Staff paper

ASAF Agenda reference: 9C
IASB Agenda reference: 7B

Accounting Standards Advisory Forum meeting

Date	**March 2026**
Project	**Post-implementation Review of IFRS 16 *Leases***
Topic	**Usefulness of information resulting from lessees' application of judgement**
Contacts	Megumi Makino (megumi.makino@ifrs.org) Raf Markowski (rmarkowski@ifrs.org) Tim Craig (tcraig@ifrs.org)

Accounting Standards Advisory Forum, March 2026, Agenda Paper 9C

This paper was prepared for discussion at the International Accounting Standards Board's (IASB's) March 2026 meeting as Agenda Paper 7B.

Purpose and structure of this paper

1. At its meeting in January 2026, the International Accounting Standards Board (IASB) discussed the summary of stakeholders' feedback to Question 2 in the Request for Information *Post-implementation Review of IFRS 16* Leases (RFI), which asked about the usefulness of information resulting from lessees' application of judgements.

2. At this meeting, the IASB will discuss our analysis of the feedback and decide how to respond to that feedback. In developing our recommendations, we applied a framework for responding to the matters identified in a post-implementation review (PIR), published on the website: IASB post-implementation reviews.

3. This paper provides:

(a) summary of staff recommendations (paragraph 4);

(b) feedback overview—key messages (paragraphs 5–10);

(a) staff analysis, recommendations and questions to the IASB (paragraphs 11 – 117); and

(c) Appendix A—Other judgement-related matters raised by a few respondents in response to Question 2 in the RFI.

Summary of staff recommendations

4. Based on the analysis in this paper, the staff recommend:

   (a) adding to the IASB's project pipeline a research project to explore targeted improvements to the usefulness of information resulting from lessees' application of judgements, for example, by developing specific requirements for lessees to disclose significant judgements made in determining:

      (i) the lease term; and

      (ii) the discount rate.

   (b) no further action in response to other lessee judgement-related matters that stakeholders raised in response to Question 2 in the RFI. Specifically, we do not recommend:

      (i) providing additional guidance or illustrative examples for determining lease term;

      (ii) simplifying the requirements for determining lease term;

      (iii) developing specific requirements for lessees to disclose items of information other than those suggested in (a) in relation to the lease term;

      (iv) providing additional guidance or illustrative examples for determining discount rates;

(v) developing specific requirements for lessees to disclose items of information other than those suggested in (a) in relation to the discount rate;

(vi) clarifying or providing additional application guidance or illustrative examples to help entities determine whether some lease payments are (1) in-substance fixed lease payments; (2) variable lease payments that depend on an index or a rate; or (3) variable lease payments that do not depend on an index or a rate; and

(vii) developing specific disclosure requirements for variable lease payments.

Feedback overview—key messages

5. Most stakeholders provided feedback to Question 2 in the RFI and many of them generally agreed that the usefulness of financial information resulting from lessees' application of judgement is largely as the IASB expected.

6. However, most stakeholders, including most users of financial statements (users), acknowledged that significant judgement required in determining the lease term, incremental borrowing rate or which variable lease payments to include in the lease liability, might lead to inconsistent application and reduce comparability between entities.

7. Although many stakeholders agreed that the requirements in IFRS 16 generally provide a clear and sufficient basis for entities to make appropriate judgements, they still suggested the IASB provide additional guidance, illustrative examples and specific disclosure requirements to support consistent application of the requirements and improve comparability.

8. Some stakeholders said the requirements in IFRS 16 do not provide a clear or sufficient basis for entities to make appropriate judgements and asked the IASB to consider clarifying and simplifying requirements, providing additional guidance and enhancing disclosure requirements.

9. A few stakeholders who commented said the subjective judgements made by lessees, particularly in determining lease terms and incremental borrowing rates, lead to significant variability in how similar leases are reported. Therefore, they disagreed with the statement that the usefulness of financial information resulting from lessees' application of judgements is largely as the IASB expected.

10. However, a few other stakeholders, including a few users, said:

    (a) the exercise of judgement is a core principle in the application of principles-based standards and is necessary to reflect facts and circumstances and changing environments;

    (b) improving the financial information resulting from the application of judgement would be challenging;

    (c) standard-setting cannot resolve matters that indicate non-compliance with the requirements or inappropriate exercise of judgement;

    (d) the requirements of IFRS 16 allow entities to make appropriate judgements and can be applied consistently; and

    (e) no additional guidance is necessary.

Introduction and overall assessment of benefits of lease-related information resulting from lessees' application of judgement

11. As set out in the description of IASB post-implementation reviews, a PIR involves assessing whether the new requirements are overall working as intended, with the benefits to users of the information arising from applying the new requirements *not significantly* lower than was expected and the costs of applying the requirements and auditing and enforcing their application *not significantly* greater than was expected.

12. The feedback in paragraphs 5–10 suggests that most stakeholders, including most users, who commented on Question 2 in the RFI, raised various concerns about the usefulness of information resulting from lessees' application of judgement.

13. We acknowledge the inherent subjectivity in determining, for example, discount rates or lease terms, because of entities' varying facts and circumstances. It is unclear whether concerns about the quality and comparability of lease-related information resulting from the application of judgement arise due to either:

    (a) appropriate exercise of judgement to reflect entities' varying facts and circumstances, but a lack of information to understand those different judgements. For example, stakeholders said the difference in the lease term can be caused by the lessee-specific and the contract-specific circumstances (paragraph 27) whereas users said, in some cases, lease terms were inconsistent with users' expectations (paragraph 29) and many stakeholders asked for additional information to be disclosed about judgements and assumptions in determining lease terms (paragraph 32). One possible solution the IASB could consider in this case would be to explicitly require information to be disclosed to improve the transparency of different judgements entities make.

    (b) diversity in judgements due to a lack of clarity of the requirements in IFRS 16. For example, stakeholders said differences in lease terms can be caused by the absence of quantitative thresholds for 'reasonably certain' or clear guidance on how to apply the notion of 'insignificant penalty' (paragraphs 27–28). One possible solution the IASB could consider in this case would be to clarify requirements or provide additional guidance.

    (c) inappropriate exercise of judgement and non-compliance with the requirements in IFRS 16. For example, a few stakeholders said there is a risk of structuring opportunities (paragraph 27). In this case, standard-setting might not be able to address the matter.

14. As the root cause is unclear, in our view, the feedback is inconclusive in assessing whether the benefits to users of lease-related information resulting from lessees' application of judgement is significantly lower than was expected. However, the feedback does indicate there are significant concerns about the quality and comparability of lease-related information resulting from lessees' application of

judgement. Therefore, we think it is reasonable to consider the criteria in paragraph 19 in deciding whether to take further action.

15. Agenda Paper 7A for this meeting analyses feedback on ongoing costs for lessees of applying the measurement requirements in IFRS 16 and we conclude that ongoing costs for lessees of applying the measurement requirements are higher than the IASB expected. Some of the suggestions stakeholders have to reduce costs could also assist some of the concerns presented in this paper—for example, suggestions to simplify how discount rates are determined. Similarly, some of the suggestions to help improve information resulting from lessees' application of judgement (for example, clarifying the requirements for determining lease term) could also reduce costs. Amending or clarifying requirements to make them simpler or less complex to apply could both reduce costs and improve comparability.

