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MASB Research Report

Transition Relief and Ongoing Practical Expedients in IFRS 16 *Leases*

A Joint AASB-MASB Project

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Foreword

Standard setting involves balancing a range of competing influences and none is more challenging than weighing up the need to produce useful and, by definition, comparable information, with the need to limit the costs of preparing and auditing the information. In that context, practical expedients can be a way of limiting the preparation and audit costs for entities while still achieving important advances in the presentation of useful financial information.

Once relief is applied on transition, and once ongoing practical expedients have become embedded in industry practices, there is potential for them to be taken for granted by stakeholders, coupled with the prospect that their initial significance may be forgotten.

The 2010 and 2013 Exposure Drafts issued by the IASB in the process of developing IFRS 16 *Leases* included some proposed practical expedients, but not the relatively extensive range of transition relief and ongoing practical expedients available to lessees that were finally agreed upon after considering the substantial feedback received from stakeholders. As IFRS 16 includes a greater variety of transition relief and ongoing practical expedients than any other IFRS Accounting Standards, it is an ideal subject of research on their use and acceptance among financial reporting stakeholders.

There are some potentially important policy lessons to be learnt from analysing the practical expedients made available in IFRS 16, including how they have been used and perceived by the major stakeholder groups – preparers, auditors and users of financial statements. This has led to the preparation of this Research Report, which focuses on the experience of applying IFRS 16 in Australia and Malaysia, based on a broad range of stakeholder interviews and the analysis of published audited financial statements. The focus of the Report is on larger entities, but it also provides useful information about the topic for all types of reporting entities.

We appreciate that the nature and extent of any practical expedients provided in a particular new or revised Standard would depend on the context of that Standard, including the significance of the changes to existing practices and the degree of complexity of the accounting. Nonetheless, we consider that the practical expedients provided in IFRS 16 provide a useful template for future use, particularly in terms of:

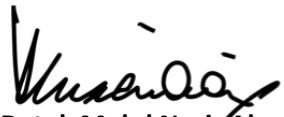
- the reasonable levels at which the practical expedients have been pitched – such as the 12-month and 'low-value' thresholds;
- the scale at which the practical expedients can be applied – such as entity-wide versus asset-by-asset; and
- the countervailing incentives underpinning the use of some practical expedients – such as those relating to not separately accounting for service components in a lease.

This Report provides a valuable contribution to the upcoming IFRS 16 post-implementation review. It also provides policy considerations on the use of transition relief and practical expedients in setting accounting standards. In particular, we encourage the IASB to consider developing policy guidance for use by the Board when it is contemplating the need for, and use of, transition relief and practical expedients. Any such guidance would potentially inform:

- decisions of the IASB in proposing transition relief and practical expedients on a particular topic;

- the basis for seeking comments from stakeholders on those proposals [that is, what questions to ask]; and
- conclusions reached on transition relief and practical expedients in finalising a new or revised IFRS Accounting Standard.

Keith Kendall
Chair, Australian Accounting Standards Board



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Executive Summary

IFRS 16 *Leases* includes a broad range of transition relief and ongoing practical expedients designed to facilitate the adoption and ongoing application of the requirements for lessees to recognise lease right-of-use (RoU) assets and lease liabilities. Based on the review of financial statements and interviews with a wide range of stakeholders in Australia and Malaysia, the predominant view of stakeholders is that the transition and ongoing practical expedients provided in IFRS 16 are generally understandable and clear. The outcomes and views expressed in the interviews were broadly consistent across both jurisdictions.

The interviews with preparers, auditors and users of financial statements revealed that many found implementing IFRS 16 to be challenging as it introduced a significant change in existing practice. The interviews also highlighted that preparers found:

- the various forms of transition relief were beneficial in terms of facilitating the transition process; and
- the ongoing practical expedients have minimised continuing application costs.

It was evident that the circumstances of the various entities were very different, based on different business models across a range of industries. Those entities for which leases are a significant source of resources and financing fall into two broad groups – those with large numbers of leased assets of moderate value and those with a relatively limited number of leased assets of very high value. For a third broad group of entities, leasing was not a significant part of their business model.

Preparers were generally very appreciative of the range of transition relief and ongoing practical expedients available to them, which could be applied according to their entities' circumstances.

Most entities researched took a modified retrospective application approach (i.e. the cumulative effect of initially applying IFRS 16 would be recognized as an adjustment to the opening balance of retained earnings) when adopting IFRS 16. The most commonly applied practical expedients were:

- not recognising RoU assets that, at transition, had a remaining term of 12 months or less;
- excluding initial direct costs from the measurement of RoU assets at the date of initial application; and
- applying hindsight for matters such as determining the lease term if the contract contains options to extend or terminate the lease.

Those entities that chose full retrospective application were typically motivated by wanting to ensure that they had an accurate stocktake of all their leases and the supporting documentation for those leases.

All entities researched applied the ongoing practical expedient of treating as a period expense the costs associated with leases of low value assets and leases with a duration of 12 months or less.

Auditors generally considered that their clients' use of transition relief and ongoing practical expedients was manageable and did not create any abnormal audit concerns. While the range of transition expedients available meant there was a need to carefully plan the audit to ensure that no material errors arose.

The users interviewed appeared to have been well-informed about the transition relief and ongoing practical expedients available to lessees, and understood the choices being made by entities they

analysed. However, the sample of users interviewed is probably biased towards those who are generally better informed about applying accounting standards, since those users are more likely to have engaged in the research. It was common for the users interviewed to comment that they knew of industry colleagues who were familiar with the transition relief and ongoing practical expedients but were not necessarily aware of the potential impacts on the information they were using.

The users interviewed were generally unconcerned about the effect of the transition relief and ongoing practical expedients and the fact that different entities might choose different approaches on the relevance and reliability of the financial statements. They were also generally appreciative of the level of disclosure that lessees are required to provide about their use of the relief and ongoing practical expedients. Some users acknowledged that any concerns they might have about a lack of comparability from applying transition relief were mitigated by the fact that entities had previously been applying IAS 17 *Leases* and had previously disclosed a considerable amount of information about lease commitments. Accordingly, having 100% comparative financial statements was not as crucial for users in the case of IFRS 16 as it might have been for transitioning to a new or revised IFRS Accounting Standard that:

- was not preceded by an earlier IFRS Accounting Standard; or
- was preceded by an earlier IFRS Accounting Standard that did not include substantive disclosures.

Users generally considered that the transition relief and ongoing practical expedients typically achieved a good balance between facilitating the application of IFRS 16 by lessees and the needs of users for useful information. Users generally assumed that the application of the ongoing practical expedients would not typically make a material difference to an entity's reported financial position or performance. However, there was some lack of awareness that no specific materiality override applied.

Overall, the findings in this Report are positive in the sense that:

- most of the IFRS 16 transition relief and ongoing practical expedients have been found, to varying degrees, useful by a large cross-section of preparers;
- auditors have not encountered major concerns in auditing the use of IFRS 16 transition relief and ongoing practical expedients; and
- users generally have a reasonable understanding of IFRS 16 transition relief and ongoing practical expedients and have not found any major concerns with the usefulness of the information provided, despite the level of choice available to entities in applying the transition relief and ongoing practical expedients.

In particular, the features of the IFRS 16 transition relief and ongoing practical expedients that appear to have contributed to their success include the following.

- The transition relief and ongoing practical expedients have been pitched at a reasonable level. For example, the 12-month threshold under which leases need not be recognised (both on transition and an ongoing basis) removes a potentially large administrative burden but has a limited impact on the financial outcomes.
- The scale at which the ongoing practical expedients can be applied. For example, allowing the low value leased assets exemption to apply on an asset-by-asset basis means that an entity can apply the expedient when all assets in a class are of low value but need not identify low-value leased assets from high-value leased assets when a whole asset class is capitalised under IFRS 16.

- The natural balance is achieved by having competing incentives to either apply or not apply an ongoing practical expedient. For example, allowing an entity to not separately identify the service component in a lease is attractive for lessees when the impact is not significant, while those lessees with significant service components have an incentive to separate them from the lease to avoid 'over-capitalising' their balance sheets.

Some preparers and users indicated that more application support, such as educational material and guidance during the transition process, ideally from the International Accounting Standards Board (IASB), would have been most helpful. Some users consider that, among some of their peers, there remains a need for more educational support; however, this was mainly in connection with making good use of the information produced by applying the IFRS 16 requirements themselves, not specifically with applying the transition relief and ongoing practical expedients.

Implications

The IASB has a wealth of 'corporate' knowledge about designing transition relief and ongoing practical expedients based on the past two decades of standard-setting experience. Each topic will require different possible types of transition relief and ongoing practical expedients, depending on the nature and complexity of the topic.

Nonetheless, it might be beneficial for the IASB to more formally set out factors that should be considered when setting transition relief and ongoing practical expedients. Based on the research performed for this Report, the following factors emerged as being important.

- The likely starting point for reporting by the various IFRS stakeholders who will need to adopt the new requirements is important for determining transition relief. For example, the nature and extent of transition relief would depend on whether:
  - a new or revised IFRS Accounting Standard replaces an existing IFRS Accounting Standard and most entities would be transitioning from a similar position;
  - a new IFRS Accounting Standard replaces either an interim IFRS Accounting Standard and/or a variety of national GAAPs and entities would be transitioning from a range of different positions.
- Although not a technical consideration, the availability of suitably skilled staff around transition time creates a bottleneck. The shortage of skilled staff indicates a need for lead times and transition relief to have regard to the broader regulatory context facing those entities that will need to apply a new or revised IFRS Accounting Standard. For this reason, while early adoption is not often widely applied it should always be available for those few entities that might wish to make the most efficient use of their resources by either:
  - adopting multiple IFRS Accounting Standards with different mandatory application dates at the same time; or
  - adopting an IFRS Accounting Standard ahead of time to avoid a skills bottleneck,
- Providing transition relief and/or ongoing practical expedients based on 'bright lines' [such as the 12-month lease term benchmark and the USD5,000 low value lease asset benchmark in the Basis for Conclusions], while not principle-based, can provide much needed clarity for all stakeholders. Provided those benchmarks are reasonable, and there is suitable disclosure, users are not generally adversely affected.
- Providing flexibility around the scale at which the transition relief or ongoing practical expedients can be applied is important to minimising costs for preparers – such as permitting entity-wide application versus asset-by-asset application of transition relief

and/or ongoing practical expedients. Limiting the use of a form of transition relief or an ongoing practical expedient to a whole entity might be more principle based, but it removes the ability of an entity to apply the transition relief or an ongoing practical expedient to only those cases when it is necessary – that is, it limits an entity's ability to avoid applying transition relief or an ongoing practical expedient where it is not necessary (e.g. not cost-beneficial).

