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STAFF PAPER

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IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs*® Standard**
Paper topic	Summary of feedback on aligning the *IFRS for SMEs* Standard with IFRS 16 *Leases*

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Purpose of the paper

1. This paper provides the International Accounting Standards Board (Board) with a summary of all forms of feedback on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* and from supplementary meetings, and the recommendations of the SME Implementation Group (SMEIG) on the alignment of Section 20 *Leases* of the *IFRS for SMEs* Standard with IFRS 16 *Leases*.

2. This paper is provided to assist the Board in considering Agenda Paper 30A *Towards an Exposure Draft—IFRS 16* Leases, which asks the Board to decide whether and how to propose amending the *IFRS for SMEs* Standard to align Section 20 with IFRS 16 making some simplifications. Consequently, this paper does not provide any staff recommendations and does not include any questions for Board members.

Structure of the paper

3. This paper is structured as follows:

   (a) background (paragraphs 5–11 of this paper);

   (b) question in the Request for Information (paragraph 12 of this paper);

   (c) overall feedback (paragraph 13 of this paper);

(d) SMEIG recommendations (paragraphs 14–23 of this paper); and

(e) detailed feedback on the Request for Information by source (paragraphs 24–79 of this paper).

4. This paper includes two appendices:

(a) Appendix A provides an overview of Section 20 of the *IFRS for SMEs* Standard and differences between IAS 17 *Leases* and Section 20; and

(b) Appendix B sets out the Board's rationale in the Request for Information for asking for views on aligning the *IFRS for SMEs* Standard with IFRS 16.

Background

Requirements in the IFRS for SMEs *Standard*

5. Section 20 of the *IFRS for SMEs* Standard is 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 A to this paper.

6. In January 2016, the Board issued IFRS 16 and completed its project to improve financial reporting for leases. IFRS 16 supersedes IAS 17 and became effective on 1 January 2019.

7. IFRS 16 was issued after the first 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.

8. For lessees, IFRS 16:

(a) eliminates the requirement to classify leases as either operating or finance leases;

(b) requires a single model for the accounting for leases and requires recognition of all lease obligations; and

(c) provides some limited optional recognition exemptions for short-term leases and leases of low-value assets.

9. IFRS 16 retains the IAS 17 requirements for lessor accounting, with improved requirements on the definition of a lease, a sublease and on the accounting for sale and leaseback transactions.

Request for Information

10. The Request for Information sought views on aligning the *IFRS for SMEs* Standard with IFRS 16 including possible simplifications. In developing the Request for Information, the Board considered that alignment would result in greater transparency about entities' financial leverage and capital employed. As discussed in the Request for Information, financial statements prepared applying the aligned Section 20 would more faithfully represent an entity's assets and liabilities and would provide useful and relevant information to users who are not able to require reports tailored to meet their needs.

11. The Board's rationale is set out in paragraphs B67–B72 of the Request for Information and reproduced in Appendix B to this paper.

Question in the Request for Information

12. Question S6 of the Request for Information asked for views on aligning Section 20 with IFRS 16 making some simplifications, for example:

    (a) permitting the option to use a discount rate by reference to market yields on high-quality corporate bonds if the interest rate implicit in the lease and the lessee's incremental borrowing rate cannot be readily determined.

    (b) changing the definition of 'lease term' to 'the non-cancellable period for which an entity is required to comply with the lease'. Any subsequent extension to the lease term then would be accounted for as a new lease.

(c) simplifying the requirements for subsequent measurement (reassessment) of the lease liability by requiring a lease to be remeasured in the event of a substantive change in the term of the contract. The effect of any other change would be reflected in the income statement for the period in which it is recognised.

(d) retaining the existing finance lease disclosures applying the *IFRS for SMEs* Standard; and

(e) simplifying the language of the Standard.

Overall feedback

13. Overall feedback on the Request for Information about aligning Section 20 of the *IFRS for SMEs* Standard with IFRS 16 was mixed. Stakeholders generally suggested the Board assess costs and benefits of proposing amendments to the *IFRS for SMEs* Standard to reflect the requirements in IFRS 16, even with simplifications, and to gain more information about the experience of entities applying IFRS 16, including via the Post-implementation Review of IFRS 16.