16. In some cases, stakeholders made the same or similar suggestions to reduce costs and to improve the usefulness of information. We have analysed particular topics either in Agenda Paper 7A for this meeting or this paper based on:

(a) prevalence of feedback—whether stakeholders have raised more concerns in the context of the usefulness of financial information or in the context of high ongoing costs; and

(b) extent of the effect of suggestions—whether suggestions primarily enhance the usefulness of financial information but also reduce costs or vice versa.

17. When we analyse the suggestions in this paper we also carefully consider the additional costs of those suggestions in light of our recommendations in Agenda Paper 7A for this meeting for the IASB to explore potential ways of reducing ongoing costs.

18. Based on the feedback received, we identified three main areas of IFRS 16 requirements that stakeholders said contribute most to their concerns about the usefulness of lease-related information. These are the requirements for determining:

(a) lease term (paragraphs 21–67);

(b) discount rates (paragraphs 68–91); and

(c) variable lease payments (paragraphs 92–117).

19. The remainder of this section analyses whether to take action in response to these lessee judgement-related matters and how to prioritise those matters depending on the extent to which evidence gathered during the PIR indicates that:

(a) the matter has *substantial consequences* (for example, widespread diversity in practice materially affects users' ability to analyse trends and compare entities);

(b) the matter is *pervasive* (for example, it affects transactions that occur frequently in various industries and jurisdictions);

(c) the matter arises from a financial reporting issue that *can be addressed* by the IASB or the IFRS Interpretations Committee (Committee)—that is, a feasible solution is likely to exist; and

(d) the benefits of any action are expected to *outweigh the costs* (considering the extent of disruption to current practice and operational costs from change in the light of the importance of the matter to users).

20. Appendix A to this paper summarises feedback on other lessee judgement-related matters raised by no more than a few respondents to Question 2 in the RFI and provides staff comments. The staff does not recommend acting on any of these matters because the feedback does not provide evidence of the matters meeting the criteria in paragraph 19(a)–(d). In particular, the feedback received does not suggest that the matters are pervasive or have substantial consequences.

Lease term

What does IFRS 16 require?

21. Lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

(a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

(b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

22. In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity applies the definition of a contract and determines the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

23. 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 considers 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.

24. A lessee reassesses an option to extend or terminate a lease upon the occurrence of a significant event or significant change in circumstances that:

(a) is within the control of the lessee; and

(b) affects the lessee's judgement of the exercise of an option.[1]

What do stakeholders say?

25. Most stakeholders responded to Question 2 in the RFI. Of those who commented, a few stakeholders, including a few users, expressed little or no concerns about the usefulness of information resulting from the lessees' application of judgement in determining the lease term. However, most stakeholders (including most users, standard-setters and preparers, and many accountancy bodies) raised various concerns.

[1] Lease term requirements are included in paragraphs 18–21 and B34–B41 of IFRS 16.

26. Most stakeholders who raised concerns said determining the lease term involves complex judgements, which have a material effect on the measurement of lease liabilities and reduce comparability between entities. In their view, determining lease term is particularly challenging for complex contracts, such as those with multiple extension and termination options, ‘evergreen’ leases (leases that renew indefinitely) or those with tacit renewals. The judgement in determining the lease term might also affect an entity’s conclusion of whether a lease contract is eligible for the short-term lease exemption.

27. Of those stakeholders, many said determining whether a lessee is ‘reasonably certain’ to exercise (or not to exercise) extension or termination options is particularly challenging due to the significant judgement involved and inherent subjectivity. For example:

    (a) some said entities are interpreting the threshold of ‘reasonably certain’ differently even in similar circumstances: Stakeholders said:

        (i) entities in similar circumstances often reach different conclusions due to the absence of quantitative thresholds;

        (ii) differences can be caused by variations in management judgement regarding the ‘reasonably certain’ probability threshold, combined with lessee-specific and contract-specific circumstances; and

        (iii) entities make judgements based on different factors such as the lessee’s current intention, past practice and contractual terms, which lead to different conclusions for similar lease agreements and underlying assets;

    (b) some said contracts like evergreen leases pose challenges because entities might determine the lease term based on the minimum enforceable period;

    (c) a few said a lessee’s lease term determination is sometimes inconsistent with customary practice or expectations of how long the asset will be used by an entity; and

(d) a few said there is a risk that entities might structure lease contracts to achieve desired accounting outcomes.

28. Some stakeholders said determining whether a contract is enforceable is challenging. Comments included:

(a) there is no clear guidance on how to apply the notion of 'insignificant penalty', and a high level of judgement is required in practice;

(b) it is not evident whether 'insignificant penalty' refers solely to the monetary charge imposed by the lessor, or if it also encompasses broader economic factors such as damage to business relationships, relocation costs, or operational disruption;

(c) entities rely on the agenda decision Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16), which explained that, in applying paragraph B34 of IFRS 16 and determining the enforceable period of the lease, an entity considers the broader economics of the contract, and not only contractual termination payments.

29. Of the many users who commented on the usefulness of information resulting from lessees' application of judgement, most users expressed some concerns about lease term determination and provided suggestions for improvements. Users' comments included:

(a) judgement in determining lease terms creates opportunities for structuring contracts, hinders comparability and complicates users' analyses. Users said they generally expected to see higher lease liabilities on entities' balance sheets on transition to IFRS 16 than those that entities reported. In these users' view, some entities have strategically shortened lease terms to reduce reported liabilities. A few users noted unexpected volatility in balance sheet amounts when lease contracts are renewed (or lease terms are reassessed), which they do not find useful. A credit rating agency said they adjust reported lease liabilities in their models to remove the fluctuations related to lease renewals (that is, they assume that leases will be renewed perpetually).

(b) entities are determining unrealistic lease terms that are inconsistent with, for example, an entity's past practice or an entity's business model, which undermines the credibility of management's judgements. A user provided two examples:

(i) a logistics entity entered into a one-year lease contract, renewable every year and determined the lease term to be one year. But the entity had a licence to operate for 15 years, it was not planning to cease or limit its operations soon and would typically lease trucks for 15 years. So, users would reasonably expect a lease liability to reflect a lease term of approximately 15 years.

(ii) a telecommunication entity determined the lease term for a mobile network tower to be five years, which is not matched by the telecom operator's service licence with a term of about 20 years.

(c) determining the lease term, in particular the assessment of extension or termination options, is the most challenging area of judgement that might hinder comparability of reported financial information. A credit rating agency said they mostly rely on judgements entities make, because, in their view, the entities have better knowledge of their business and lease arrangements. However, in some cases, lease terms that entities determined were inconsistent with the user's expectations, in which case they said they might make qualitative adjustments to the entity's credit rating.

30. Many stakeholders who commented on the usefulness of information resulting from lessees' application of judgement suggested providing additional guidance and illustrative examples to support lessees in making complex judgements. Stakeholders' suggestions included:

(a) in relation to the notion of 'reasonably certain' (suggested by some stakeholders):

(i) quantifying the threshold.

(ii) providing the minimum factors for lessees to consider or a rebuttable presumption.

(iii) clarifying the guidance in paragraphs B37–B40 of IFRS 16 to improve understandability.

(iv) providing additional examples illustrating the assessment of 'reasonably certain' for complex leases (for example, including multiple options). These stakeholders said the examples should incorporate market-based factors such as rising rental costs, limited availability of alternative premises, and interdependency with other leases to reflect broader commercial incentives that may influence a lessee's decision to exercise (or not to exercise) an option in the contract.