- The design of transition relief or an ongoing practical expedient that has countervailing incentives underpinning its use can be very effective. For example, the ability under IFRS 16 to choose to not separately account for service components in a lease is unlikely to be abused because there is a natural incentive to separately account for material service components to avoid over-capitalising lease liabilities.
- Consideration should be given to the various potential flow-on effects of an ongoing practical expedient, some of which may not be immediately obvious. Those considerations would be best outlined in the Basis for Conclusions (BC) to enable prepares to understand the limits applying to the use of an ongoing practical expedient. For example, while the research indicated that the ability to elect to account for leases at a portfolio level is not a widely used ongoing practical expedient, it can have consequences for onerous contract accounting and asset impairment because the aggregation to a portfolio level might conceal onerous contracts/impairments that would be revealed at an individual asset level.
- While the IASB already has a thorough due process, specific consideration should be given to seeking input from users on their tolerance for, and understanding of, the application of various forms of transition relief or ongoing practical expedients. This has the potential to provide a greater level of comfort for the IASB in designing suitable transition relief or ongoing practical expedients that have the potential to save material costs for preparers and their auditors while posing little or no detriment for users.
- The IASB's deliberations and conclusions on whether the application of ongoing practical expedients might have a material impact on an entity's reported financial position or performance should be given prominence in educational material.

1. Introduction

The Australian Accounting Standards Board (AASB) and Malaysian Accounting Standards Board (MASB) have jointly researched the use in Australia and Malaysia of transitional relief and ongoing practical expedients available to lessees under IFRS 16 *Leases*.[1] This research aims to identify possible lessons that can be learnt from implementing IFRS 16 that might prove helpful in identifying transition relief and ongoing practical expedients to be made available in future (new or amended) IFRS Accounting Standards. Specifically, through a review of financial statements and interviews with a broad range of stakeholders, this Report aims to provide insights into:

- the extent to which the transitional relief and ongoing practical expedients have been applied;
- the reasons for lessees choosing to apply, or not apply, transitional relief and/or ongoing practical expedients;
- the views of lessees and the views of users and auditors of lessees' financial statements on the transitional relief and ongoing practical expedients and the related disclosure requirements;
- suggestions/ideas for alternative forms of transition relief or ongoing practical expedients that might have been useful; and
- recommendations to the IASB for consideration when developing transition relief/ongoing practical expedients for future IFRS Accounting Standards.

These matters are addressed based on a sample of 80 of the largest listed companies in Australia and Malaysia in their year of transition to IFRS 16 and interviews with stakeholders with experience in transitioning to IFRS 16 and the ongoing application of IFRS 16. Auditors and users of financial statements were also interviewed to gain an understanding of how the transition relief and ongoing practical expedients have impacted audit and investment decisions, respectively.

The outcomes reported are also expected to contribute to the upcoming IFRS 16 post-implementation review (PIR).[2]

1.1 Structure of the Paper

The remainder of this Report is structured as follows:

- Section 2: New lease accounting model and transition relief in IFRS 16
- Section 3: Research method
- Section 4: Findings about the use and usefulness of the IFRS 16 transition relief
- Section 5: Other comments in relation to IFRS 16
- Section 6: Concluding remarks

1 Both jurisdictions adopt IFRS unmodified for application to entities with public accountability.

2 The IASB plans to complete the PIR of IFRS 16 as a priority for 2022 to 2026 and to undertake possible priority follow-on projects if findings from the PIR require further action. See IASB Snapshot: Third Agenda consultation.

2. New lease accounting model and transition relief in IFRS 16

The previous accounting model for leases under IAS 17 *Leases* required lessees to classify their leases as either finance or operating leases and account for them differently. It required lessees to recognise assets and liabilities arising from finance leases while operating leases remained off the balance sheet. Stakeholders had raised concerns about this model, including that information reported about operating leases lacked transparency and did not meet the needs of users of financial statements [IFRS16.BC3]. Also, the existence of two different accounting models for leases, in which assets and liabilities associated with leases were not recognised for operating leases but were recognised for finance leases, meant that economically similar transactions might be accounted for differently.

To address the stakeholders' concerns, the IASB developed IFRS 16, which introduced a new lease model to require a lessee to recognise assets and liabilities for all leases, except those with a term of less than 12 months and for which the underlying asset is of low value. Ten years after its first consultation document opened for comments in 2009, the new lease standard IFRS 16 came into effect for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted.[3]

In response to stakeholders' concerns about implementation costs raised during the consultation process,[4] the IASB simplified the lessee transition requirements by including a range of transition relief and ongoing practical expedients in IFRS 16. The range of transition relief choices and ongoing practical expedients are summarised in Section 2.1.

2.1 Recognition and measurement requirements

Definition of a lease

On transition, IFRS 16 permits a lessee to not reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity can apply IFRS 16 to all leases (and only those leases) previously identified under IAS 17 and Interpretation 4 *Determining whether an Arrangement Contains a Lease* (IFRIC 4) [IFRS 16.C3].

Consequently, an entity can choose to:

- apply the requirements of IFRS 16 to all existing contracts that meet the definition of a lease by applying the requirements of IAS 17 and IFRIC 4; and
- not reassess existing contracts that did not meet the definition of a lease applying the requirements of IAS 17 and IFRIC 4, but may have done so under IFRS 16.

The IASB considered the costs of requiring entities to reassess existing contracts applying the lease definition guidance in IFRS 16 would not be justified. The IASB expected that, if an entity does not reassess its existing contracts applying the lease definition requirements in IFRS 16, the entity would consequently recognise slightly more leases on the transition to IFRS 16 than otherwise would be the case [IFRS 16.BC274].

3 IFRS 16 is effective for periods beginning on or after 1 January 2019 in Australia and Malaysia.

4 The standard-setting process dated back to March 2009 when IASB and Financial Accounting Standards Board (FASB) published a joint *Discussion Paper Leases: Preliminary*. First Exposure Draft published in August 2010 and second Exposure Draft in May 2013.

Approach to transition

Based on a cost-benefit consideration [IFRS 16.BC276], IFRS 16 includes a choice between two approaches for lessees transitioning from IAS 17 to IFRS 16.

(a) Full retrospective application, under which a lessee applies IFRS 16 retrospectively to each prior reporting period presented applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* [IFRS 16.C5(a)].

A full retrospective approach would require entities to determine the carrying amounts of all leases in existence at the earliest comparative period as if those leases had always been accounted for applying IFRS 16 and to restate comparative information.

(b) Modified retrospective application [IFRS 16.C5(b)] under which the cumulative effect of initially applying IFRS 16 would be recognised as an adjustment to the opening balance of retained earnings (or other components of equity as appropriate) of the annual reporting period that includes the date of initial application [IFRS 16.C7].

The modified retrospective application eliminates the need to restate financial information in comparative periods on transition. The IASB expected this approach, along with the additional disclosures, would help to reduce the transition costs while providing useful information to financial statement users in understanding the effect of applying IFRS 16 for the first time [IFRS 16.BC281]. The cost of restating comparative information can be significant because the implementation of IFRS 16 affects a number of elements of the financial statements.

The choice of transition approach applies at the entity level. All leases must be transitioned under the same approach [IFRS 16.C6].

Leases previously classified as operating leases – additional relief for entities that elected to use the modified retrospective approach

To reduce the costs of implementing IFRS 16, the IASB also introduced a number of additional forms of transition relief relating to leases previously classified as operating leases. These additional forms of transition relief are available only for lessees transitioning to IFRS 16 with a modified retrospective application approach.

Concerns were raised during the IASB's consultation period that determining the measurement of the right-of-use (RoU) asset under a full retrospective approach could be onerous as a lessee would have to determine the initial measurement of the lease liability for leases that may have commenced many years before the transition to IFRS 16. The cost of capturing historical information, such as lease start dates and historical payment schedules, would still be significant, especially for entities with a high number of leases. To address stakeholders' concerns, IFRS 16 permits a lessee:

(a) using the information available at the date of transition, to measure a lease liability at the present value of remaining lease payments discounted using the lessee's incremental borrowing rate (IBR) at initial recognition [IFRS 16.C8(a)]; and

(b) measure the RoU asset at an amount either:

(i) as if IFRS 16 had been applied since the commencement date but discounted using the lessee's IBR at the date of initial application [IFRS 16.C8(b)(i)] (Option 1); or

(ii) equal to the lease liability, adjusted for any existing prepaid or accrued lease payments [IFRS 16.C8(b)(ii)] (Option 2).

To further ease the costs on transition, IFRS 16 also allows a lessee to elect to use one or more of the following forms of transition relief summarised in Table 1.

Table 1 Transition Relief and Ongoing Practical Expedients in IFRS 16	
Transition relief	**IASB reasoning (see IFRS 16.BC287)**
Forms of relief permitted for transition (on a lease-by-lease basis)	
Portfolio approach to the discount rate A lessee can apply a single discount rate to a portfolio of leases with reasonably similar characteristics [IFRS 16.C10(a)].	The IASB expects that permitting a lessee to apply a single discount rate to a portfolio of similar leases on transition will provide cost savings to lessees and will not have a significant effect on reported information. For leases for which the RoU asset is measured at an amount equal to the lease liability (adjusted by the amount of any previously recognised prepaid or accrued lease payments) on the date of initial application [IFRS 16.BC285], this relief enables a lessee to apply the transition requirements collectively to portfolios of leases of similar assets in similar economic environments with the same end date.
Previously recognised onerous lease provisions A lessee may rely on pre-transition assessments (under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) of whether leases are onerous and adjust the RoU asset at the date of the initial application by the amount of any provision for onerous leases recognised immediately before the date of initial application [IFRS 16.C10(b)]. This approach is an alternative to performing an impairment review under IAS 36 *Impairment of Assets*.	It could be costly for a lessee to perform an impairment review of each of its RoU assets on the transition to IFRS 16. In addition, any onerous operating lease liability identified applying IAS 37 is likely to reflect impairment of the RoU asset. Accordingly, the IASB concluded that this relief would provide a cost saving to lessees on the initial application of IFRS 16 without any significant effect on reported information.
Leases for which the lease term ends within 12 months A lessee can treat leases with 12 months or less to run on transition as giving rise to expenses on a straight-line or other systematic basis[5] [IFRS 16.C10(c)].	For a lessee that does not restate its comparative information, leases for which the term ends within 12 months of the date of initial application are very similar in effect to those captured by the short-term lease exemption and thus, similar considerations apply [IFRS 16.BC87-BC97]. In addition, feedback from lessees indicated that this relief would provide a