SMEIG recommendations

14. The SMEIG met:

(a) on 4–5 February 2021 to discuss the feedback from stakeholders on the Request for Information and develop recommendations to enable the Board to decide on whether and how to align the *IFRS for SMEs* Standard with IFRS 16;[1] and

(b) on 9 September 2021 to discuss possible approaches to aligning Section 20 of the *IFRS for SMEs* Standard with IFRS 16, considering all forms of

[1] The Report on the SMEIG meeting, held via remote participation, on 4–5 February 2021 can be accessed here.

feedback on the Request for Information and from supplementary meetings.[2]

February 2021 SMEIG meeting

15. Most SMEIG members agreed that the Board should undertake additional work to understand the practical challenges entities faced or are facing in implementing or applying IFRS 16 before deciding whether to align the *IFRS for SMEs* Standard with IFRS 16.

16. One SMEIG member suggested, as a relief for SMEs, requiring or permitting a later effective date for the revised Section 20 the *IFRS for SMEs* Standard if that section is aligned with IFRS 16.

17. Two SMEIG members expressed concerns about simplifying the definition of 'lease term' to 'the non-cancellable period for which an entity is required to comply with the lease'. In their view, this simplification could lead to structuring opportunities in drafting lease contracts and would not result in faithful representation of lease obligations.

September 2021 SMEIG meeting

18. SMEIG members discussed three possible approaches to aligning Section 20 of the *IFRS for SMEs* Standard with IFRS 16:

    (a) Approach 1—aligning Section 20 with IFRS 16 with possible simplifications (as described in the Request for Information);

    (b) Approach 2—aligning Section 20 with the main principle of IFRS 16 by extending the existing accounting for finance leases in the *IFRS for SMEs* Standard to all leases; and

[2] The Report on the SMEIG meeting, held via remote participation, on 9 September 2021 can be accessed here.

(c) Approach 3—improving disclosure requirements for operating leases without changing the recognition and measurement requirements in the *IFRS for SMEs* Standard.

19. There was no consensus on which approach would be best—support was split between Approach 1 and Approach 3.

20. Some SMEIG members supported aligning Section 20 with IFRS 16 with possible simplifications (Approach 1) because:

(a) in developing IFRS 16 the Board agreed that a lessee obtains an asset and a liability. These members say this position applies equally to an entity applying the *IFRS for SMEs* Standard and an entity applying IFRS 16.

(b) leases are an important source of finance for SMEs. Recognising all leases in the statement of financial position results in greater transparency.

(c) most leases to which SMEs are parties do not include complex terms and conditions and IFRS 16 already includes some recognition exemptions for leases of low value assets and short-term leases. Applying the accounting required by IFRS 16 to these leases would therefore not impose excessive costs on SMEs.

21. Two SMEIG members supporting Approach 1 expressed concerns about simplifying the definition of 'lease term' to 'the non-cancellable period for which an entity is required to comply with the lease'. These members said such a simplification could lead to lease contracts being structured to obtain a specific accounting outcome.

22. Some SMEIG members supported improving the disclosure requirements for operating leases without changing the recognition and measurement requirements in the IFRS for SMEs Standard (Approach 3) because:

(a) this approach would meet the information needs of users of SMEs' financial statements, which focus on future cash flows and an entity's ability to repay debt and continue as a going concern. Approach 3 would also maintain the Standard's simplicity for SMEs that typically have limited resources and would avoid any tax implications that could arise from a change in the accounting requirements for operating leases.

(b) for some SMEs, the assets and liabilities arising from leases are not significant. For example, one SMEIG member said that in his jurisdiction the average lease term is between three and five years.

23. A small number of SMEIG members supported Approach 2 as a second choice. One SMEIG member recommended the staff analyse the differences in outcome between Approach 1 and Approach 2 to help the Board decide which approach to propose.

Detailed feedback on the Request for Information by source

24. Stakeholders provided feedback on Question S6 of the Request for Information in several ways, including:

(a) comment letters (paragraphs 28–54);

(b) outreach events (paragraphs 55–58);

(c) online survey (paragraphs 59–62);

(d) user survey (paragraphs 63–68);

(e) user interviews (paragraphs 69–72); and

(f) SME preparer interviews (paragraphs 73–74).

25. In addition, the staff have conducted outreach with members of the Global Preparers Forum (GPF) to understand any practical challenges they may have experienced in implementing or applying IFRS 16 as discussed in paragraphs 75–79 of this paper.[3]

26. Paragraph 13 of this paper provides an overall summary of feedback. In that summary, the term ‘stakeholders’ refers to all stakeholders who commented either through comment letters or through the other ways outlined in paragraph 24 of this paper.