(v) clarifying in application guidance that broader economic consequences of termination (beyond contractual payments) should also be considered, consistent with what paragraph BC157 of the Basis for Conclusions on IFRS 16 says.

(vi) aligning with other thresholds of 'virtually certain', 'highly probable' and 'more likely than not'.

(vii) clarifying to what extent past practice and entities' expectations should (or should not) influence the determination of the lease term.

(b) in relation to the enforceability of the lease term (suggested by some stakeholders):

(i) providing additional guidance and practical examples to illustrate the application of the concept of 'no more than an insignificant penalty'.

(ii) incorporating in IFRS 16 the explanatory material included in the agenda decision [Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16)](). A few stakeholders said the agenda decision only deals with a specific fact pattern and the meaning of 'broader economics' is unclear.

(iii) to incorporate in IFRS 16 the diagram in paragraph 6 of Agenda Paper 3 for the June 2019 Committee meeting, which illustrates the relationship between non-cancellable period, lease term and enforceable period.

(c) providing additional guidance to help entities determine the non-cancellable period for some complex scenarios, for example, when the non-cancellable period becomes fixed only after lease commencement (suggested by a few stakeholders).

(d) general suggestions for additional guidance or illustrative examples (suggested by some stakeholders).

31. A few stakeholders (mainly preparers) suggested simplifying the determination of lease terms, especially for complex contracts or contracts that renew indefinitely, for example by:

(a) specifying that the lease term should cover only the non-cancellable period; or

(b) excluding contracts with a tacit renewal option or indefinite life from the scope of IFRS 16.

32. Many stakeholders, including many users, who commented on the usefulness of information resulting from lessees' application of judgements suggested the IASB explicitly require lessees to disclose information about judgements and assumptions in determining lease terms. Such disclosure could include explanations of the factors considered when assessing whether options to extend or terminate are 'reasonably certain' to be exercised.

33. A few stakeholders, including a few users, suggested the IASB require lessees to disclose:

(a) information about the useful life (or at least a range of useful lives) of underlying assets to improve the comparability of information between lessees and entities that purchase assets;

(b) a comparison of the current lease term with the average period over which the entity typically uses the underlying asset;

(c) minimum and maximum contractual terms;

(d) the proportion of the lease liability that is subject to extension or termination options;

(e) more granular information about expected lease renewals;

(f) weighted-average lease term;

(g) the range of lease terms by class of assets; or

(h) sensitivity analysis for lease liabilities, showing how the carrying amount would have been affected by changes in lease terms.

Staff analysis

Does the matter have substantial consequences?

34. Most stakeholders commented on the usefulness of information resulting from lessees' application of judgement. Of those, most stakeholders, including most users, raised various concerns. Most stakeholders who raised concerns said determining the lease term involves complex judgements, which have a material impact on the measurement of lease liabilities and reduce comparability between entities (see paragraphs 25–28). Users also raised concerns about structuring opportunities, hindered comparability and unrealistic lease terms undermining the credibility of managements' judgements (see paragraph 29). Therefore, considering this feedback, we think that the criterion in paragraph 19(a)—the matter has *substantial consequences*—is met.

Is the matter pervasive?

35. Considering that *most* stakeholders (including most users, standard-setters and preparers, and many accountancy bodies) from various jurisdictions (including most stakeholders from Asia-Oceania, Europe, Africa and some stakeholders from Latin

America) raised various concerns about the usefulness of information resulting from the lessees' application of judgement in determining the lease term, we think that the criterion in paragraph 19(b)—the matter is *pervasive*—is met.

Is there a feasible solution and are the benefits of the solutions expected to outweigh the costs?

36. Based on the feedback (see paragraphs 30–33), we identified three main suggestions aimed at enhancing the usefulness of lease-related information resulting from lessees' application of judgement in determining the lease term. They are for the IASB:

    (a) to provide additional guidance and illustrative examples to help apply the concepts of 'reasonably certain' and 'insignificant penalty' (paragraphs 37–47);

    (b) to simplify the requirements for determining lease term (paragraphs 48–52); and

    (c) to develop specific disclosure requirements (paragraphs 53–65).

To provide additional guidance and illustrative examples

37. Paragraph B34 of IFRS 16 states that a lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with 'no more than an insignificant penalty'. Some stakeholders raised concerns about the lack of clarity of what is meant by 'penalty'—whether it only includes contractual termination payments or also includes the broader economics of the contract.

38. We note that in November 2019, the Committee published Agenda Decision Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16 *Property, Plant and Equipment*) that includes explanatory material for paragraph B34 of IFRS 16. In addition, in 2017 the IFRS Foundation published a Lease Term Q&A webcast to address implementation questions in relation to paragraph B34 of IFRS 16.

39. In developing IFRS 16, many stakeholders thought that because options to extend or terminate leases affect the economics of those leases, there is a need to include some

options in determining the lease term. Some thought that if a lessee expects to exercise an option, including the period covered by that option in the lease term would provide a more faithful presentation of the economics of the lease. In the IASB's view, the lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used because that approach provides the most useful information.[2]

40. The IASB considered a number of ways of determining that reasonable expectation of what the term will be. These included requiring an entity to include optional periods for which the lessee has a significant economic incentive to exercise an option. The IASB noted that requiring an economic incentive provides a more objective threshold than a threshold based solely on management's estimates or intention, and consequently would help to address concerns that other approaches would be complex to apply. However, stakeholders were concerned about the costs of implementing any new concept regarding the lease term. Stakeholders suggested that, if the IASB viewed the 'significant economic incentive' threshold as similar to the 'reasonably certain' threshold in IAS 17 *Leases*, the IASB should retain the terminology in IAS 17.[3]

41. In light of the feedback received, the IASB decided to retain the concept and terminology of IAS 17 to achieve consistent application between entities. However, the IASB observed that applying the concept of 'reasonably certain' requires judgement and decided to provide application guidance in paragraphs B37–B40 of IFRS 16 to help entities to apply this concept.[4] For example:

    (a) paragraph B37 of IFRS 16 provides examples of factors to consider that could create an economic incentive for the lessee to exercise, or not to exercise, the option, which includes:

        (i) contractual terms and conditions for the optional periods;

[2] See paragraphs BC155–BC156 of the Basis for Conclusions on IFRS 16.
[3] See paragraph BC156 of the Basis for Conclusions on IFRS 16.
[4] See paragraph BC157 of the Basis for Conclusions on IFRS 16.

(ii) significant leasehold improvements undertaken;

(iii) costs relating to the termination of the lease;

(iv) the importance of the underlying asset to the lessee's operation; and

(v) conditionality of the option.

(b) paragraph B39 of IFRS 16 provides guidance about the relationship between the length of the non-cancellable period of a lease and the probability of exercising options (the shorter the non-cancellable period, the more likely a lessee is to exercise an option because of the costs associated with replacement);

(c) paragraph B40 of IFRS 16 provides guidance in relation to a lessee's past practice (a lessee's past practice and its economic reasons may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise an option).

42. We note that in 2016 and 2017 the IFRS Foundation published materials explaining the key requirements in IFRS 16 and the IASB's thinking when developing some of the requirements. One of these materials, IFRS 16: Lessee Measurement webcast, explains what to consider when assessing 'reasonably certain'.