5 Effectively treating leases as 'operating leases' as if IAS 17 still applied.

Table 1 Transition Relief and Ongoing Practical Expedients in IFRS 16	
Transition relief	**IASB reasoning (see IFRS 16.BC287)**
	significant cost saving on the initial application of IFRS 16.
Exclusion of initial direct cost A lessee may exclude initial direct costs from the measurement of the RoU asset at the date of initial application [IFRS 16.C10(d)].	Incremental costs of a lessor to obtain a lease are consistent with the costs of obtaining a contract under IFRS 15 [IFRS 16.BC237]. The IASB expects that including initial direct costs in the measurement of RoU assets would not have a significant effect on reported information. Consequently, the IASB decided that the cost for lessees of requiring initial direct costs to be identified and included in the measurement of RoU assets would outweigh the benefits in terms of reported information.
Use of hindsight A lessee may use hindsight in applying IFRS 16, for example, in determining the lease term if the contract contains options to extend or terminate the lease [IFRS 16.C10(e)].	Permitting lessees to apply hindsight on the transition to IFRS 16 is expected to result in useful information, particularly with respect to areas of judgement such as the determination of lease terms for contracts that contain options to extend or terminate a lease. Feedback from stakeholders also indicated that permitting the use of hindsight will make the initial application of IFRS 16 somewhat simpler for lessees.
Practical expedients ongoing basis (lease-by-lease basis)	
Short-term leases Short-term leases (those with a term of 12 months or less) can be treated as giving rise to expenses on a straight-line or other systematic bases [IFRS 16.5(a) & 6]. This ongoing practical expedient is applicable on a class of assets basis.	IFRS 16 defines a short-term lease as a lease that, at the commencement date, has a lease term of 12 months or less. The IASB concluded that this practical expedient provides suitable cost reprieve for lessees while not detracting from the information reported [IFRS 16.BC91-97].
Low-value asset leases Leases of RoU assets (when new) of low value can be treated as giving rise to expenses on a straight-line or other systematic bases [IFRS 16.5(b) & 6]. This ongoing practical expedient is applicable on a lease-by-lease basis.	The IASB determined through fieldwork – in most cases, assets and liabilities arising from leases within the scope of the ongoing practical expedient would not be material, even in aggregate. The IASB noted this ongoing practical expedient may be of limited benefit to lessees because most leases within its scope might instead be excluded from the recognition requirement of IFRS 16 by applying the concept of materiality in IAS 1 *Presentation of Financial*

Table 1 Transition Relief and Ongoing Practical Expedients in IFRS 16	
Transition relief	**IASB reasoning (see IFRS 16.BC287)**
	Statements [IFRS 16.BC101]. However, it would provide a substantial cost reprieve to many lessees (and, in particular, smaller entities) by removing the burden of justifying that such leases would not be material in the aggregate.
Not separating lease and non-lease components Non-lease components[6] need not be accounted for separately from lease components and can be accounted for as a single lease component [IFRS 16.15]. This practical expedient applies by class of underlying asset.	The IASB decided to permit this ongoing practical expedient for cost-benefit reasons and in response to requests from preparers not to require separation in all scenarios [IFRS 16.BC135(b)]. In the IASB's view, the ongoing practical expedient will reduce the cost and complexity for some lessees while not creating significant comparability issues. This is because, generally, a lessee is not expected to adopt the ongoing practical expedient for contracts with significant service components because that would significantly increase the lessee's lease liabilities. The IASB expects that lessees are likely to adopt this ongoing practical expedient only when the non-lease components of the contract are relatively small.
Portfolio approach Instead of accounting for individual leases, a lessee can choose to apply IFRS 16 to a portfolio of leases with similar characteristics if the entity reasonably expects the effects on the financial statements of applying a portfolio basis would not differ materially from applying an individual lease basis [IFRS 16.B1]. A portfolio approach can be applied only if the company can demonstrate that the effect of applying the Standard to the portfolio is not materially different from applying it to individual leases. By contrast, in transition a portfolio approach is available when leases have similar characteristics.	The IASB expects this ongoing practical expedient may be beneficial for lessees with a large number of similar leases and would have no material impact on the financial statements [IFRS 16.BC83].

6 Non-lease components would include, for example, service components such as cleaning and security services bundled into an arrangement for leased office accommodation but cannot include 'embedded derivatives' that meet the criteria in paragraph 4.3.3 of AASB 9 *Financial Instruments* or paragraph 4.3.3 of MFRS 9 *Financial Instruments*.

Other measurement models for right-of-use asset

Transition adjustments are not required for leases previously accounted for as investment property using the fair value model in IAS 40 *Investment Property* [IFRS 16.C9(b)].[7] Instead, the RoU asset and lease liability are accounted for using IAS 40 and IFRS 16 from the date of initial application.

Leases previously classified as finance leases

The lessee accounting model in IFRS 16 is similar to the accounting requirements for finance leases in IAS 17. Consequently, IFRS 16 does not contain detailed transition requirements for leases previously classified as finance leases if a lessee elects to apply the modified retrospective approach. For these leases, IFRS 16 requires a lessee to measure the carrying amount of an RoU asset and the lease liability at the date of initial application of IFRS 16 as the carrying amount of the leased asset and lease liability immediately before that date applying the finance lease accounting requirements in IAS 17.

2.2 Disclosure requirements

Lessees must disclose information on the transition approach applied and which transition choices were used [IFRS 16.C4, C12 & C13].

Comparative information is not restated when the modified retrospective approach is applied. Therefore, the IASB decided to require additional disclosures to help users of financial statements understand the effect of applying IFRS 16 for the first time. Consequently, IFRS 16 requires a lessee using the modified retrospective approach to disclose the following information on transition about leases that were previously classified as operating leases:

(a) the weighted average incremental borrowing rate applied to lease liabilities [IFRS 16.C12(a)];

(b) an explanation of any difference between:

  (i) operating lease commitments disclosed under IAS 17 immediately preceding transition, discounted using the IBR; and

  (ii) lease liabilities recognised in the statement of financial position at the date of initial application [IFRS 16.C12(b)]

3. Research method

Following Davern, Gyles, Hanlon and Pinnuck (2019), a two-stage research method was employed to understand the use and usefulness of the transition relief and ongoing practical expedients in IFRS 16.[8]

In the first stage, we reviewed publicly available financial statements of 50 Australian Stock Exchange (ASX) listed companies and 35 Bursa Malaysia listed companies in the year they transitioned to IFRS 16 to gain an appreciation of the impacts of adopting IFRS 16 and the utility of transition relief and ongoing practical expedients based on disclosures. In the second stage, we developed a semi-structured interview protocol to gain a more -in-depth understanding of the rationale behind transition choices and the usefulness of transition relief in practice with a

7 This transitional relief is not addressed further in this Report because we did not conduct interviews with a sufficient number of lessees affected by this relief to provide useful feedback. Research on the use of this relief would need to be more specifically targeted at stakeholders with an interest in leased investment properties.

8 Davern, M., Gyles, N., Hanlon, D., and Pinnuck, M.(2019), *Is Financial Reporting Still Useful? Australian Evidence*, ABACUS, vol. 55, no. 1, pp. 237-272.

semi-structured interview protocol. AASB and MASB staff interviewed a range of stakeholders with experience in implementing IFRS 16 as preparers, auditors or users of listed entity financial statements.

3.1 Review of financial statements

Transition to IFRS 16 was mandated for annual reporting periods beginning on or after 1 January 2019. Early adoption of IFRS 16 is permitted for annual periods beginning before 1 January 2019 if IFRS 15 *Revenue from Contracts with Customers* is also applied to the same period. The actual date of adoption was confirmed by reference to financial reports and disclosures relating to accounting policies and the impact of changes in accounting policies. Information about transition relief and the use of ongoing practical expedients was hand collected based on the disclosures in sample entities' financial statements. It is assumed that the entity did not use the transition relief or ongoing practical expedients if there is no explicit disclosure in the financial statements.

Australia's final sample comprises the 50 largest ASX-listed entities in the year they transitioned to IFRS (AASB) 16.[9] The sample was selected based on their market capitalisation as of 30 June 2020. One entity in the sample early adopted IFRS 16 from the financial period started on 1 July 2018, along with IFRS 15. Three firms have a 31 December financial year-end adopted from 1 January 2019. All other 46 entities implemented IFRS 16 for the financial year starting 1 July 2019.

Table 2 shows the sample distribution by the 11 sector classifications of the Global Industry Classification Standard (GICS).

Table 2 Sample Distribution by **Global Industry Classification Standard (GICS) 11 sector classification**

	Sample (No. of entities)	
Industry	Australia	Malaysia
Communication Services	4	3
Consumer Discretionary	4	2
Consumer Staple	3	2
Energy	4	2
Financials	9	2
Health Care	4	1
Industrials/Conglomerates	7	7
Information Technology	2	1
Materials	5	7
Real Estate	6	7
Utilities	2	1
Total	**50**	**35**

9 The final sample does not include the exchange traded funds (ETFs), real estate investment trusts (REITs) and foreign entities

3.2 Interview

In the second stage, for a better understanding of the rationale behind transition choices and the usefulness of transition relief in practice, AASB and MASB staff interviewed a range of stakeholders with experience in implementing IFRS 16 as preparers, auditors or users of listed entity financial statements. We developed a semi-structured interview protocol focusing on the use and usefulness of the transitional relief and practical expedients in IFRS 16. The use of standard protocol ensured we had a base set of questions that were asked of all interviewees in both jurisdictions. The protocol compromises six main questions, with prompts to ensure elaboration by the interviewee on issues of particular concern.

Interviewees were identified through a range of direct (e.g. professional contacts) and indirect sources (e.g. professional contacts of peers, or snowballed recommendations of direct contacts). Since the purpose of the interviews was to gain insight into the use and usefulness of the transitional relief and practical expedients in IFRS 16, we did not seek a statistically representative sample. Rather, the purpose of our sampling was to ensure we solicited a diverse range of views from the relevant stakeholders. We did not explicitly determine the number of interviews to be conducted but maintained a rough balance across jurisdictions as we progressed the project. By completion of 26 and 31 interviews in Australia and Malaysia respectively, it was evident that we had reached saturation, with only negligible incremental insights from additional interviews and a high degree of consistency in the perspectives across the two jurisdictions and the three different stakeholder groups. Table 3 summaries types and number of interviewees in both jurisdictions.

Table 3 Interviewees in Malaysia and Australia

Stakeholders	Australia	Malaysia
Listed preparers (lessees)	15	17
Users	5	7
Auditors	6	7

To understand experiences transitioning to IFRS 16, 15 Australian preparers were interviewed. As 11 of those preparers are from the top 50 listed Australian entities, their financial statements were also analysed in the stage one review (see Section 4). In addition, two preparers of two smaller-sized entities (unlisted) were interviewed to identify whether smaller-sized entities shared the same experience as the large entities. The remaining two preparers were also from listed entities. Six auditors and five users (analysts) from Australia also participated in this study.