[3] The GPF is an independent body from the Board, with the specific aim to provide the Board with regular input from the international community of preparers of financial statements.

27. Respondents to the Request for Information who commented on aligning Section 20 with IFRS 16 expressed mixed views:

(a) paragraphs 28–50 of this paper discuss feedback from comment letters supporting alignment; and

(b) paragraphs 51–54 of this paper discuss feedback from comment letters not supporting alignment.

Feedback from comment letters supporting alignment

28. Many respondents support aligning Section 20 with IFRS 16 with possible simplifications because, in their view:

(a) IFRS 16 introduces improvements to financial reporting that are relevant for all entities, regardless of whether they have public accountability and provides useful information to users:

(i) in developing IFRS 16 the Board agreed that a lessee leasing an asset obtains an asset and a liability at the start of a lease—this rationale is equally applicable to entities applying the *IFRS for SMEs* Standard because an entity is financially assessed using similar financial indicators, regardless of size and complexity. For example, one accounting firm said:

> 'The IASB [Board] has concluded that lease liabilities meet the definition of a liability and right-of-use assets meet the definition of an asset, therefore the same must be true under the *IFRS for SMEs* [Standard]'

(ii) IFRS 16 introduces improvements in the accounting for leases by lessees and results in greater transparency, that is it improves faithful representation.

(iii) applying the existing lessee accounting model in Section 20, transactions that are economically similar could be accounted for differently; retaining the existing accounting for lessees in Section 20 would lead to a major divergence on a significant matter affecting most SMEs, whereas alignment would bring uniformity in lease accounting—ie ensuring that all leases are reflected in the statement of financial position—and would improve comparability and provide better-quality information to users.

(iv) lenders are becoming increasingly familiar with the model of accounting for leases in IFRS 16 and delaying alignment of the requirements in the *IFRS for SMEs* Standard with those in IFRS 16 would carry the risk of the *IFRS for SMEs* Standard no longer represent up-to-date thinking about how to account for leases—creating a gap between the accounting practices applied by SMEs and entities applying IFRS Standards.

(b) timely improvements in the accounting for leases by SMEs that are lessees are needed at this stage:

(i) leases continue to be an important source of finance for SMEs (ie the topic is relevant);

(ii) property leases for long periods are becoming more typical, increasing the need to recognise rights-of-use assets and related liabilities;

(iii) aligning the requirements in the *IFRS for SMEs* Standard with those in IFRS 16 is consistent with the alignment approach and the alignment principles (relevance to SMEs, simplicity and faithful representation) discussed in the Request for Information;

(iv) alignment would make it easier to train accountants;

(v) sufficient implementation experience from entities applying IFRS 16 is available to enable the Board to consider alignment.

(c) the benefits of IFRS 16 would outweigh the cost of its implementation for SMEs:

(i) the single model would not bring significant challenges for most preparers applying the *IFRS for SMEs* Standard and it is simpler than the existing requirements in Section 20; and

(ii) alignment would retain the current lessor accounting in Section 20 because IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17 and therefore would not impose significant costs to SMEs that are lessors.

Feedback on possible simplifications if Section 20 is aligned with IFRS 16

29. As discussed in paragraph 12 of this paper, the Request for Information asked for views on possible simplifications if Section 20 is aligned with IFRS 16.[4]

30. Some respondents supporting alignment said reliefs already included in IFRS 16 would help SMEs applying the IFRS 16 single model for the accounting for leases by lessees. Examples of reliefs in IFRS 16 mentioned by respondents include:

(a) optional recognition exemptions for short-term leases and leases of low-value assets;

(b) practical expedients not to separate non-lease components from lease components in a contract; and

(c) a practical expedient to apply the requirements in IFRS 16 to a portfolio of leases with similar characteristics (portfolio application).

31. In addition, some respondents said that the possible simplifications discussed in the Request for Information would provide additional relief to lessees, without resulting in a significant loss of useful information to users of SME financial statements.

32. Some respondents who support aligning Section 20 with IFRS 16 also commented on the possible simplifications outlined in the Request for Information as discussed in paragraphs 33–47 of this paper.

[4] See Appendix B to this paper.

1—Discount rate

33. Most respondents generally welcomed a possible option permitting entities applying the *IFRS for SMEs* Standard to use a discount rate by reference to market yields on high-quality corporate bonds if the interest rate implicit in the lease and the lessee's incremental borrowing rate cannot be readily determined because, in their view:

    (a) it would reduce application costs for SMEs; and

    (b) determining the discount rate has been one of the most challenging areas for preparers applying IFRS 16.