43. Many stakeholders agreed that the requirements in IFRS 16 generally provide a clear and sufficient basis for entities to make appropriate judgements; however, some stakeholders disagreed (see paragraph 7).

44. As we explain in paragraphs 38–42, during the development of IFRS 16, the IASB provided application guidance and since issuing IFRS 16, the IASB and the Committee have worked together to provide materials supporting consistent application of the requirements in response to scenarios most frequently met in practice. We are unsure what additional guidance, beyond material already developed, would have significant benefits, in particular for frequently encountered scenarios. Further, as described in paragraphs 40–41, the 'reasonably certain' threshold was carried forward from IAS 17 to help achieve consistent application. Quantifying or

aligning this with other thresholds would likely result in broader changes that could cause additional costs for all stakeholders.

45. We think that some stakeholders' feedback and concerns relate to complex lease arrangements and the nature of stakeholders' comments and concerns does not indicate that there are flaws or gaps in the requirements. In addition, some stakeholders' feedback suggests that differing outcomes arising from entities' assessments of lease terms might reflect their varying facts and circumstances.

46. In our view, illustrative examples are usually most useful when they illustrate how an entity applies a specific requirement in a fact pattern that can be applied broadly. Illustrative examples for specific complex fact patterns would be unlikely to help many stakeholders—the outcome for other entities might be different depending on seemingly minor variations in the contracts and entity-specific circumstances and it could increase the risk of an entity inappropriately analogising the example to its situation without appropriately considering all the relevant facts and circumstances. Therefore, in our view, there is not a feasible solution that would help most stakeholders, so the criterion in paragraph 19(c) is not met.

47. In our view, additional illustrative examples or guidance could also lead to disruption in practice and additional costs because many entities would need to review their current accounting practices to determine whether they are affected by any new guidance or examples. We think that the benefits of providing additional application guidance or illustrative examples that might help only some (but not all) stakeholders would not justify the costs (of changes and disruption in practice), so the criterion in paragraph 19(d) is not met. For this reason, we do not recommend any action.

To simplify the requirements for lease term

48. Simplification of the requirements would reduce the need for judgements (or make the judgements easier to make) and therefore could reduce the costs of determining the lease term. In Agenda Paper 7A for this meeting, we conclude that the ongoing costs for lessees of applying the measurement requirements in IFRS 16 are higher than the IASB expected when it issued IFRS 16 and identify four main areas that contribute

most to high ongoing costs. Determining the lease term is not one of those four areas (see paragraph 14 in Agenda Paper 7A for this meeting).

49. Further only a few stakeholders suggested simplifying the requirements, especially for complex lease arrangements (see paragraph 31), and many stakeholders agreed that the requirements in IFRS 16 generally provide a clear and sufficient basis for entities to make appropriate judgements (see paragraph 7).

50. As described in paragraph 39, the IASB decided to include in the lease term an entity's reasonable expectation of the period over which the underlying asset will be used. Many stakeholders during the development of IFRS 16 said there was a need to include options when determining the lease term and, in the IASB's view, including options would provide the most useful information. For example, as described in paragraph 29(b), users raised concerns about entities' unrealistic lease terms that are inconsistent with their past practice or business model which indicates that users are interested in the judgements entities make about lease term.

51. Although simplifying requirements—such as developing an approach to lease term determination based solely on the non-cancellable period—would reduce the need to apply judgement and hence costs, it might impair the usefulness of the information; therefore, it could heighten concerns raised by the users (see paragraph 50). In addition, changes in the requirements would disrupt current practice.

52. Based on our analysis in paragraphs 48–51, we do not recommend simplifying the requirements for lease term determination.

To develop specific disclosure requirements

53. Many stakeholders, including many users, suggested the IASB explicitly require lessees to disclose information about judgements and assumptions in determining lease terms (see paragraph 32). In their view, this additional information would provide more transparency about lease-related balances and would likely enhance comparability of lease-related information between entities. Only a few stakeholders suggested the IASB develop other specific disclosure requirements (see paragraph 33).

54. We observe that:

(a) paragraph 122 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose the judgements (apart from those involving estimations) that have the most significant effect on the amounts recognised in the financial statements.

(b) paragraph 125 of IAS 1 requires entities to disclose information about assumptions and other sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

(c) paragraph 123 of IFRS 15 *Revenue from Contracts with Customers* requires an entity to disclose the judgements, and changes in the judgements, made in applying IFRS 15 that significantly affect the determination of the amount and timing of revenue from contracts with customers.

(d) FASB ASC Topic 842 Leases (Topic 842) requires a lessee to disclose information about significant assumptions and judgments made in applying Topic 842, although it does not include the determination of lease term as an example.[5] We note the positive feedback that the FASB received about the disclosure requirements in Topic 842. In their *Post-Implementation Review Summary Report Topic 842—Leases* the FASB note: Almost all investors indicated that the disclosures provided are an improvement to those provided under legacy GAAP. Investors highlighted that the disclosures of the components of lease cost (that is, fixed, variable, and short-term) and the weighted-average remaining lease term and weighted-average discount rate are useful.[6]

55. We undertook an AI-assisted review of a sample of financial statements to assess the frequency and quality of information disclosed by entities about significant

[5] FASB ASC paragraph 842-20-50-3 c requires a lessee to disclose information about significant assumptions and judgements made in applying the requirements of Topic 842, which may include (1) the determination of whether a contract contains a lease, (2) the allocation of the consideration in a contract between lease and nonlease components and (3) the determination of the discount rate for the lease.

[6] See page A-16 in the *Post-Implementation Review Summary Report Topic 842—Leases*.

judgements in accordance with paragraph 122 of IAS 1—for more information, see paragraphs 16–23 in Agenda Paper 7C for this meeting. Of the 753 entities in the sample, 24% disclosed significant accounting judgements related to leases and determination of the lease term was the most common area identified as a significant judgement. We found that most disclosures on the significant judgements about lease term did not include entity-specific information. These disclosures were often boilerplate and contained wording similar to that in the requirements in IFRS 16 for lease term.

56. In developing IFRS 16 the IASB considered lessees' concerns about the costs of complying with the disclosure requirements proposed in the 2010 and 2013 Exposure Drafts. The IASB set the current disclosure requirements after considering these concerns from preparers and the needs of users.[7] In particular, information about significant assumptions and judgements made in applying the Standard was one of the proposed disclosure requirements in 2010 and 2013 Exposure Drafts.

57. Considering the feedback to the RFI from many users and evidence from entities' disclosure practices applying IAS 1, we think the IASB could consider whether the benefits of developing specific disclosure requirements about significant judgements made in determining the lease term would outweigh the costs.

58. However, even if this information was specifically required (similar to IFRS 15), there still could be some questions about how useful the disclosed information would be. Our AI-assisted review of a sample of financial statements summarised in paragraph 55 raises questions about how much entity- and lease-contract-specific information would be provided. The usefulness of the information might also be affected by the size of entities' lease portfolios, with those entities with large lease portfolios likely to provide more aggregated information. Entities with large lease portfolios might also be more likely to consider judgements about individual leases in that portfolio as insignificant.

[7] See paragraphs BC213–BC214 of the Basis for Conclusions on IFRS 16.

59. Entities would need to incur some additional costs in preparing the information to comply with any new disclosure requirements. We generally expect the information to be available to entities, because making judgements in determining lease terms is already part of entities' accounting for leases and, if those judgements are significant, IAS 1 already requires an entity to disclose the information. However, it is unclear how granular stakeholders are suggesting this information needs to be, and that might affect the cost of providing the information.