Seventeen Malaysian preparers were interviewed for their experiences transitioning to IFRS 16 as lessees. All the financial statements for the preparers interviewed are included in the stage one review. All of the entities were relatively large in the context of Bursa Malaysia. Seven Malaysia-based auditors and seven users participated in this study. The users comprise two fund managers, one rating agency analyst and four credit analysts.

The interviews were conducted throughout 2021 and early 2022 and focused on the financial statements for the year in which IFRS 16 was adopted and at least one subsequent year of IFRS 16 application. Each interview was conducted via video call, usually with a duration of 30 minutes, with supplementary information obtained via email when relevant.

4. Findings about the use and usefulness of IFRS 16 transition relief

4.1 Review of financial statements (Stage 1)

Definition of a lease

Most Australian entities (37 of 50 entities, 74%) utilised the transition relief in IFRS 16 to not reassess whether a contract is, or contains, a lease at the date of initial application. Ten entities disclosed that they had reassessed whether they had any leases under the lease definition in IFRS 16 at transition.

Of the 35 Malaysian sample entities, about half (17 of 35 entities, 49%) utilised the transition relief to not reassess whether a contract is, or contains, a lease at the date of initial application. Eleven entities disclosed that they had reassessed if they have any leases under the lease definition in IFRS 16 at transition.

Some entities (three in Australia and seven in Malaysia) did not disclose if they had conducted any reassessment on transition. This is a potential concern that users may not have sufficient information to determine these entities' use of transition relief. However, the absence of a material impact is a possible reason for entities not disclosing their use of this transition relief.

Approach to transition

As shown in Table 4, the majority of entities surveyed in Australia and Malaysia adopted the modified retrospective approach. This is not surprising as implementing the full retrospective approach requires more granular data. Only six entities (12%) of the sampled entities in Australia chose the full retrospective approach when transitioning to IFRS 16. Most of the Australian sample (44 entities, 88%) elected to adopt the modified retrospective approach. Three (9%) of the sampled Malaysian entities elected the full retrospective approach when transitioning to IFRS 16. Most of the Malaysian sample (32 entities, 91%) elected to adopt the modified retrospective approach.

Many entities that utilised the modified retrospective approach indicated that their choice was based on cost considerations. However, based on the disclosure, it is unclear why certain entities chose the full retrospective approach. We intended to better understand the reasons behind the transition relief through interviews, with findings reported in Section 4.2.

Table 4 Sample distribution by industry and method of transition to IFRS 16

GICS	Transition method					
	Australia			Malaysia		
	Modified retrospective	Full retrospective	Total	Modified retrospective	Full retrospective	Total
Communication Services	4		4	3		3
Consumer Discretionary	3	1	4	1	1	2
Consumer Staples	2	1	3	2		2
Energy	4		4	2		2
Financials	9		9	2		2
Health Care	4		4	1		1
Industrials	5	2	7	6	1	7
Information Technology	2		2	1		1
Materials	5		5	7		7
Real Estate	5	1	6	6	1	7
Utilities	1	1	2	1		1
Total	44	6	50	32	3	35

Measurement of RoU assets

Overall observation

Table 5 displays the sample distribution by industry and measurement of RoU assets at transition. Many entities that adopted the modified retrospective approach in IFRS 16 chose to measure their RoU assets using Option 1 (i.e. measure their RoU assets at amounts determined as if IFRS 16 had been applied since the commencement date but discounted using the lessee's IBR at the date of initial application, 2 (i.e. measure RoU assets at an amount equal to the lease liability, adjusted for any existing prepaid or accrued lease payments) or both options on a lease-by-lease basis. However, it is difficult to determine the basis for entities' decisions from a review of their financial statements. The interviews in Stage 2 of this research helped to provide insights to explain how these choices have been made.

Australia

Among the 44 entities that elected to adopt IFRS 16 using the modified retrospective approach, one entity did not explicitly disclose how its RoU assets were measured at transition, which may have been due to the impact being immaterial. Sixteen of these entities (37% of the 43 entities with sufficient disclosure) chose to measure their RoU using Option 1. Ten firms (23%) elected to measure RoU assets under Option 2. Seventeen entities (39%) elected to measure RoU assets at transition on a lease-by-lease basis and utilised both Options 1 and 2.

Malaysia

Among the 32 entities that elected to adopt the modified retrospective approach in IFRS 16, five entities did not explicitly disclose how their RoU assets were measured during the transition; however, two of these were interviewed and had applied the modified retrospective approach. Accordingly, information on the approach applied is available for 29 entities. Among the 29 entities, five (21%) chose to measure their RoU assets at amounts determined as if IFRS 16 had been applied since the commencement date but discounted using the lessee's IBR at the date of initial application (Option 1). Seventeen entities (62%) elected to measure RoU assets at an amount equal to the lease liability, adjusted for any existing prepaid or accrued lease payments (Option 2). Seven entities (28%) elected to measure RoU assets at transition on a lease-by-lease basis and utilised both Options 1 and 2.

Table 5 Sample distribution by industry and measurement of right-of-use asset at the transition

GICS	How the right-of-use asset was measured at transition							
	Australia				Malaysia			
	Option 1* Only	Option 2** Only	Both Option 1 and 2 on a lease-by-lease basis	Total	Option 1* Only	Option 2** Only	Both Option 1 and 2 on a lease-by-lease basis	Total
Communication Services	2	2	-	4		2	1	3
Consumer Discretionary	-	1	2	3	1		1	2
Consumer Staples	1	-	1	2		1	1	2
Energy	2	-	2	4		1	1	2
Financials	3	1	5	9		1	1	2
Health Care	2		2	4		1		1
Industrials	3	1	1	5	1	4		5
Information Technology	-	1	1	2		1		1
Materials	2	2	-	4	1	2	1	4
Real Estate	1	2	2	5	2	4		6
Utilities	-	-	1	1			1	1
Total	16	10	17	43***	5	17	7	29

*Option 1 refers to the method under which the RoU asset is measured at an amount as if IFRS 16 had been applied since the commencement date but discounted using the lessee's IBR at the date of initial application.

** Option 2 refers to the method under which the RoU asset is measured at an amount equal to the lease liability, adjusted for any existing prepaid or accrued lease payments.

*** One firm did not disclose how its RoU assets were measured at transition.

Use of forms of relief available for entities transitioning with a modified retrospective approach

Table 6 summarises the use and total number of practical expedients used by the sample entities in both jurisdictions.

Table 6 Use of further practical expedients at the transition

Panel A: Count of use of each practical expedient

Practical expedients	Australia		Malaysia	
	No. of entities using the transition relief	% based on 44 entities using a modified retrospective approach	No. of entities using the transition relief	% based on 32 entities using a modified retrospective approach
Portfolio approach to the discount rate	29	65.9	20	63
Previously recognised onerous lease provisions	24	54.5	19	59
Leases for which the lease term ends within 12 months	43	97.7	33	94
Exclusion of initial direct cost	22	50.5%	27	84
Use of hindsight	26	59.1%	26	81

Panel B: Number of practical expedients used by entities

Total number of practical expedients used	Australia		Malaysia	
	No. of entities using the transition relief	% (out of no. of eligible entities)	No. of entities using the transition relief	% (out of no. of eligible entities)
1	9	20.5	3	9
2	6	13.6	3	9
3	6	13.6	6	19
4	10	22.7	15	47
5	13	29.5	5	16

Australia

Among the five additional forms of relief available for entities transitioning to IFRS 16 using a modified retrospective approach, not recognising an RoU asset that has a lease term of 12 months or less was the most frequently used.[10] Of the 44 entities, 43 chose this practical expedient, and one entity did not disclose its treatment for this type of lease at transition. Twenty-nine entities (66%) applied the portfolio approach to discount rates, and 24 entities elected to rely on their assessments under IAS 37 as to whether leases are onerous, with assessments made immediately before initial application as an alternative to performing an impairment review. Twenty-two entities (50%) elected to exclude initial direct costs from the measurement of the RoU assets at the date of initial application. Twenty-six entities (59%) used hindsight in applying IFRS 16.

Entities that elected a modified retrospective approach appear to have found some of the practical expedients of limited benefit in practice. For example, under Option 2, an RoU asset is measured at an amount equal to the lease liability, and the calculation uses only current information. Therefore, entities electing to measure RoU assets using Option 2 would not necessarily need to consider whether to exclude initial direct costs from the measurement of RoU assets or use hindsight. However, observations from the sample indicate that some of these entities still used these two practical expedients. Four of the ten entities (40%) that elected to measure RoU assets using only Option 2 at transition disclosed that they had used hindsight in applying IFRS 16 and excluded the initial direct costs. The initial direct cost would be irrelevant to their choice of transition when measuring RoU assets at the date of initial application.

Malaysia

Twenty entities (63%) used a single discount rate for portfolios of leases. Three of the 12 entities that did not choose to apply this transitional relief were the subject of interviews and typically noted their decision was based on having mainly leases of more significant assets or the types of assets that would be difficult to classify into portfolios.

Nineteen entities (59%) elected to rely on their assessments under IAS 37 as to whether leases are onerous, with assessment made immediately before initial application as an alternative to performing an impairment review on transition.

All but two of the 32 entities transitioning to IFRS 16 using a modified retrospective approach chose not to recognise RoU assets that, at transition, had a remaining term of 12 months or less. One of these entities was the subject of an interview and indicated it chose not to use the relief available because it was simpler for the entity to apply the same approach to all existing leases rather than have a different treatment depending on the remaining lease term.

All but five of the 32 entities transitioning to IFRS 16 using a modified retrospective application chose to exclude initial direct costs from the measurement of RoU assets at the date of initial application. Ten of the entities that were the subject of an interview applied the transition expedient. Most indicated their reason for doing so was the absence of relevant information and/or the likely immaterial amounts involved.

Of the 32 entities transitioning to IFRS 16 using a modified retrospective approach, 26 applied hindsight for matters such as determining the lease term if the contract contains options to extend

10 Use of ongoing practical expedients was assessed based on the firms' disclosure in their financial statements.

or terminate the lease. The entities that applied hindsight and were subject to interview were generally of the view that the resulting information was easier to produce and probably of better quality because it was based on current knowledge.

Ongoing practical expedients

For practical expedients available on an ongoing basis:

- almost all of the sampled entities in Australia and Malaysia used the short-term lease expedient (except for two Australian entities) and all (but one Australian entity) used the low-value asset expedient;
- a small number of entities used the practical expedient to not separate non-lease components from lease components (i.e. two entities in Australia and at least four entities in Malaysia), according to disclosures in their financial statements. Three Australian entities explicitly mentioned that they did not use this expedient. There may have been more entities applying this practical expedient but not disclosing its use; and
- only one entity from Australia (and none in Malaysia) disclosed that it applies IFRS 16 to a portfolio of leases with similar characteristics on an ongoing basis. The rest of the sample was silent on whether they used this expedient.