34. A small number of respondents suggested permitting a discount rate by reference to the yield on government bonds if there is no deep market in high-quality corporate bonds.

35. Some respondents expressed the following concerns regarding the simplification for the discount rate:

    (a) a discount rate by reference to market yields on high-quality corporate bonds may not be reflective of the risk associated with the lease liability, even though it reflects the time value of money and includes a risk allowance.

    (b) market yields on high-quality corporate bonds are one proxy for discount rate and other proxies may exist. Therefore, SMEs should not be restricted from using a discount rate by reference to an alternative source when this serves as a more suitable proxy. For example, if the interest rate implicit in the lease and the lessee's incremental borrowing rate cannot be readily determined, there could be a rebuttable presumption to use a discount rate by reference to market yields on high-quality corporate bonds.

    (c) permitting the option to use a discount rate by reference to market yields on high-quality corporate bonds would not be helpful because SMEs do not have easy access to such information. Therefore, permitting SMEs to use such a discount rate would lead some SMEs to recognise amounts in their statement of the financial position that do not reflect the economic substance of some leases and could raise additional questions from users of SME financial statements.

2—Lease term

36. Regarding the possible simplification for lease term, many respondents were concerned about changing the definition of ‘lease term’ to ‘the non-cancellable period for which an entity is required to comply with the lease’ with any subsequent extension to the lease term accounted for as a new lease. Specifically, respondents said:

   (a) the amount of lease liability would not reflect the period covered by a lessee’s option to extend the lease, even if the lessee is reasonably certain to exercise that option. This:

      (i) would result in a significant understatement of lease liabilities on the statements of financial position;

      (ii) could encourage structuring opportunities to significantly reduce the amount of lease liabilities recognised in the financial statements; and

      (iii) could result in accounting which does not faithfully represent the substance of the lease arrangement and would not provide useful information to users of SME financial statements.

   (b) options to extend a lease and options to terminate a lease are very common in lease arrangements and it is important that these options are assessed as part of the lease term by determining the likelihood they will be exercised.

   (c) some assets are leased on rolling contracts which may continue indefinitely (ie renewable leases) and the possible change to the definition of lease term outlined in the Request for Information would be an over-simplification. As SMEs seek flexible lease arrangements, these types of contracts may become more prevalent. Therefore, it is important that the economic substance of these lease arrangements is reflected in the financial statements of entities applying the *IFRS for SMEs* Standard.

(d) the possible simplification for the lease term could be perceived as inconsistent with IFRS 16, introduce an additional complexity for SMEs and create confusion.

37. To address situations where the lessee engages in a lease that is longer than the useful life to that entity of the asset being leased, one respondent suggested the lease term to be defined as the earlier of:

(a) the non-cancellable period for which an entity is required to comply with the lease; or

(b) the useful life of the asset.

3—Subsequent measurement (reassessment) of the lease liability

38. The Request for Information sought views on simplifying the requirements for subsequent measurement (reassessment) of the lease liability by requiring a lease to be remeasured in the event of a substantive change in the terms of the contract. The effect of any other change would be reflected in the income statement for the period in which it is recognised.

39. A small number of respondents commented on this simplification and said the reassessment of lease liabilities may be burdensome and costly, especially if a lessee has many leases—for example, by frequently tracking the changes in the index or rate used to determine the revised lease payments. One respondent suggested the Board consider whether changes in lease payments might instead continue to be accounted for by applying the requirements of Section 11 of the *IFRS for SMEs* Standard if the Standard is aligned with IFRS 16.[5] In the view of this respondent, retaining this approach may be a simpler alternative rather than introducing specific requirements covering these changes.

[5] Paragraph 20.11 of the *IFRS for SMEs* Standard.

4—Retaining the existing finance lease disclosures applying the IFRS for SMEs *Standard*

40. Overall, most respondents support retaining the finance lease disclosures in the *IFRS for SMEs* Standard because:

    (a) the existing disclosures are relevant for SMEs and meet users' information needs;

    (b) the existing disclosures are working well in practice;

    (c) the existing disclosures are simpler than those in IFRS 16; and

    (d) the disclosures in IFRS 16 would be burdensome for SME preparers.