60. If the IASB were to explore specifically requiring entities to disclose information about significant judgements in determining lease terms, these questions would need to be considered.

61. The level of concern about the usefulness of information resulting from lessees' application of judgement is similar to that about high ongoing costs. As described in paragraph 14, it is unclear whether the benefits to users of lease-related information resulting from lessees' application of judgement is significantly lower than was expected because it is difficult to judge the root cause of these concerns. We think that improving transparency about significant judgements entities make by explicitly requiring entities to disclose this information, for example, such as in Topic 842 or IFRS 15, could be a solution whatever the root cause is. This is because the disclosed information would help users to understand better why entities determine lease term differently to other entities or from users' expectations, if applied appropriately.

62. On balance, despite the concerns in paragraphs 58–61, we recommend the IASB add to its pipeline a research project to explore targeted improvements to the usefulness of information resulting from lessees' application of judgement in determining lease terms, for example, by developing specific requirements for lessees to disclose significant judgements made in determining lease terms.

63. In Agenda Paper 7A for this meeting, we recommend the IASB add to its project pipeline and explore in a separate research project the feasibility of potential cost-reduction measures. In paragraph 90, we recommend the IASB add to its pipeline a research project to explore targeted improvements to the usefulness of the information resulting from lessees' application of judgements in determining discount rates, for

example, by developing specific requirements for lessees to disclose significant judgements made in determining discount rates. We think disclosure requirements about significant judgements made in determining lease term and discount rates should be considered as part of a single research project together with the potential cost-reduction measures. We think that this would allow the IASB to consider any additional costs from the additional disclosure requirements together with the potential cost-reduction measures to assess the overall ongoing cost for lessees properly. It would also be a more efficient and cost-effective approach for the IASB and its stakeholders.

64. In response to suggestions from a few stakeholders (including only a few users) for other specific disclosure requirements in paragraph 33, we think that:

(a) they are not prevalent and the benefits for users would be unlikely to justify the costs for entities of providing the information.

(b) in addition to specific items of information required in paragraphs 53–58 of IFRS 16, paragraph 59 of the Standard requires lessees to disclose additional (qualitative and quantitative) information about its leases that is necessary to meet the disclosure objective in paragraph 51 of IFRS 16. This information includes, but is not limited to, information that helps users to assess future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This exposure arises from, for example, extension options and termination options. Paragraphs B50–B52 of IFRS 16 provide application guidance for lessees to determine whether, and if so what, additional information about leases they should disclose to meet the disclosure objective.

(c) paragraph IE10 in Illustrative Examples accompanying IFRS 16 (Example 23) illustrate how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B50 of IFRS 16 about extension options and termination options.

65. In our view, considering stakeholders' feedback, the disclosure requirements in IFRS 16 are sufficient and appropriately balance users' needs with costs for preparers.

It is unlikely that additional specific disclosure requirements (other than those that we recommend in paragraph 62) would provide useful information without a significant negative effect on ongoing costs for lessees. We also think the potential disclosure requirements for significant judgements might capture some information suggested by stakeholders.

Staff recommendation and question for the IASB

66. For the reasons discussed in paragraphs 53–63, we recommend the IASB add to its project pipeline a research project to explore targeted improvements to the usefulness of information resulting from lessees' application of judgement in determining lease terms, for example, by developing specific requirements for lessees to disclose significant judgements made in determining the lease term.

67. For the reasons discussed in paragraphs 37–52 and 64–65, we do *not* recommend taking further action in response to stakeholders' suggestions:

    (a) to provide additional guidance or illustrative examples for determining lease term;

    (b) to simplify the requirements for determining lease term; or

    (c) to develop specific requirements for lessees to disclose items of information described in paragraph 33.

Question 1 for the IASB
Do IASB members agree with the staff recommendations in paragraphs 66–67 of this paper?

Discount rates

What does IFRS 16 require?

68. Paragraphs 58–60 in Agenda Paper 7A for this meeting summarise the IFRS 16 requirements for discount rates. For brevity, we have not repeated them in this paper.

What do stakeholders say?

69. Paragraphs 61–66 in Agenda Paper 7A for this meeting summarise stakeholders' feedback about ongoing costs for lessees of applying the requirements in IFRS 16 for discount rates.

70. Question 2 in the RFI asked stakeholders about their views on the usefulness of information resulting from the application of judgement (for example, in determining discount rates). Most of those who commented on Question 2 in the RFI (including most standard-setters, many accountancy bodies and many preparers) raised various concerns about determining discount rates in IFRS 16. Of those stakeholders:

    (a) many said interest rates implicit in leases are rarely observable. The absence of observable inputs necessitates the use of judgement and estimates in determining incremental borrowing rates (IBRs), which leads to variations in outcomes and hinders comparability between entities.

    (b) some said different methodologies used by entities produce materially different IBRs for similar leases.

    (c) a few said consideration of entity-specific factors such as the lessee's credit risk, lease term, and nature of the underlying asset often results in variability across entities.

    (d) a few said the lack of sufficient information disclosed to understand how IBRs are determined makes it difficult to analyse and compare entities.

    (e) a few stakeholders, mainly from Latin America, said:

(i) they observed that the IBRs used by some entities are significantly higher than the entities' observable borrowing rates, which artificially reduces the lease liabilities.

(ii) when an economy is subject to high inflation, applying discount rates (that incorporate expected inflation) to variable lease payments (that are not adjusted for expected inflation) results in an economically inappropriate measurement of a lease liability.

71. Many users commented on the usefulness of information resulting from lessees' application of judgement in determining discount rates.

72. Most of them raised some concerns about the use of judgement in determining discount rates and how it hinders comparability of financial information. Users' comments included:

(a) using IBR results in artificial differences when entities of different credit standings enter identical leases—they report different lease liabilities even if they lease the same asset; and

(b) the measurement of the lease liability is one of the 'controversial points' in IFRS 16 because it is highly dependent on management's judgement in determining discount rate (and lease term).

73. However, some users, including a credit rating agency, expressed little or no concern about the usefulness of information resulting from the application of judgement in determining discount rates. For example, users said:

(a) discount rates determined in accordance with IFRS 16 are more accurate than the estimates made when leases were off balance sheet, even if determining those discount rates requires judgement.

(b) insufficient information about discount rates is less problematic than insufficient information about lease terms. This user said they can check whether an entity's assumptions about discount rates are reasonable by discounting lease payments (disclosed in maturity analysis required by IFRS 7 *Financial Instruments: Disclosures*), using their own discount rates, and comparing their calculation of the net present value with the carrying amount of lease liabilities reported by the entity.

74. Many of those who responded to Question 2 in the RFI made suggestions to the IASB relating to discount rate requirements which, in their view, would help to reduce complexity and variability in application. These stakeholders' comments included that the IASB should consider:

(a) requiring lessees to disclose explicitly:

(i) key assumptions and judgements made in determining IBRs—many of those who made suggestions, including many users, suggested this;

(ii) methodology used in determining IBRs—some of those who made suggestions suggested this;

(iii) sensitivity analysis of the lease liability to changes in the discount rates—some of those who made suggestions suggested this;

(iv) weighted average discount rate—a few stakeholders, including a few users, suggested this;[8] and

(v) range of possible discount rates—a few stakeholders suggested this;

(b) clarifying how (and providing illustrative examples) to determine an IBR in complex scenarios—many stakeholders suggested this; and

(c) introducing a single reference rate or allowing entities to use observable borrowing rates or readily available information from external sources (such as a government yield curve plus a credit spread or a risk-free rate) to reduce subjectivity in determining discount rates and enhance comparability—some stakeholders suggested this.