4.2 Interviews (Stage 2)

4.2.1 Lessees

Early adoption of IFRS 16

The following discussion relating to findings from lessee preparer interviews covers both jurisdictions since the observations were largely compatible between the Australian and Malaysian responses. However, in some cases, observations are flagged as applying to one jurisdiction or the other.

Consistent with the observations from a review of financial statements, most of the interviewed lessee preparers did not early adopt IFRS 16. All 15 Australian lessee preparers who participated in the interviews transitioned and implemented IFRS 16 at the mandatory effective date (i.e. their annual periods starting on or after 1 January 2019). Stakeholders considered that IFRS 16 is a complicated standard to implement. Entities had spent substantial amounts of time and effort to understand the requirements of IFRS 16, assess its impact, and develop appropriate accounting policies for implementation. Preparers actively consulted their auditors at the initial application. Some entities engaged with professional advisory teams to help implement IFRS 16. As such, there appeared to be no tangible benefits with early adoption.

A small number of entities (two out of 17 lessee preparers from Malaysia) elected to adopt IFRS 16 early. They adopted IFRS 16 at the same time as adopting IFRS 15 *Revenue from Contracts with Customers*, which has a mandatory application date of periods beginning on or after 1 January 2018. These entities considered that adopting both Standards simultaneously would be more efficient than adopting them in successive years.

Most preparers noted that there was a concentrated and high demand for skilled staff to enable the adoption of IFRS 16, particularly in the year preceding the mandatory application date. This was a general motivating factor for many preparers to apply the available transition relief.

Definition of a lease

Consistent with the pattern exhibited from a review of financial statements in Section 4.1, the majority of the Australia preparers (13, 87%) used the expedient not to reassess whether their existing lease contracts under IAS 17 are, or contain, a lease under the definition of IFRS 16 at the date of initial application. Over half of the Malaysian preparers (8, 53%) used this expedient.

Preparers from both jurisdictions found this expedient very useful in saving transition costs and making the transition process more manageable, particularly for large preparers with hundreds or even thousands of leases. Most considered that it would be unlikely to identify different leases using IFRS 16 than under (the superseded) IAS 17 and IFRIC 4, and considered that the relief was highly cost beneficial. These preparers generally had high confidence that the leases already identified under IAS 17 would materially be the same as those identified under IFRS 16.

Some preparers (two from Australia and seven from Malaysia) used transition as an opportunity to review their lease contracts. These entities often had many subsidiaries in various jurisdictions, some of which do not adopt IFRS Accounting Standards. Many used the process of checking for the existence of leases as an integral part of the training process for staff in adopting IFRS 16 and ensuring that systems can capture the relevant data.

One preparer (Australian) commented that this expedient (i.e. IFRS 16.C3 and C4) would be more useful if it could be applied on a lease-by-lease basis rather than being an accounting policy choice that applies to *all* contracts at the date of transition. The lease-by-lease approach would have allowed the entity to apply the practical expedient to some contracts but not others depending on the nature of the contract (e.g. immaterial contracts).

Approach to transition – full or modified retrospective application

Overall, preparers found the transition relief in IFRS 16 beneficial. From the interviews conducted, only a few preparers (one out of 15 in Australia and two out of 17 in Malaysia) adopted the full retrospective approach. The rest of the preparers (14 (93%) in Australia and 15 (88%) in Malaysia) applied IFRS 16 using the modified retrospective approach, recognised the cumulative effect of the initial application to opening retained earnings and did not restate comparative information.

The Australian preparer who adopted the full retrospective approach mentioned that the business has complex recurring leases. The entity considered full retrospective application was necessary to provide better information about the full impact of IFRS 16 adoption to its shareholders. The two entities from Malaysia that applied the full retrospective approach indicated that they either wanted to 'improve' their records of past leasing transactions or ensure beyond a reasonable doubt that their records of leases are comprehensive and accurate.

Entities adopted the modified retrospective approach for cost-benefit reasons and the following considerations were most often taken into account:

- data availability and the state of existing lease records – in some cases, particularly for leases commenced decades ago, the records of lease transactions may be inadequate to 'reconstruct' fully retrospective accounting information, or undue cost and effort would be involved in doing so;
- availability of sufficiently skilled staff and the cost of either diverting them from regular activities or temporarily hiring additional staff;

- for some lessees, the large volumes of leases involved and their size – the sheer number of leases meant a full retrospective approach was not considered feasible;
- for some lessees, with either a small number of leases or a large number of smaller leases, a disproportionate effort would be needed to fully retrospectively account for a less-than-significant exposure to leases; and
- many lessees hold leases via subsidiaries, some of which do not have IFRS accounting policy expertise on a stand-alone basis – the knowledge for applying IFRS 16 needed to be set from head office from a specified time, making a modified retrospective approach more feasible.

Ten Australian preparers noted that, before deciding which transition approach to use, they thoroughly assessed the transition relief to understand the potential impact each form of relief might have on the balance sheet, and other performance measures such as earnings before interest, taxes, depreciation, and amortisation (EBIDTA). These preparers are generally comfortable with the chosen transition approach (i.e. modified retrospective approach) because their assessments show that there is no material difference between using the modified or full retrospective approach when transitioning to IFRS 16. These preparers considered that the cost of the full retrospective approach did not justify its benefit, as commented by one preparer that,

> "We did actually set up policy and we actually did a deep dive of our portfolio to actually work out what give us the best option and best outcome, from a practically perspective and from financial impact [comparability] perspective as well….our transition options were fairly limited.. in terms of having available data probably went back, you know, maybe a few decades… So it makes it a challenge. And so we felt it was most appropriate to take a balanced approach in applying the modified retrospective method, using all of the information we had…the integrity and of our information was paramount."

Some Malaysian interviewees suggested that, while they appreciated the reasons for requiring one approach across the whole reporting entity, in many cases, lessees would have preferred to apply a full retrospective approach to some leases and a modified retrospective approach to others. A 'mixed' approach was more likely to be of interest to lessees that have a disparity in the types of leases across the consolidated group or have a disparity in the quality of lease records in different subsidiaries across the group.

> "Full retrospective application would have been achievable for the parent entity and the long-standing subsidiary companies operating in Malaysia and other IFRS jurisdictions but was not feasible for the more recently acquired subsidiary companies in the Group that operate primarily in non-IFRS jurisdictions. Accordingly, the Group as whole took a modified retrospective approach."

Measurement of RoU assets

Among those preparers who applied IFRS 16 using the modified retrospective approach, fewer than half of them (five out of 14 in Australia, and five out of 12 in Malaysia) used Option 2 to measure the RoU asset (i.e., RoU asset equals the lease liability, adjusted for any existing prepaid or accrued lease payments) at transition. The rest of the preparers used a mix of Option 1 (i.e. as if IFRS 16 had been applied since the commencement date but discounted using the lessee's IBR at the date of initial application) and Option 2 on a lease-by-lease basis, under which approximately 80% of the leases were accounted for using Option 2.

Preparers noted that they generally preferred Option 2 as it was the more practical method, with less data availability constraints and was easier to implement. Where data was sufficient, entities applied Option 1. Also, when RoU assets were significant to the entity, or the difference between RoU assets amount and lease liability were expected to be material, lessees were generally more likely to measure RoU assets as if IFRS 16 had always applied (Option 1). When RoU assets were not significant to the entity or were relatively few, entities were likely to apply Option 2.

Further transition relief

Overall, preparers generally found the further transition relief beneficial. Preparers commented that IFRS 16 is a complex standard. Regardless of the entity's size, implementing IFRS 16 required significant work and resources. They noted that they considered carefully which transition relief, if any, should be used to simplify their transition to IFRS 16.

Among the 29 preparers (14 from Australia and 15 from Malaysia) interviewed who applied IFRS 16 using the modified retrospective approach:

- Twenty-three preparers (10 Australian and 13 Malaysian) used the expedient to apply a single discount rate to a portfolio of leases with reasonably similar characteristics. The portfolio was often determined, for example, by lease terms and types of underlying assets (e.g. retail property leases vs. residential property leases). Some considered the meaning of 'weighted' [IFRS 16.C12(a)] unclear. They were unsure about whether the weighted discount rate needs to be a single number or could be a range; and considered that it would have been helpful to have had more guidance on performing the weighting. The two entities that did not use this transition relief generally had only large leases of assets that could not be classified into portfolios.
- All but one entity (Malaysian) interviewed did not recognise RoU assets for leases with 12 months or less to run, and they considered this transition relief very useful. The one entity that did not use this transition relief considered that it would be more practical to apply the same process on the transition to all lease types that are likely to require asset and liability recognition in the future. On transition, this entity had leases with less than one year to run but did not expect to make use of the ongoing short-term lease practical expedient.

  Despite its usefulness, there was some confusion amongst preparers regarding how to determine the lease terms at the time of transition. For example, some commented that they were unsure if some of the leases were eligible for the short-term lease exemption, particularly for those with holdover clauses or leases with a high likelihood of being extended or modified. These interviewees noted that there were no clear rules or sufficient guidance to determine whether the extended/modified lease should be treated as a new lease. Preparers applied judgements with guidance from their auditors at initial application.
- Twenty preparers (11 Australian and 9 Malaysian) chose to rely on their assessments of whether leases are onerous by applying IAS 37 immediately before the date of initial application, as an alternative to performing an impairment review. Interviewees commented that they did not expect the outcome would be materially different whether they applied the transition relief or not. Nonetheless, they appreciated the option to allow them some time and resources to focus on other complex components of IFRS 16. The following statements from one interview with an Australian preparer was typical of comments made on this aspect,

> "They are useful…. One thing less to worry about, among other things, practically. But, you know, we didn't view that even if we had to do that, we would have had very different outcomes anyway."

Some noted that, in cases when recently changed circumstances meant that there might be a previously unreported impairment, they undertook an impairment assessment in any case.

The entities (Malaysian) that did not use this transition relief were experiencing changed circumstances that necessitated a re-assessment of the carrying amounts of assets previously recognised under finance leases. Their decisions were based mainly on their approach to transition more broadly, which was to undertake a thorough 'stocktake' of their leases and the values attributable to leased assets on adopting IFRS 16.

> "The Group took the transition to MFRS 16 as an opportunity to hire a project team to catalogue all leases and perform a cost-benefit assessment of leased assets and the costs of lease financing in light of the current business environment."