41. Some respondents who supported retaining the finance lease disclosures in Section 20 of the *IFRS for SMEs* Standard suggested the Board expand the disclosures to require entities applying the *IFRS for SMEs* Standard to disclose the following additional information, if Section 20 is aligned with IFRS 16:

    (a) lease payments for assets and liabilities that are not recognised in the statement of financial position. Depending on the definition of 'lease term', this may include information about future cash outflows related to extension options or renewable leases that are not reflected in the measurement of lease liabilities.

    (b) short-term leases and leases of low-value assets—amount recognised in the income statement for the period.

    (c) variable lease payments—amount recognised in the income statement for the period and narrative explanation of the exposure of the entity to variable lease payments.

42. A small number of respondents expressed concerns about retaining the finance lease disclosures in Section 20. In the view of these respondents, the finance lease disclosures in Section 20 may not meet the alignment principle of faithful representation because IFRS 16 no longer differentiates finance and operating leases for lessees. These respondents think the disclosure requirements in Section 20 should be aligned with IFRS 16 because, in their view, alignment would:

(a) be consistent with the recognition and measurement requirements of IFRS 16; and

(b) be consistent with the alignment approach and satisfy the alignment principles discussed in the Request for Information (ie relevance to SMEs, simplicity, and faithful representation).

5—Simplifying the language of the Standard

43. Most respondents support simplifying the language of IFRS 16 because, in their view, the use of less technical or sophisticated language—for topics such as variable lease payments, determining the discount rate and the term of the lease—would be helpful for SMEs and users of SME financial statements in clarifying the requirements in Section 20.

44. Some respondents who supported simplifying the language of the Standard also said:

(a) where the language in IFRS 16 is simple, it should not be further simplified;

(b) changes to the language should not result in increased complexity or uncertainty in the understandability of the main principles in IFRS 16; and

(c) the use of alternative language without any good reason could introduce unnecessary complexity.

45. In contrast, one respondent did not support simplifying the language of the Standard; in their view simplifying the wording of IFRS 16 principles could lead to unintended consequences, create confusion in the understanding the requirements and is against the alignment approach.

6—Other feedback on possible simplifications outlined in the Request for Information

46. A small number of respondents expressed the following general concerns regarding the possible simplifications in the Request of Information if Section 20 is aligned with IFRS 16:

(a) there is a lack of evidence about whether the possible simplifications will reduce application costs for SMEs;

(b) if significant simplifications are introduced, it might be challenging to satisfy the alignment principle of faithful representation; and

(c) care should be taken in simplifying the requirements of IFRS 16—the outcome should be consistent with the accounting model in IFRS 16.

47. For example, one accounting firm said:

> The more simplifications that are introduced, the more IFRS 16 in its original form is distorted—which could potentially undermine the original question of alignment. Complexity in applying the requirements of IFRS 16 is unavoidable and would require far too many simplifications (such as changing the way in which an entity determines the incremental borrowing rate, or determines the appropriate cash flows or lease term) to allow application by SMEs.

Other feedback on additional possible simplifications

48. A small number of respondents suggested the Board consider transitional reliefs. For example, one accounting firm said:

> … it would be important to give SMEs time for implementation and adaptation (transitional relief), as was done for companies in applying IFRS 16, by allowing SMEs to continue their current leasing recognition policies for any contracts already in progress at the transition date or scheduled to be completed within a set time after the transition date.

49. Some respondents suggested additional possible simplifications if Section 20 is aligned with IFRS 16, for example:

(a) IFRS 16 optional recognition exemption for leases of low-value assets:

(i) specify different categories of assets which generally are not material in amount—for example, tablets and smartphones—rather than monetary amount.

(ii) specify a threshold of USD50,000—to avoid subjectivity in interpretation, provide greater transparency, reduce application costs for SMEs, make it easier for users of SME financial statements to understand and improve comparability.

(b) IFRS 16 optional recognition exemption for short-term leases:

(i) define short-term lease as a lease that, at the commencement date, has a lease term of 30 months or less[6];

(ii) require disclosure of annual fixed lease costs for the first seven years of a lease, covering the most common term of operating leases—ie transparency could be strengthened through improved disclosures rather than through recognition of leases with a lease term of less than seven years on the statement of financial position.

50. One respondent said the requirements for sale and leaseback transactions in Section 20 should be aligned with IFRS 16 in order to reflect the substance of the transactions.