[8] We note that FASB ASC paragraph 842-20-50-4 requires a lessee to disclose weighted-average discount rate.

Staff analysis

Does the matter have substantial consequences?

75. Most stakeholders commented on the usefulness of information resulting from lessees' application of judgement. Of those, most stakeholders (including most standard-setters, most users, many accountancy bodies and many preparers) raised various concerns about determining discount rates in IFRS 16, saying that differences in discount rates lead to different measurements of lease liabilities. Therefore, we think that the criterion in paragraph 19(a)—the matter has *substantial consequences*—is met.

Is the matter pervasive?

76. Considering that *most* stakeholders including most standard-setters, most users, many accountancy bodies and many preparers, from various jurisdictions (including most stakeholders from Africa, Latin America and Europe and many stakeholders from Asia-Oceania) raised various concerns about the usefulness of information resulting from the lessees' application of judgement in determining discount rates, we think that the criterion in paragraph 19(b)—the matter is *pervasive*—is also met.

Is there a feasible solution and are the benefits of the solutions expected to outweigh the costs?

77. Based on our analysis of the feedback in Agenda Paper 7A for this meeting, we concluded that ongoing costs for lessees of applying the measurement requirements in IFRS 16 are higher than the IASB expected when it issued the Standard. We identified discount rate requirements as one of the major ongoing cost drivers (see paragraph 14 in Agenda Paper 7A for this meeting). In this section we analyse whether to take actions primarily from the perspective of enhancing the usefulness of information resulting from lessees' application of judgement in determining discount rates.

78. Based on the feedback, we identified three main suggestions aimed at enhancing the usefulness of lease-related financial information resulting from lessees' application of judgement in determining discount rates. They are for the IASB:

(a) to develop specific disclosure requirements (paragraphs 79–84).

(b) to clarify how (and provide additional guidance or illustrative examples) to determine an IBR in complex scenarios (paragraphs 85–89). Many stakeholders suggested this in response to Question 2 of the RFI to enhance the usefulness of the information (with a secondary benefit of reducing costs, because reducing the complexity of making judgements may also help reduce costs). We have also analysed this topic in Agenda Paper 7A for this meeting because we have identified determining the discount rate as one of the major ongoing cost drivers and, although suggested by only a few stakeholders, some suggestions were specifically provided in response to Question 4 of the RFI to reduce costs.

(c) to introduce a single reference rate or to allow lessees to use observable borrowing rates or readily available information from external sources (see paragraphs 70–78 of Agenda Paper 7A for this meeting for staff analysis and paragraph 90 of Agenda Paper 7A for this meeting for our staff recommendation). We have analysed these suggestions in Agenda Paper 7A for this meeting because these are primarily suggestions that reduce ongoing costs of applying IFRS 16. However, these suggestions could also simplify the judgements entities make and improve the comparability of information.

To develop specific disclosure requirements

79. Many of those who provided suggestions for how to enhance the usefulness of information resulting from the application of judgement in determining discount rates (including many users) said the IASB should consider specifically requiring lessees to disclose the judgements and assumptions made in determining the IBR (see paragraph 74(a)(i)). In paragraphs 53–62 of this agenda paper we analyse stakeholders'

suggestions for requiring lessees to specifically disclose information about judgements and assumptions in determining lease terms.

80. In our view our analysis and arguments we make in paragraphs 53–62 are equally relevant to this section. Therefore, we recommend the IASB add to its pipeline a research project to explore enhancing the usefulness of information resulting from lessees' application of judgement in determining discount rates, for example, by explicitly requiring lessees to disclose significant judgements made in determining discount rates.

81. Regarding stakeholders' other suggestions in paragraph 74(a)(ii)–(v), we note that paragraph 51 of IFRS 16 sets an overall disclosure objective and paragraph 59 of IFRS 16 requires a lessee to disclose additional (qualitative and quantitative) information about its leasing activities necessary to meet the disclosure objective. However, as the feedback and our academic literature review suggests,[9] the specific items of information in paragraph 74(a)(ii)–(v) are not necessarily disclosed because they are not specifically required by IFRS 16.

82. In paragraphs 117–133 in Agenda Paper 7A for this meeting, we analyse stakeholders' feedback on high ongoing costs of disclosing information required in IFRS 16 that, in these stakeholders' view, provide little or no observed benefits to users. In our view, the additional ongoing costs that would arise if the IASB required *all* lessees specifically to disclose items of information suggested by (some or only a few) stakeholders in paragraph 74(a)(ii)–(v) would be higher than potential benefits to users.

83. We observe that the suggestions for specific items of information were generally not prevalent, and only a few users specifically suggested requiring lessees to disclose weighted average discount rate. In addition, the benefit of information about entities' weighted average discount rates is questionable if entities have a high volume of leases, in particular when leases have unique terms and conditions. We also think

[9] Delgado-Vaquero, Morales-Díaz, and Zamora-Ramírez (2022) showed evidence of limited and inconsistent disclosure practices about discount rate assumptions in the notes to financial statements of 68 European listed entities in the hotel and retail sectors (see paragraph 24 of February 2026 Agenda Paper 7C).

other information required to be presented separately or disclosed in IFRS 16 such as maturity analysis of undiscounted lease payments and the (discounted) carrying amount of lease liability could be used to estimate the weighted average discount rate.

84. In addition, if the IASB agrees with our recommendation in paragraphs 66 and 80 (to consider requiring lessees to disclose information about significant judgements in determining lease terms and discount rates), we think that some lessees might also provide information suggested by some stakeholders in paragraph 74(a)(ii)–(v) if that information is material.

To provide additional guidance or illustrative examples to determine the IBR

85. IFRS 16 defines IBR in Appendix A to IFRS 16 and paragraph BC162 of the Basis for Conclusions on IFRS 16 explains that in determining the IBR, depending on the nature of the underlying asset and the terms and conditions of the lease, a lessee may be able to refer to a rate that is readily observable as a starting point and then adjust such an observable rate as is needed.

86. Stakeholders said further clarification on the methodology or illustrative examples in determining the IBR for complex scenarios would improve consistency in application. A few stakeholders said there are practical challenges in determining the IBR, particularly when observable rates for loans with similar payment profiles and security associated with the right-of-use asset are not available.

87. We note that since the IASB issued IFRS 16, in response to stakeholders' questions about determining the IBR, the IASB and the Committee have worked together to support implementation and consistent application of the requirements in IFRS 16, for example:

    (a) in August 2017 the IASB staff published a webcast IFRS 16: Lessee Measurement that explains possible approaches to determining IBR; and

    (b) in September 2019 the Committee published Agenda Decision Lessee's Incremental Borrowing Rate (IFRS 16) in response to a request about the definition of a lessee's IBR in IFRS 16. The request asked whether a lessee's

IBR is required to reflect the interest rate in a loan with both a similar maturity to the lease and a similar payment profile to the lease payments.