- All but three entities (one Australian and two Malaysian) chose to exclude initial direct costs from the measurement of the RoU asset at the date of initial application. The entities that did not use this transition relief considered that, since they would be including initial direct costs post-transition, it would be appropriate to establish that practice on transition. A lack of sufficient data and the state of existing lease records were the main reasons preparers used this transition relief, especially for the lease contracts that commenced decades ago. The records of lease transactions may be inadequate to identify initial direct cost or undue cost and effort would be involved in doing so. One preparer made the following comment on this aspect,

> "There was no consensus on what should be included in 'initial direct costs'… It would be very difficult to separate them from those leases commenced decades ago."

- All 29 preparers chose to apply hindsight. In Australia, it was commonly used for property leases, especially where certain terms were renegotiated during the term of the leases. Most lessees considered that this practical expedient was essential because, in many cases, the relevant information was not available that would have enabled a lessee to avoid applying hindsight, particularly for very long-term leases. Many also thought that using hindsight potentially resulted in better information in any case.

Ongoing practical expedients

Overall, preparers generally found the ongoing practical expedients for short-term leases and leases with low-value assets very useful, but less so for the other two (i.e. portfolio approach and not separate non-lease components from lease components).

Among the 29 preparers (14 from Australia and 15 from Malaysia) interviewed who applied IFRS 16 using the modified retrospective approach:

- All applied both the short-term lease and low-value lease asset practical expedients for cost-benefit reasons. The types of lease transactions that the practical expedient enables lessees to account for on an operating expense basis depend on the business of the relevant entities. The main types of lease transactions that the short-term lease practical expedient has enabled lessees to account for on an 'operating expense' basis include:

- motor vehicle rentals;
- temporary accommodation/office rentals; and
- temporary equipment hire.

All lessees indicated that the affected leases are not material (in aggregate). As discussed above, there was some confusion among preparers about determining the lease terms, especially those with roll-over options, when IFRS 16 was first implemented. Some lessees considered that 'short-term' should be judged by the entity within the context of the business's operating cycle. Others supported a fixed 12-month benchmark based on providing clarity and avoiding debates within management and with auditors.

- The main types of lease transactions that the low-value lease asset practical expedient enables lessees to account for on an 'operating expense' basis include:
  - laptops, mobile phones, photocopiers and other small items of office equipment; and
  - other assets that support administrative functions.

  All lessees considered the practical expedient to be sensible. However, a few preparers commented on the significant effort required to collect, validate and disclose, for example, leases with low-value assets. Even though there is no need to recognise RoU assets, entities must constantly monitor lease activity to ensure these assets are below the recognition benchmark.

  Mixed views were expressed regarding the guidance of the dollar-value benchmark. There was a general understanding in both Australia and Malaysia that the reference in paragraph BC100 of IFRS 16 to the USD 5,000 benchmark for identifying a low-value leased asset is not a formal benchmark. Nonetheless, many entities view it as a useful benchmark to help guide their thinking on what constitutes 'low value'. Most lessees simply use the USD 5,000 benchmark (or other currency equivalents). Some lessees used a lower or higher benchmark based on the size of their asset base and/or liability base and the business size.

  Most of the lessees interviewed considered it appropriate that there is no overall materiality override for an aggregate of low-value leased assets – although most noted that, even if such an override existed, it would be unlikely to be breached in practice in any case. That is, all lessees indicated that the affected short-term and low-value leases are generally not material (in aggregate). However, a few lessees noted that USD 5,000, even after adjustment for inflation and foreign exchange rate adjustments (e.g. for entities that used AUD 10,000 as the benchmark), could be too low, particularly for large entities. These entities prefer guidance with reference to materiality (instead of a dollar-value benchmark) which would allow entities to make more relevant decisions to their circumstances.

  Some lessees had alternative suggestions for the types of leased assets they would have preferred to be the subject of the practical expedients. These included:
  - a practical expedient for core assets (to be accounted for by applying IFRS 16) and non-core assets (to be accounted for on an 'operating expense' basis) – with core to be based on the lessee's business model(s); and
  - a low value practical expedient based on the asset value when the lease commences (not the 'as new' asset value).

- Although there was no explicit disclosure in their financial statements, eight preparers in Australia, mostly large entities, indicated in their interviews that they apply the portfolio approach to account for leases with similar characteristics. The nature of the underlying

assets commonly determines the portfolios (e.g. property leases vs. non-property leases and commercial property vs. residential property) and terms of the lease contracts.

In contrast, none of the preparer entities that were interviewed in Malaysia applied this practical expedient. Many of the preparer entities that were interviewed had not seriously considered using the practical expedient prior to engaging in the research project. Some entities indicated that they might consider applying this practical expedient at some time in the future. However, most entities were of the view that they are unlikely to apply this practical expedient on the basis that:

- they do not have assets that would form a suitable portfolio – they noted that most of their smaller assets that might be the subject of a portfolio are the subject of the low-value leased asset practical expedient; and
- they consider the cost involved in identifying assets that could form a portfolio, and establishing that the portfolio would not differ materially from applying the Standard to the individual leases within that portfolio, would outweigh any likely benefits.

Similar to the comments made by Malaysia preparers above, one Australian preparer also questioned the usability and usefulness of the portfolio approach in IFRS 16. This preparer found it particularly challenging in their business to continuously prove there would be no material difference in accounting for leases on their individual basis and on a portfolio basis. They considered that more guidance on how the portfolio could be determined would be helpful, making the comment,

> "Once you set up a portfolio, you need to come up with a set of rules. I can't really think any lease contracts that are so homogenous that they will behave the same way."

- Only a few preparers (four of the preparer entities in Malaysia) interviewed applied the practical expedient that permits an entity not to separate non-lease components from lease components and instead account for both components as a lease. They applied this practical expedient to at least one class of assets based on cost-benefit reasons.

  Most lessees that applied the practical expedient for some classes of assets found it useful for leases that include non-lease components such as cleaning and security services accompanying a lease of office accommodation, and service agreements associated with some larger forms of office equipment.

  Most of the entities not applying this practical expedient either did not consider separating non-lease components would be overly complex or did not have leases that included non-lease components. Two entities not applying this practical expedient mainly had leases with substantive non-lease components that they preferred to account for separately.

  There were a variety of reasons given for why an entity might not apply this practical expedient to a particular class of assets, including:

  - the underlying leased asset is managed separately from a service component attaching to the leased asset, for example, different personnel are responsible for their procurement and/or performance;
  - when there is a large non-lease service component to the lease contract, not separating it from the leased asset would artificially inflate the value of the RoU assets and depreciation charges; and

- the entity had some non-lease assets with separate maintenance agreements and some leased assets with integral maintenance agreements, and they wanted to ensure the same accounting was applied to all maintenance agreements.

Underpinning all three points is that the larger the service components of a lease, the more likely they are to be managed separately from the underlying leased assets.

Disclosures about transition choices

Overall, lessees in Australia and Malaysia generally found the disclosure requirements clear and understandable, had few concerns about the required disclosures and considered them reasonable. One concern raised by some Malaysian preparers was that the disclosures had become boilerplate and may not always be tailored to the circumstances of particular entities.

4.2.2 Auditors

The following discussion relating to findings from auditor interviews relates to both jurisdictions, since the observations were largely compatible between the Australian and Malaysian responses, However, in some cases, observations are flagged as relating to one jurisdiction or the other.

Early adoption of IFRS 16?

All the auditors indicated that their clients had consulted them about the transition to IFRS 16 and their choice of transition relief and ongoing practical expedients.

The auditors observed a lack of incentive to adopt IFRS 16 early as many of their clients did not consider that early adoption would bring any tangible benefits. Many of their clients found IFRS 16 a challenging standard to transition into, which required substantial investment in time and resources. Given the complexities of IFRS 16, entities needed the time to properly consider and assess the impact of IFRS 16, and develop appropriate accounting policies. One Australian auditor observed that users and other stakeholders would not necessarily look at the entity differently if it were to early adopt IFRS 16, which further discouraged early adoption.

Those few audit clients that early adopted IFRS 16 did so in scenarios where:

- it was the first time the entities, as lessees, entered a lease contract right before the mandatory adoption date of IFRS 16. It was more practical for these entities to account for their leases under IFRS 16 rather than accounting for them under IAS 17 and subsequently transition to IFRS 16 in a year's time;
- entities early adopted IFRS 16 together with IFRS 15 and/or IFRS 9, and they employed the services of a contactor to address all the implementation issues at once; and/or
- entities early adopted IFRS 16 and IFRS 15, and the early adoption of IFRS 16 would have an insignificant impact on them.

Definition of a lease

The majority of audit clients adopted this expedient, and auditors generally considered that using this expedient made no material difference in the lessees' financial statements.

Most auditors (five of the six Australian and all seven Malaysian auditors) were comfortable with the transition relief exempting entities from reassessing whether a contract is, or contains, a lease at the date of initial transition. They found this expedient useful from a lessee and auditor perspective as it

would reduce the time and effort required for implementing IFRS 16 and smooth the transition process. One Australian and two Malaysian auditors commented that this practical expedient is very accommodating for lessees from different circumstances. For example, it could be very challenging in some cases to trace back possible lease transactions in history due to changes in the management team and staff. Staff handling transition may not necessarily process the same knowledge around certain transactions or lease arrangements across time. This expedient avoids the need for lessees to trace and reassess lease arrangements from decades ago. One Australian auditor commented in this aspect that,

> "Going back and reassessing things may not be impractical, but not necessary in many cases. It would not necessarily lead to a better outcome."

All of the interviewed auditors considered that applying this practical expedient would only have minimal impact on their work.

Two Australian auditors raised concerns that this practical expedient may not be well understood or well applied by some lessees. Auditors need to ensure that the audit team understands what the clients are doing with all the available relief and that the clients understand their transition relief options. Auditors need to be comfortable that there was a considered assessment before they were comfortable with clients' selections. Many of the clients used this practical expedient without thoroughly thinking through the impact it might have in the longer term. IFRS 16 is a complex standard to implement, and there was some concern that entities were choosing this practical expedient based on being the simplest possible way to transition.

One Malaysian auditor noted a preference for having clients' test' their systems for identifying leases by not applying the practical expedient. They noted that some entities put in place new systems for identifying leases on the introduction to IFRS 16, and those systems sometimes remained largely untested until subsequent years when the practical expedient no longer applied.

One Australian auditor commented that such transition relief may provide limited cost-saving benefits at initial implementation but would cause more confusion in the subsequent period. In situations where the entities need to track back for some transactions, they could not determine if they had applied the practical expedient because it was available to them at the time of transition or because they had a solid assessment that the outcome would be the same whether they use the practical expedient or not.[11]

Two Australian auditors also commented that applying this practical expedient, rather than reducing the assessment cost, actually deferred the cost. Many clients must apply the new definition of leases in IFRS 16 subsequent to the initial implementation, as soon as a new lease contract arises, or the existing contract is significantly modified. One of those auditors suggested that it would have been better if all entities were required to apply the definition of leases in IFRS 16 at initial application and consider simplification with other relief options.