Feedback from comment letters not supporting alignment

51. Some respondents do not support aligning Section 20 with IFRS 16 as part of the second comprehensive review of the *IFRS for SMEs* Standard. Most of these respondents said the Board should gain a better understanding of IFRS 16 implementation issues and costs, including via the Post-implementation Review of IFRS 16, before deciding on whether to propose aligning the *IFRS for SMEs* Standard with IFRS 16, even with simplifications. For example, some of these respondents said:

> … the current level of IFRS 16 implementation experience may be insufficient to appropriately and effectively align and/or simplify its requirements for the SMEs' purposes.

[6] IFRS 16 defines a short-term lease as a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

> … substantial costs associated with obtaining the necessary information required to comply with the standard are being incurred by those entities currently implementing IFRS 16. It is therefore unclear whether the benefits offered from a transition to IFRS 16 by SMEs will exceed the associated costs. Therefore, we recommend that the IASB establish whether SME investors need this new information and how this cost benefit challenge might be resolved in developing appropriate new requirements.
>
> … it is important to fully investigate the application and implementation experience of publicly accountable entities before considering the alignment with simplification.
>
> … further simplifications may be identified in the IFRS 16 PIR [Post-implementation Review] that the Board may also wish to consider.

52. Other reasons provided by respondents who do not support aligning Section 20 with IFRS 16 include:

    (a) complexity for SMEs—the implementation of IFRS 16 has been a challenge for entities applying IFRS Standards. Some respondents noted, the IFRS Interpretations Committee has published five agenda decisions on IFRS 16, and in May 2020 the Board issued *Covid-19-Related Rent Concessions*, which amended IFRS 16.[7] In the view of these respondents, this suggests that IFRS 16 is complex and further implementation experience is necessary before considering alignment. Furthermore, covid-19 continues to have a significant impact on many SMEs. As leasing can have a critical role for many SMEs, the Board should take into consideration the current economic environment of SMEs in considering alignment.

    (b) different users' needs—lenders to SMEs generally rely on the cash-flows information on leases disclosed in the notes to the financial statements. In the view of some respondents:

[7] The amendment permits lessees, as a practical expedient, not to assess whether particular rent concessions occurring as a direct consequence of the covid-19 pandemic are lease modifications and, instead, to account for those rent concessions as if they were not lease modifications.

(i) there is no evidence that more information is needed or that extra information will be useful to SME stakeholders.

(ii) the most common higher value leases of SMEs are buildings and retail and office space. For other leases recognising a right-of-use asset, and a corresponding liability, and the associated depreciation and interest expense would not be useful to users of SME financial statements.

(c) the fundamental flaws with the previous lessee accounting in IAS 17 are not relevant to SMEs, according to some respondents. These respondents said SMEs do not use leasing to avoid showing financial liabilities in the statement of financial position but to obtain access to a financing option, complementary to traditional bank loans.

53. One respondent argued that the Board needs to carefully balance the cost and benefits in considering aligning Section 20 with IFRS 16. In the view of this respondent, the costs to SMEs will be proportionally higher than those for entities applying IFRS Standards, including both direct costs and indirect costs associated with taxation and other national legislation—whilst the benefits to users of SME financial statements will be lower as these users have different primary objectives compared to those of listed entities.

54. Two respondents who hold the view that Section 20 should not be aligned with IFRS 16 suggested the Board consider the following alternatives:

(a) introduce in Section 20 the simplified model for accounting for operating leases in US GAAP (ASU No. 2016-02 - (Topic 842 of ASC)). Applying this simplified model to operating leases, a lessee would:

(i) recognise a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position;

(ii) recognise a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and

(iii) classify all cash payments within operating activities in the statement of cash flows.

(b) retain the Section 20 existing classification of leases by lessees as operating or finance leases—this approach will allow simple leases, such as leases of office spaces, to continue to be accounted for as operating leases, without the need to undertake calculations to initially and subsequently measure the right-of-use asset and the lease liability.

Feedback from outreach events

55. During the comment period, Board members and the staff undertook outreach activities including round-table meetings and discussion forums. The events were attended by nearly 2,000 participants and were organised in conjunction with national standard-setters, professional bodies, practitioners/auditors and SMEIG members.

56. Consistent with respondents to the Request for Information via comments letters, participants to outreach events also expressed mixed views on aligning Section 20 of the *IFRS for SMEs* Standard with IFRS 16.