88. Providing additional guidance or illustrative examples might to some extent improve comparability between entities, but the costs for all lessees from disruption and changes to practice would likely outweigh the benefits. We think that:

(a) IFRS 16 does not provide or limit the method to determine IBR, and so additional guidance or clarification of the methodology might force a change in current practice;

(b) providing additional illustrative examples would force lessees to revisit their methodology to see whether their current methodology is consistent with the added illustrative examples;

(c) illustrative examples would only address specific facts and circumstances which are often entity-specific and their applicability and usefulness would be limited; and

(d) lessees' overreliance on illustrative examples in some cases could lead to inappropriate exercise of judgement in their specific circumstances and result in less useful information than they currently provide—for example, it could increase the risk of an entity inappropriately analogising the example to its situation without appropriately considering all the relevant facts and circumstances.

89. In Agenda Paper 7A for this meeting, we recommend the IASB add to its project pipeline and explore in a separate research project the feasibility of potential cost-reduction measures relating to discount rates. If, as a result of that project, the IASB decides to amend IFRS 16, we think the IASB might need to reconsider some of the disclosure requirements relating to discount rates or provide examples illustrating the application of the new requirements.

Staff recommendation and question for the IASB

90. For the reasons discussed in paragraphs 79–80, we recommend the IASB add to its project pipeline a research project to explore targeted improvements to the usefulness of information resulting from lessees' application of judgements in determining discount rates, for example, by developing specific requirements for lessees to disclose significant judgements made in determining the discount rate.

91. For the reasons discussed in paragraphs 81–89, we do *not* recommend taking further action in response to stakeholders' suggestions:

    (a) to provide additional guidance or illustrative examples for determining the IBR; or

    (b) to develop specific requirements for lessees to disclose items of information described in paragraph 74(a)(ii)–(v).

Question 2 for the IASB
Do IASB members agree with the staff recommendations in paragraphs 90–91 of this paper?

Variable lease payments

What does IFRS 16 require?

92. At the commencement date, a lessee includes in the measurement of the lease liability, among others, fixed payments (including in-substance fixed payments) and variable lease payments that depend on an index or a rate less any lease incentives received.[10]

93. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable.[11]

[10] See paragraph 27 of IFRS 16.

[11] See paragraph B42 of IFRS 16.

94. Variable lease payments that depend on an index or a rate include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate and payments that vary to reflect changes in market rental rates.[12]

What do stakeholders say?

95. Many of those who commented on Question 2 in the RFI (mainly standard-setters, accountancy bodies, preparers and accounting firms) said there is unclear or insufficient guidance to determine whether some lease payments are in-substance fixed lease payments, variable lease payments that depend on an index or a rate, or variable lease payments that do not depend on an index or a rate. Only a few users highlighted variable lease payments as an area of judgement which they are concerned with but provided no further details.

96. The most frequently raised comments related to the application guidance for in-substance fixed lease payments in paragraph B42 of IFRS 16. Many of those who commented on Question 2 said these requirements do not provide a clear and sufficient basis to decide whether lease payments are in-substance fixed or 'genuinely' variable in some fact patterns. This is because:

(a) determining whether a future event 'has no genuine possibility of not occurring' is challenging. For example, stakeholders said in renewable electricity contracts it is unclear whether variable lease payments linked to a nature-dependent source of electricity (such as the sun or wind) are (or are not) in substance-fixed lease payments. A few said not recognising lease liabilities for such payments (which, in form, contain variability but, in substance, are unavoidable) does not reflect their economic substance.

(b) paragraph B42(a)(ii) of IFRS 16 refers only to payments that are initially structured as variable lease payments (linked to the use of the underlying asset) but 'become fixed for the remainder of the lease term'. So, stakeholders said it is unclear how to account for lease payments that are initially variable,

[12] See paragraph 28 of IFRS 16.

become fixed for only a portion of the lease term, and then become variable again.

97. A few stakeholders said the absence of a clear definition of 'an index or a rate' in some cases requires the use of judgement to determine whether variable lease payments depend on an index or a rate. Practical challenges arise in particular when variable lease payments depend on an index or a rate that is not linked to general market conditions, the performance of the lessee or the underlying asset (for example, lease payments based on the lessee's credit rating or the government's official value of the leased property).

98. Some of those who responded to Question 2 in the RFI suggested the IASB provide clearer or additional guidance or illustrative examples to help lessees distinguish between in-substance fixed lease payments, variable lease payments that depend on an index or rate and other variable lease payments. Stakeholders' suggestions included:

(a) providing additional application guidance that would clarify how to interpret 'genuine variability' in paragraph B42(a) of IFRS 16 and 'no genuine possibility of not occurring' in paragraph B42(a)(i) of IFRS 16—suggested by some stakeholders;

(b) clarifying how to apply the requirement in paragraph B42(a)(ii) of IFRS 16 to determine when lease liabilities should (or should not) be remeasured if lease payments change between being fixed in some periods and variable in others during the lease term—suggested by some stakeholders; and

(c) clarifying the definition and scope of the terms 'index' or 'rate'—suggested by a few stakeholders.

99. A few stakeholders suggested that the IASB should require lessees to disclose more detailed information about variable lease payments. For example, a credit rating agency said it is often not clear whether and why particular variable lease payments are expensed or included in the measurement of the lease liability.

Staff analysis

Does the matter have substantial consequences?

100. Determination of whether variable lease payments are (or are not) included in the measurement of the lease liability has a potential of substantial consequences for users' ability to analyse trends and to compare entities, because the accounting for the two types of variable lease payments differs significantly (that is, they are either included in the measurement of the lease liability and expensed over time within depreciation of the right-of-use asset or expensed when incurred). However, considering that only *a few* users highlighted variable lease payments as an area of judgement which they are concerned with, we think that the criterion in paragraph 19(a)—the matter has *substantial consequences*—is not met.

Is the matter pervasive?

101. Most stakeholders commented on the usefulness of information resulting from lessees' application of judgement. Of those, only *a few* users highlighted variable lease payments as an area of judgement which they are concerned with, but *many* stakeholders including standard-setters, accountancy bodies, preparers and accounting firms (including many stakeholders from Europe and Asia-Oceania and some stakeholders from Latin America and Africa) said there is unclear or insufficient guidance to measure lease liabilities in relation to variable lease payments. Considering this feedback, especially from many stakeholders other than users, we think that the criterion in paragraph 19(b)—the matter is *pervasive*—is met.

Is there a feasible solution and are the benefits of the solutions expected to outweigh the costs?

102. Based on the feedback (see paragraphs 98–99), we identified three main suggestions aimed at enhancing the usefulness of lease-related information resulting from lessees' application of judgement in determining whether some variable lease payments should (or should not) be included in the measurement of the lease liability. They are for the IASB:

(a) to provide clearer or additional guidance and illustrative examples to distinguish between in-substance fixed lease payments and genuine variable lease payments (paragraphs 103–109);

(b) clarify the definition and scope of the terms 'index' or 'rate' (paragraphs 110–113); and

(c) require lessees to provide more detailed information about variable lease payments (paragraphs 114–116).