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11 For example, the IFRS Interpretations Committee (IFRIC) decision concluded that the swap contract between the electricity retailer and the wind farm does not contain a lease under the definition of leases in IFRS 16. The entity may not be clear if it needs to restate financial statements as a change in accounting policy because of the IFRIC agenda decision. If the entity previously recognised power purchase contracts as leases under IAS 17 and grandfathered these contracts when transitioned into IFRS 16. The power purchase contracts would be consequently assumed to be leases under IFRS 16. The IFRIC agenda decision would then require the affected entities to change their accounting policies and restate comparatives as per IAS 108. If entities had thought through the definition of leases at transition, they could have avoided the change in accounting policies and the confusion in the post-IFRS 16 periods.

Approach to transition

Consistent with observations from the review of financial statements, the majority of audit clients applied IFRS 16 using the modified retrospective approach. And among the clients who adopted the modified retrospective approach, Option 2, measuring RoU assets at an amount equal to the lease liability, adjusted for any existing prepaid or accrued lease payments, was the most popular choice, particularly among the smaller-sized entities. Some clients used a mix of Option 1 and Option 2. Very few of their clients used only Option 1. Entities preferred the modified retrospective approach and Option 2 for their simplicity, which reduces implementation complexity and cost. Entities that chose Option 1 usually had better information systems and sufficient historical data.

Very few entities applied the full retrospective approach. These entities had sufficient data, which enabled them to carefully evaluate the impact of each adoption option before deciding on the option with minimal impact on their balance sheet performance. Notably, larger entities, being relatively more conscious of their performance from year to year, would plan and consider the transition approach more. Some of their well-resourced large clients had, for example, calculated the accumulated depreciation position under each form of transition relief and assessed the ongoing influence of each transition approach at the initial implementation.

Although the auditor had to spend more time initially understanding the transition relief, all of them found it helpful to facilitate the audit. The modified retrospective approach facilitates a more straightforward implementation, and is less time-consuming for both preparers and auditors. Auditors generally agreed that, in many circumstances, it could be too difficult to trace all the relevant information for some previous transactions. Some auditors also noted that the modified retrospective approach allowed more time to be focused on the management judgements required on transition. One Malaysia-based auditor shared that,

> "A key audit focus was to review areas involving management estimates or judgement relating to data used to apply transition provisions, such as the robustness of processes applied to determining an incremental borrowing rate, remaining lease terms, and estimated dismantling costs."

Further practical expedients at the transition

Table 7 summarises auditors' comments on each form of practical expedient. Overall, auditors found the five forms of transition relief available for preparers who elected modified retrospective approach useful for their audit clients and the audit process. Even though, initially, there was a need for auditors to educate themselves on these forms of transition relief to gain a thorough understanding of their application, the relief provided a much simpler transition, which freed up time and resources for both preparers and auditors to focus on other complex issues within IFRS 16.

Table 7 Summary of auditors' comments on each form of practical expedient

Practical expedient	Auditors' comments
Practical expedients at transition	
Portfolio approach to the discount rate	Overall, auditors find this a useful expedient for lessee preparers and audits, particularly for entities with a large number of lease contracts. This practical expedient was used by a majority of audit clients at transition, although less frequently by smaller clients with fewer lease

Table 7 Summary of auditors' comments on each form of practical expedient

Practical expedient	Auditors' comments
	contracts. Commonly used for retailers with large volumes of leases and vehicles, but not as common for land and buildings. Initially, auditors spent considerable time understanding the practical expedient (e.g. the meaning of "leases with reasonably similar characteristics") including the meaning of a similar class of underlying assets and a similar economic environment. In practical terms, preparers could make a reasonable range of estimates for an IBR on a portfolio basis, which facilitated the transition process. They indicated they could gain a greater degree of confidence in the IBR than might have been the case by attempting to identify discount rates on a lease-by-lease basis.
Previously recognised onerous lease provisions	Same as above, considerable time and resources were devoted to determining how best to apply the impairment requirements to RoU assets. Impairment of RoU assets was, and still is, one of the significant challenges in applying IFRS 16. Dealing with IFRS 16 and its interaction with IAS 36 can be complex for some entities. Auditors noted that, while many entities assessed impairment at the cash-generating-unit level, few did so at the individual RoU asset level. One Australian auditor and one Malaysian auditor considered that it would be better to address the potential impairment issues at transition, which may save time and effort in the long run. However, some auditors noted that, in theory, impairment testing prior to adopting IFRS 16 should have been sufficiently robust to ensure that few if any impairments would go unrecognised under the transition expedient and that it posed a low audit risk.
Leases for which the lease term ends within 12 months	All the auditors interviewed consider this to be a very useful practical expedient for their clients. However, the application also faced challenges, particularly when dealing with lease contracts with holdover clauses,[12] which requires judgement. Changes in lease term assumptions may result in some leases being recognised on the balance sheet.[13] One Australian auditor considered it might be simpler for some entities to not exclude any leases on transition and rely on the use of materiality judgements in deciding if any leases would be exempted from balance sheet recognition.
Exclusion of initial direct cost	All the auditors interviewed consider this practical expedient to be very useful. Retrieving initial direct cost would be challenging for many

12 No specified contractual term. Continues indefinitely until either party to the contract gives notice to terminate.

13 IFRIC agenda decision – determining the 'lease term' for cancellable and renewable leases

Table 7 Summary of auditors' comments on each form of practical expedient	
Practical expedient	**Auditors' comments**
	entities due to data availability and how these costs were dealt with in the past, for example, what constituted an initial direct cost.
Use of hindsight	All auditors found this practical expedient to be particularly practical and useful. This expedient simplified the calculation of the RoU assets and also the documentation of the calculation. It could be challenging for entities to reassess lease terms that someone else decided years ago. Entities relied heavily on what they knew when making assessments and judgments on the transition day. One Australian auditor noted that the manner in which the practical expedient is expressed in IFRS 16 implies it is applicable to all transition approaches. However, it appears that an entity can elect to apply hindsight only to information it would have been required to estimate if it had always applied the new Standard (i.e. Option 1 to measure RoU assets at initial implementation). This practical expedient would not be relevant to entities measuring RoU assets at transition under Option 2 (i.e. no hindsight is needed for that method). However, one Australian auditor found cases where some entities misused this practical expedient by using hindsight in calculating lease liabilities, whereas, hindsight should be only used only in determining the lease term; for example, purchase, renewal and termination options.
On-going practical expedients	
Short-term leases	Considered to be very helpful and commonly used among audit clients. Predominately used for plant and equipment, sometimes for vehicles. Comment similar to earlier discussion on page 34 about leases for which terms ends within 12 months.
Low-value asset leases	Widely used among clients. Some referred to the USD 5,000 benchmark, with adjustments for foreign exchange rate and inflation. Four Australian and three Malaysian auditors commented that the dollar-value benchmark had facilitated the implementation of IFRS 16. They consider the threshold straightforward to understand and be applied by lessee preparers, particularly for middle-sized entities. However, some auditors noted that, for large entities, USD 5,000 is not a particularly helpful benchmark. Three Australian auditors and three Malaysian auditors suggested that referring to the materiality principle in IAS 1 would have been a better way to determine a lease of low-value assets. There have been many client discussions around identifying the meaning of 'low value', and the benchmark has been adopted differently by different preparers (e.g. when calculating foreign exchange rate and inflation adjustments).

Table 7 Summary of auditors' comments on each form of practical expedient

Practical expedient	Auditors' comments
	One Malaysian auditor was particularly critical of the USD 5,000 benchmark as being contrary to principle-based standard setting.
Not separating lease and non-lease components	Auditors in Australia have not seen many of their clients use the practical expedient to not separate lease and non-lease components on an ongoing basis. The incidence of this practical expedient among clients seemed greater for the Malaysian auditors. In general, auditors considered that most lease contracts are written sufficiently clearly to enable separate identification of lease and non-components. They noted that entities are generally reluctant to recognise RoU assets and lease liabilities for a material non-lease component because it has the potential to inflate the balance sheet. Although not widely used in an Australian context, all the interviewed auditors considered it a useful expedient that saves time and effort for preparers and auditors in cases where it can be challenging to separate the lease and non-lease components on a relative stand-alone price basis. The analysis process can be very complex and separating the components in many cases is unlikely to add value to the financial statements.
Portfolio approach	Auditors have not seen many of their clients apply the portfolio approach on an ongoing basis and have observed misinterpretation of this expedient among their clients. Some entities might consider their lease suitable for the general portfolio approach as prescribed in paragraph B1 of IFRS 16 by applying the same IBR to a group of leases based on the assumption that it is reasonable to do so, similar to the approach on transition. However, the portfolio approach is broader than just applying the same IBR. The portfolio approach can be applied only for a group of leases with similar characteristics if the entity reasonably expects that the effects on the financial statement of applying IFRS 16 to the portfolio would not differ materially. If accounting for the portfolio approach, the estimates and assumptions should reflect the size and composition of the portfolio. Most of the auditors interviewed indicated that, with sufficient data, entities find it easier to account for each lease contract individually, mainly because the lease contracts may require later modification. Auditors observed that many entities are still learning how they might apply the portfolio approach appropriately. One Malaysian auditor noted that the portfolio practical expedient could be used to minimise the subsequent impact of impairment assessments because individual assets are more likely than a whole portfolio to be impaired.

Disclosures about transition choices

In general, auditors considered the disclosure requirements about transition reasonable. One Australian auditor observed that entities tended to over-disclose information not relevant to their particular circumstances at transition, for example, quoting definitions of RoU assets or lease liability from IFRS 16. While acknowledging the additional information could be useful for education purposes, the length of the disclosure could compromise effective communication between the entities and users of financial statements. The useful information could be obscured by the length of general descriptions. Disclosure in subsequent years appeared to be more fit for purpose.

One Australian auditor and two Malaysian auditors commented that the accessibility, clarity and usefulness of disclosure could be influenced by the location of IFRS 16-related disclosure. On transition, some entities presented separate disclosure for changes in accounting policies for IFRS 16 adoption and accounting policies for leases. The two sections could be pages apart in the financial statements. To understand the full impact of IFRS 16 adoption, users of financial statements needed to sort through many pages, which may not be the most user-friendly disclosure format.

4.2.3 Users

The following discussion relating to findings from user interviews relates to both jurisdictions since the observations were largely compatible between the Australian and Malaysian responses. However, in some cases, observations are flagged as relating to one jurisdiction or the other.

All the users interviewed were made aware of the changes that IFRS 16 was likely to bring about to the financial statements of the entities they analysed and were generally aware of the transition and ongoing practical expedients.

