lessor for expected inflationary cost increases, Section 20 does not require a lessee or lessor to recognise lease payments under operating leases on a straight-line basis.[32] IAS 17 contains no equivalent exceptions to the straight-line basis.

B10. IAS 17 provides guidance on how to treat provisions in lease contracts to adjust lease payments for changes in the construction or acquisition cost of the leased property or for changes in some other measure of cost or value, such as general price levels. Section 20 does not include corresponding guidance.

[32] Paragraph 20.15(b) of the *IFRS for SMEs* Standard.

B11. IAS 17 states that the definition of a lease includes hire purchase contracts. Section 20 is silent on this.

B12. when a lease is for both land and buildings, IAS 17 requires each element to be assessed separately. IAS 17 also provides detailed guidance on measurement, for example how to split minimum lease payments between the land and the building elements. Section 20 does not address this issue.

B13. full IFRS Standards (see SIC Interpretation 15 *Operating Leases—Incentives*) provide guidance on how incentives in an operating lease should be recognised in the financial statements of both the lessee and the lessor. Section 20 is silent on this issue.

B14. while the disclosure requirements in the financial statements of lessors of both finance and operating leases are the same applying IAS 17 and Section 20, there are some minor differences for disclosure requirements in the financial statements of lessees. For example, in the financial statements of lessees of finance leases, IAS 17 requires disclosure of contingent rents recognised as an expense in the period and total future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period. These are not required to be disclosed applying Section 20. In addition, applying IAS 17 both lessor and lessee are required to meet the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* in addition to the requirements in IAS 17 *Leases*. There is no such requirement applying Section 20 as there is no equivalent to IFRS 7 in the *IFRS for SMEs* Standard.

B15. in sale and lease back transactions, for operating leases if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately. There is no such requirement applying Section 20.