To provide clearer or additional guidance and illustrative examples to distinguish between in-substance fixed lease payments and genuine variable lease payments

103. Paragraph B42 of IFRS 16 states that in-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. IFRS 16 requires a lessee to include in-substance fixed lease payments in the measurement of lease liabilities because those payments are unavoidable and, thus, are economically indistinguishable from fixed lease payments. The IASB decided to include in paragraph B42 of IFRS 16 examples of the types of payments that are considered to be in-substance fixed payments to help in applying the requirement.[13]

104. We note that in 2016 and 2017 the IFRS Foundation published materials explaining the key requirements in IFRS 16 and the IASB's thinking when developing some of the requirements. One of these materials, IFRS 16: Lessee Measurement webcast, explains what to consider to distinguish between in-substance fixed lease payments and genuine variable lease payments, acknowledging that this determination requires judgement.

105. We observe that many stakeholders agreed that the requirements in IFRS 16 generally provide a clear and sufficient basis for entities to make appropriate judgements. Some stakeholders disagreed (see paragraph 7) and many stakeholders who commented on Question 2 in the RFI said the requirements in paragraph B42 do not provide a clear and sufficient basis to decide whether lease payments are in-substance fixed or

[13] See paragraph BC164 of the Basis for Conclusions on IFRS 16.

'genuinely' variable in *some* fact patterns (see paragraph 96). In our view, although stakeholders raised concerns about the lack of guidance, stakeholders' suggestions for clarifications or illustrative examples stem from the fact that application of judgement is complex, especially for complex lease arrangements. However, the nature of stakeholders' comments and concerns does not indicate that there are fundamental flaws in the requirements.

106. We note that stakeholders' concerns focused on complex contracts such as those with lease payments that are initially variable, become fixed for only a portion of time, and then become variable again or renewable electricity contracts.

107. As we explain in paragraph 104, since issuing IFRS 16, the IASB provided materials to support consistent application of the requirements, in particular in areas that need judgement. In our view, illustrative examples are usually most useful when they illustrate how an entity applies a specific requirement in a fact pattern that can be applied broadly. Illustrative examples for specific complex fact patterns would be unlikely to help many stakeholders—the outcome for other entities might be different depending on seemingly minor variations in the contracts and entity-specific circumstances. In addition, judgements are inevitable, in particular, for complex fact patterns, when applying principles-based Accounting Standards. Therefore, in our view, there is not a feasible solution that would help most stakeholders, so the criterion in paragraph 19(c) is not met.

108. In our view, additional illustrative examples or guidance could also lead to disruption in practice and additional costs because many entities would need to review their current accounting practices to determine whether they are affected by any new guidance or examples. Regularly adding illustrative examples or guidance to respond to emerging transactions and economic phenomena, such as renewable energy contracts, could also disrupt practice.

109. Therefore, we think that the benefits of providing additional application guidance or illustrative examples that might help only some (but not all) stakeholders would not justify the costs (of changes and disruption in practice), so the criterion in paragraph 19(d) is not met. For this reason, we do not recommend any action.

To clarify the definition and scope of the terms 'index' or 'rate'

110. Only a few stakeholders raised concerns about the absence of a clear definition of the term 'index' or 'rate' (see paragraph 98(c)) and many stakeholders agreed that the requirements in IFRS 16 generally provide a clear and sufficient basis for entities to make appropriate judgements (see paragraph 7).

111. We note that the IASB decided to include variable lease payments that depend on an index or a rate in the measurement of lease liabilities for similar reasons to those when it decided to include in-substance fixed lease payments in the measurement of the lease liability. The IASB observed that variable lease payments that depend on an index or a rate meet the definition of liabilities because they are unavoidable and do not depend on any future activity of the lessee.[14]

112. Considering that only a few stakeholders suggested clarifying the meaning of 'index' or 'rate' (whereas others might apply judgement or have less complex leases for which the assessment is straightforward), we think the benefits of clarifying requirements to help a few stakeholders would not outweigh the costs of potential disruption to current practice. In addition, we think that any potential clarification of the requirements could have unintended consequences.

113. Therefore, we do not recommend clarifying the definition and scope of the terms 'index' or 'rate'.

To develop specific disclosure requirements

114. A few stakeholders, including a credit rating agency, suggested that the IASB should require lessees to disclose more detailed information about variable lease payments. We observe that:

(a) these suggestions are not prevalent and the benefits for users would be unlikely to justify the costs for entities to provide the additional information.

(b) in addition to specific items of information required in paragraphs 53–58 of IFRS 16, paragraph 59 of the Standard requires lessees to disclose additional

[14] See paragraph BC165 of the Basis for Conclusions on IFRS 16.

(qualitative and quantitative) information about its leases that is necessary to meet the disclosure objective in paragraph 51 of IFRS 16. This information includes, but is not limited to, information that helps users to assess future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This exposure arises from, for example, variable lease payments. Paragraph B49 of IFRS 16 provides examples of information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective.

(c) paragraph IE9 in Illustrative Examples accompanying IFRS 16 (Example 22) illustrate how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B49 of IFRS 16 in relation to variable lease payments.

115. In our view, considering stakeholders' feedback, we think the disclosure requirements in IFRS 16 are sufficient and appropriately balance users' needs with costs for preparers. It is unlikely that any additional specific disclosure requirements would provide useful information without a significant negative effect on ongoing costs for lessees which, as discussed in Agenda Paper 7A for this meeting, are already higher than the IASB expected.

116. Therefore, we do not recommend providing any additional specific disclosure requirements for variable lease payments.

Staff recommendation and question for the IASB

117. For the reasons discussed in paragraphs 100–116, we do *not* recommend taking further action in response to stakeholders' suggestions that the IASB should:

(a) clarify or provide additional application guidance or illustrative examples to help entities determine whether some lease payments are in-substance fixed lease payments, variable lease payments that depend on an index or a rate, or variable lease payments that do not depend on an index or a rate; or

(b) develop specific disclosure requirements for variable lease payments.

Question 3 for the IASB
Do IASB members agree with the staff recommendation in paragraph 117 of this paper?

Question 4 for the IASB
As explained in paragraph 20, the staff recommend no action in relation to the matters discussed in Appendix A. Do IASB members agree with the staff recommendation?

Appendix A—Other judgement-related matters raised by a few respondents to Question 2 in the RFI

Matter raised by stakeholders	Staff response
1. Paragraph 20 of IFRS 16 requires an entity to reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances. A few stakeholders said that determining when a lessee should reassess these options is challenging. A few said there is not enough guidance about what constitutes 'a significant event or a significant change in circumstances'. A few said an entity should be permitted to voluntarily reassess the lease term.	We recommend taking no action because limited feedback suggests that the matter is not pervasive.
2. Paragraph 44 of IFRS 16 requires a lessee to account for a lease modification as a separate lease if the modification increases the scope of lease and the consideration increases by an amount commensurate with the stand-alone price for the increase. A few stakeholders said determining whether a lease modification should be accounted for as a separate lease is challenging. A few stakeholders more generally said accounting for a lease modification is complex.	We recommend taking no action because limited feedback suggests that the matter is not pervasive. See also paragraphs 51–54 of Agenda Paper 7A for this meeting which analyses similar feedback and also recommends no further action.
3. A few stakeholders suggested the IASB consider incorporating agenda decisions relating to IFRS 16 published by the IFRS Interpretations Committee (including the agenda decision mentioned in paragraph 30(b)(ii)) into the main body of the Standard (rather than as annotations) to improve the accessibility and clarity of the requirements and to help entities apply the requirements consistently.	We recommend taking no action because limited feedback suggests that the matter is not pervasive. In paragraphs 37–47 we analyse the suggestion to incorporate in IFRS 16 the explanatory material included in Agenda Decision Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16).