57. Specifically, some participants who supported alignment said:

(a) applying the requirements in IFRS 16 will be less challenging for SMEs because the terms and conditions of most leases entered into by SMEs do not include complex features such as variable lease payments;

(b) possible simplifications to the requirements in IFRS 16 are expected to reduce complexity for SMEs; and

(c) non-alignment will delay benefits of IFRS 16 to SMEs.

58. Some participants expressed concerns on aligning Section 20 with IFRS 16, including:

(a) the need to balance benefits to users with cost and effort for preparers;

(b) the complexity of IFRS 16 single model for the accounting of leases for SMEs;

(c) the need to simplify the difficult areas of IFRS 16 (for example, determining the discount rate); and

(d) the need to consider the implementation experience of entities that apply IFRS 16.

Feedback from the online survey

59. An online survey addressed to all stakeholders was made available during the comment period of the Request for Information.

60. The online survey replicated the questions of the Request for Information. Thirty online surveys were completed, of which 21 from individuals and nine from organisations.

61. Responses to the online survey were mixed, slightly more respondents supported aligning Section 20 with IFRS 16, with simplifications, because:

    (a) leases are important sources of financing for SMEs; and

    (b) alignment would bring uniformity in lease accounting by ensuring that all leases are reflected in the statement of financial position.

62. In contrast, some respondents expressed concerns on aligning Section 20 with IFRS 16, with simplifications, because, for example:

    (a) SMEs would face cost and complexity (even if the simplifications were introduced) to apply the requirements in IFRS 16 if they were included in the *IFRS for SMEs* Standard; and

    (b) the information needs of users of SME financial statements might differ from those of users of financial statements prepared applying IFRS Standards.

Feedback from the user survey

63. To obtain feedback from users of SME financial statements, an online survey addressed to users of SME financial statements (user survey) was made available during the comment period of the Request for Information.

64. Fifty-four user surveys were completed, of which 14 from users and 40 from non-users.[8]

65. The survey had 10 questions on:

    (a) the alignment approach—whether the *IFRS for SMEs* Standard should be aligned with full IFRS Standards;

    (b) users' information needs—factors the Board considers in setting disclosures in the *IFRS for SMEs* Standard (paragraph BC157 of the Basis for Conclusions on the *IFRS for SMEs* Standard); and

    (c) any additional matters relating to the disclosure requirements.

66. On the topic of leases, Question B4 of the user survey asked:

    > What information about leases in the financial statements of an SME would be useful for you to evaluate the lease obligations of an entity? Please explain your answer.

67. Users suggested the following information is useful to evaluate lease obligations of an entity:

    (a) lease liabilities for significant lease arrangements (for example, shipping and aircraft);

    (b) the residual duration of the lease and legal obligations of leases; and

    (c) lease payments due in the next reporting period.

68. Non-users suggested the following information is useful to evaluate lease obligations of an entity:

[8] Although the user survey made clear the aim of the survey was to elicit users' views, the survey was also completed by some 'non-users'. Responses to the survey have been considered by type of respondent.

(a) termination date of leases;

(b) fair value of leased assets;

(c) discount rate used to measure the lease liability; and

(d) any past default on lease payments.

Feedback from user interviews

69. The staff conducted 13 interviews with users of SME financial statements from seven jurisdictions.

70. During the interviews the staff asked users for their views on:

(a) whether the principles for setting disclosure requirements in the *IFRS for SMEs* are still appropriate to identify the information that is helpful to users of SMEs financial statements (paragraph BC157 of the Basis for Conclusions on the *IFRS for SMEs* Standard);

(b) information about leases that would be useful; and

(c) the usefulness of a reconciliation between the opening and closing balances of liabilities arising from financing activities recognised in the statement of financial position.

71. On the topic of leases, most users said that recognising operating leases on the statement of financial position:

(a) will help assess repayment capacity;

(b) will result in better disclosure—for example, providing information about the maturity of lease liabilities; and

(c) should not be challenging for SMEs because most SMEs do not enter into complex lease arrangements.

72. A small number of users said recognising leases on the statement of financial position do not impact their credit assessments of SMEs because the leased asset cannot be

collateralised. Furthermore, some users said they have access to centralised credit registers[9].

Feedback from SME preparer interviews

73. Following the SMEIG meeting and the Board's request, the staff held 18 outreach meetings with SME preparers[10] to obtain additional feedback about:

    (a) their experience of applying the *IFRS for SMEs* Standard based on IFRS Standards; and

    (b) the information they are regularly asked to provide to lenders and other users of their financial statements to better understand users' information need.