- The two fund managers (Malaysian) interviewed obtained most of their information about the impacts of IFRS 16 from the entities that they analysed by way of investor briefings.
- The nine analysts (five from Australia and four from Malaysia) interviewed typically did not have direct relationships with their target entities and obtained their information about the impacts of IFRS 16 from a range of sources, including their employer (for example, the relevant relationship managers in a bank), presentations by large audit firms and trainers hired specifically to educate them about IFRS 16.
- The rating agency analyst (Malaysian) interviewed conducted their assessment of the likely impacts of IFRS 16 and obtained detailed information from their client entities to make assessments specific to those clients.

All the users interviewed were comfortable with not having completely comparable information for past reporting periods on transition, largely because the IAS 17 lease commitment disclosures provided for past periods provided a reasonable basis for determining the significance of lease-related transitions during the transition period. Some users noted that, in the absence of that IAS 17 disclosure, they would have wanted to see the full retrospective application of IFRS 16 on transition. Two analysts expressed concerns about the modified retrospective approach. They noted that recognising the cumulative impact of adopting IFRS 16 on the opening balance of retained earnings at the transition year would cause problems for comparability of financial performance over time. For those users, recognising the cumulative effect of adopting IFRS 16 on the opening balance of retained earnings at the year of transition has caused considerable disruption in evaluating entities' financial performance, making forecasting difficult.

While all the users interviewed were aware of the choice available to entities to apply either a full or modified retrospective approach to adopting IFRS 16, four users (Malaysian) were not fully aware of all the available transition relief and ongoing practical expedients. For example:

- four users were not aware of the transition relief relating to determining whether a transaction contains a lease;
- three users were not aware of the transition relief from assessing whether contracts are onerous;
- none of the users was aware of the ongoing portfolio practical expedient.

Generally, users considered both the transition relief and ongoing practical expedients to be reasonable and are not concerned about the possible misuse or abuse of the relief or practical expedients. Four users noted that this view is based on a perception that the preparers and their auditors would have thoroughly considered the appropriateness of the practical expedients for the entities concerned.

One credit analyst (Malaysian) noted they were initially concerned that the short-term and low-value lease asset practical expedients are not subject to an overall materiality override; however, they had satisfied themselves that, in practice, the expedient is unlikely to have a material effect on their clients' reporting. Nonetheless, they consider that the expedient for not separately accounting for non-lease components should be the subject of a materiality override.

One fund manager (Malaysian) considered that there should be a limitation on the practical expedient relating to not separating non-lease components, such as a service component of 20% or more being required to be separated from the lease. All the users interviewed consider disclosing information about the relief used on transition and the practical expedients used on an ongoing basis crucial. Two users consider the disclosure could be more extensive and include, for example, the reasons for choosing either to use or not use some of the particular expedients. While these users appreciated that most entities would choose the ongoing short-term lease and low-value leased asset expedients for cost-benefit reasons, they would, for example, prefer to see some explanation for why the expedient for not separately accounting for non-lease components was used or not used.

Two credit analysts considered there should be a disclosure of the amount of lease commitments for short-term leases accounted for using the ongoing practical expedient, regardless of whether the portfolio of short-term leases to which the entity is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense relates. The same user also wanted disclosure of commitments under non-lease (service) components that have been separated from leases.

One of the fund managers and one of the credit analysts considered that there should be more disclosure about the nature and use of leased assets in the entities' businesses. However, they conceded that the same concern is probably true for other (non-lease) assets and is a topic broader than leases.

5. Other comments in relation to IFRS 16

Although they are not the focus of this Report, the authors note the following additional comments provided at the post-implementation review of IFRS 16:

- Lessor accounting – some preparers raised concerns about the potential for misalignment in accounting treatments between lessee and lessor under IFRS 16. For example, the expedient of not-separating non-lease components from lease components is available only for the lessee but not for the lessor. One lessor suggested they would also appreciate the similar expedient being made available for the lessor.
- Lease liability measurement and incremental borrowing rate (IBR) – preparers, auditors and users have all raised concerns over the measurement of lease liabilities based on IBRs:

- A few preparers also shared other concerns about the inconsistency between the measurement of the lease liability and other provisions, and the comparability across entities. Assuming entities apply IFRS 16 appropriately, each entity would have its own distinct IBR determined via thorough consideration of their debt financing arrangements and the types of leases into which they typically enter. However, the assumptions about the determination of IBR are not necessarily disclosed in the financial statements. Financial statement users are aware that different entities are using different IBRs and are requesting more information about the IBR. A concern also shared by the users of financial statements, lessees could potentially engage in opportunistic behaviour through the construction of their IBR to, for example, influence their credit rating. One lessee preparer also commented that the IBR model has made forecasting more challenging with the ongoing need to adjust the entity IBR.
- A few preparers also highlighted determining the IBR as an ongoing challenge, particularly the process of constructing IBR. They had extensive discussions with their treasury team and auditors on how IBR should be determined and what would be the most appropriate rate to use. The sensitivities and impact of the IBR on entities' indebtedness, and consequently credit rating, has resulted in this matter increasingly being identified by auditors as a key audit matter.
- Auditors raise concerns over the inconsistency, at the conceptual level, between the measurement of lease liabilities in IFRS 16 and other types of provisions under IAS 19 (e.g. employee benefit-related provisions are determined by reference to market yields on high-quality corporate bonds at the end of the reporting period).
- Users also expressed concerns about the IBR calculation and commented that the communication between entities and investors on lease liability calculation has been difficult. Users acknowledged the benefit of increasing lease commitment visibility on the balance sheet. However, they also noticed reduced visibility in terms of the income statements due to using IBR in lease liabilities. Each entity has its IBR, and there are no sufficient details in the disclosure about how these IBR were determined. Some analysts decided to unwind the discount for measuring lease liabilities with the provided IBR and then apply their own discount rate for all the entities within their investment portfolio to improve comparability. For some users, the IBR has added an extra layer of complexity to determine the lease liability and expense.

- Some users consider that IFRS 16 has resulted in a distortion of classification of cash flows. Cash flows that were previously operating in nature are identified as financing cash flows because the lease liability is regarded as akin to debt. Some of those users are reconstructing the information they receive back to the IAS 17 approach and to reclassify all cash flows associated with leases as operating.
- One user considers that leases should be capitalised only to the extent that the lessee is committed to the leased asset. They view the potential for extending a lease to be in the nature of a line of credit that the lessee may choose to use, which is different from a 'committed' lease liability that is akin to bank debt. They would support more information being provided by lessees about the 'committed' and 'optional' portions of lease liabilities to enable them to perform a more informed analysis of a lessee's funding position and funding opportunities.

6. Concluding remarks

Overall, the findings in this Report suggest that most of the IFRS 16 practical expedients have been found, to varying degrees, useful by preparers. Auditors have not encountered major concerns in

auditing the use of IFRS 16 practical expedients. Users also generally have a reasonable understanding of IFRS 16 practical expedients and have not found any major concerns with the usefulness of the information provided, despite the level of choice available to entities in applying the practical expedients. The practical expedients have been pitched at a reasonable level that removes a potentially large administrative burden but has a limited impact on the financial outcomes. IFRS 16 is a complex standard to implement and understand, with consensus across preparers, auditors and users of financial statements. The various forms of transition relief were very helpful and accommodating to preparers and greatly facilitated the transition process, saving on implementation costs. A few preparers and auditors highlighted the importance and usefulness of implementation guidance during the transition, suggesting that IASB provide more educational material and technical support in respect of new and revised IFRS Accounting Standards in the future.

Based on the research performed for this Report, the following factors emerged as being important:

- The likely starting point for reporting by the various IFRS stakeholders who will need to adopt the new requirements is important for determining transition relief. For example, the nature and extent of transition relief would depend on whether:
    - a new or revised IFRS Accounting Standard replaces an existing IFRS Accounting Standard and most entities would be transitioning from a similar position;
    - a new IFRS Accounting Standard replaces either an interim IFRS Accounting Standard and/or a variety of national GAAPs and entities would be transitioning from a range of different positions.
- Although not a technical consideration, the availability of suitably skilled staff around transition time creates a bottleneck and indicates a need for lead times and transition relief to have regard to the broader regulatory context facing those entities that will need to apply a new or revised IFRS Accounting Standard. For this reason, while early adoption is not often widely adopted it should always be available for those few entities that might wish to make the most efficient use of their resources by either:
    - adopting multiple IFRS Accounting Standards with different mandatory application dates at the same time; or
    - adopting an IFRS Accounting Standard ahead of time to avoid a skills bottleneck,
- Providing transition relief and/or ongoing practical expedients based on 'bright lines' [such as the 12-month lease term benchmark and the USD5,000 low-value lease asset benchmark in the BC], while not principle-based, can provide much needed clarity for all stakeholders. Provided those benchmarks are reasonable, and there is suitable disclosure, users are not generally adversely affected.
- Providing flexibility around the scale at which the transition relief or ongoing practical expedients can be applied is important to minimising costs for preparers – such as permitting entity-wide application versus asset-by-asset application of transition relief and/or ongoing practical expedients. Limiting the use of a form of transition relief or an ongoing practical expedient to a whole entity might be more principle based, but it removes the ability of an entity to apply the transition relief or an ongoing practical expedient to only those cases when it is necessary – that is, it limits an entity's ability to avoid applying transition relief or an ongoing practical expedient where it is not necessary (e.g. not cost-beneficial).
- The design of transition relief or an ongoing practical expedient that has countervailing incentives underpinning its use can be very effective. For example, the ability under

IFRS 16 to choose to not separately account for service components in a lease is unlikely to be abused because there is a natural incentive to separately account for material service components to avoid over-capitalising lease liabilities.

- Consideration should be given to the various potential flow-on effects of an ongoing practical expedient, some of which may not be immediately obvious. Those considerations would be best outlined in the Basis for Conclusions to enable prepares to understand the limits applying to the use of an ongoing practical expedient. For example, while the research indicated that ability to elect to account for leases at a portfolio level is not a widely used ongoing practical expedient, it can have consequences for onerous contract accounting and asset impairment because the aggregation to a portfolio level might 'conceal' onerous contracts/impairments that would be revealed at an individual asset level.
- While the IASB already has a thorough due process, specific consideration should be given to seeking input from users on their tolerance for, and understanding of, the application of various forms of transition relief or ongoing practical expedients. This has the potential to provide a greater level of comfort for the IASB in designing suitable transition relief or ongoing practical expedients that have the potential to save material costs for preparers and their auditors while posing little or no detriment for users.
- The IASB's deliberations and conclusions on whether the application of ongoing practical expedients might have a material impact on an entity's reported financial position or performance should be given prominence in educational material.