74. Some SME preparers commented on aligning the *IFRS for SMEs* Standard with IFRS 16. These SME preparers said some SMEs do not have the resources to apply the finance lease requirements in Section 20. In their view, aligning Section 20 of the *IFRS for SMEs* Standard with IFRS 16 will be challenging for SMEs and possible simplifications to IFRS 16 may not lead to faithful representation.

Outreach with GPF members

75. The staff interviewed three GPF members to understand their practical experience applying IFRS 16.

76. GPF members mentioned they faced or are facing the following practical challenges in implementing or applying IFRS 16:

    (a) using spreadsheet for around 400–500 leases was complex because of the number of variable inputs; and

    (b) using a software to implement IFRS 16 was the biggest challenge which required a more intensive implementation effort than expected.

[9] See SMEIG Agenda Paper 5 *User survey and user interview feedback summary*

[10] Preparers include SME accountants and external accountants preparing general purpose financial statements.

77. In addition, GPF members said:

    (a) identifying all the lease contracts and determining lease terms was not challenging but extracting the required information to apply IFRS 16 was a challenge; and

    (b) two-year implementation period was helpful.

78. One GPF member said that determining the discount rate could be challenging for SMEs as some of the inputs are not directly related to the lease documentation.

79. Another GPF member said the IFRS 16 implementation experience may not have many parallels with SMEs because of possible differences in the nature of leases contracts.

Appendices

Appendix A—Overview of Section 20 and differences between IAS 17 *Leases* and Section 20 *Leases*

Overview of Section 20

Introduction to the requirements

A1. The objective of Section 20 is to prescribe the accounting and disclosure requirements for leases in the financial statements of lessees and lessors.

A2. 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

A3. 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

A4. 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.

A5. 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

A6. 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

A7. 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

A8. The main differences between the requirements of IAS 17 and Section 20 are as follows:

(a) 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.

(b) 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.[11] IAS 17 contains no equivalent exceptions to the straight-line basis.

(c) 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.

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

(e) 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.

(f) 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.

(g) 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

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

such requirement applying Section 20 as there is no equivalent to IFRS 7 in the *IFRS for SMEs* Standard.

(h) 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.

Appendix B—Board's rationale in the Request for Information for asking views on aligning the *IFRS for SMEs* Standard with IFRS 16

B1. Question S6 asks for views on aligning Section 20 *Leases* of the *IFRS for SMEs* Standard with IFRS 16 *Leases*. In deciding whether to ask about aligning Section 20 the Board applied the 'alignment principles' and in considering relevancy, the Board noted that a 2015 report *The Use of Leasing Amongst European SMEs* stated that leasing is the third most important source of financing for SMEs, that about 40% of SMEs use leases and that 17% of their total investment is financed by leasing.

B2. IFRS 16 eliminates the classification by lessees of 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, subject to some limited optional recognition exemptions for short-term leases and leases of low-value assets.

B3. IFRS 16 retains the IAS 17 requirements for lessor accounting; however, it adds guidance for lessors on the definition of a lease, a sublease and on the accounting for sale and leaseback transactions. Consequently, aligning Section 20 with IFRS 16 need not affect the accounting by lessors.

B4. The Board is seeking views on aligning Section 20 with IFRS 16. The Board considers that aligning the *IFRS for SMEs* Standard would result in greater transparency about entities' financial leverage and capital employed. In the Board's view, financial statements prepared applying the aligned Section 20 would more faithfully represent an entity's assets and liabilities and would provide useful and relevant information to users who are not able to require reports tailored to meet their needs.

B5. The Board is also seeking views on possible simplifications if Section 20 is aligned with IFRS 16, for example:

(a) permitting the option to use a discount rate by reference to market yields on high-quality corporate bonds if the interest rate implicit in the lease and the lessee's incremental borrowing rate cannot be readily determined.

(b) changing the definition of 'lease term' to 'the non-cancellable period for which an entity is required to comply with the lease'. Any subsequent extension to the lease term then would be accounted for as a new lease.

(a) simplifying the requirements for subsequent measurement (reassessment) of the lease liability by requiring a lease to be remeasured in the event of a substantive change in the term of the contract. The effect of any other change would be reflected in the income statement for the period in which it is recognised.

(b) retaining the existing finance lease disclosures applying the IFRS for SMEs Standard.

(c) simplifying the language of the Standard.

B6. These additional potential simplifications would not, in the Board's view, impede faithful representation.