Submissions received from for-profit sector and other stakeholders that responded to the the questions in IASB's RFI.

3 September 2025

Dr K Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Dr Kendall

AASB Invitation to Comment ITC 55 *Post-implementation Review of AASB 16 Leases*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on AASB Invitation to Comment ITC 55 *Post-implementation Review of AASB 16 Leases.* The views expressed in this submission represent those of all Australian members of ACAG, unless specifically identified.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the ITC. Also attached is ACAG's response to the International Accounting Standards Board (IASB) Request for Information *Post-implementation Review of IFRS 16 Leases.*

Overarching feedback

ACAG found that the implementation of AASB 16 in public sector agencies has presented numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

The submission notes various areas where additional guidance or examples could be provided to provide more clarity to preparers and auditors and drive greater consistency in application of AASB 16 in the public sector.

The ongoing costs of auditing operating leases for lessees under AASB 16 are generally higher than under AASB 117, particularly for entities with a significant number of leases. While including leases on balance sheet does provide more transparent information on leases and helps comparability between entities, it is unclear whether the benefits have been fully realised by users of the public sector's financial statements.

Notwithstanding the issues raised above, the costs of implementing any proposed changes to the framework should be considered when making decisions about any amendments to AASB 16. Further, the majority of ACAG jurisdictions support keeping the accounting policy choice for concessionary leases. One jurisdiction that supports the FV approach for concessionary ROU assets has shared their rationale in Topic 5 of the attachment.

Once again, thank you for the opportunity to comment on this post-implementation review. I hope you will find ACAG's comments, helpful when assessing whether the effects of applying the requirements are as intended.

Yours sincerely

Rachel Vagg
Chair
ACAG Financial Reporting and Accounting Committee

Attachment

SECTION 1 – AASB GENERAL MATTERS FOR COMMENT

> **General Matter for comment 1**
>
> Are there any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 *Leases*?

The application of AASB 16 creates convergence differences with the Australian Government Finance Statistics (GFS) Manual, as GFS continues to distinguish between operating and finance leases for lessees and does not recognise operating leases in the Statement of Financial Position.

ACAG is not aware of any other regulatory or other issues in the Australian environment that adversely affect the application of AASB 16.

> **General Matter for comment 2**
>
> Does the application of the requirements in AASB 16 result in major auditing or assurance challenges?

Implementation of AASB 16 in public sector agencies has presented numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

Key issues identified by ACAG in the implementation of AASB 16 include:

- **Completeness and accuracy of lease calculations:** auditors faced challenges in verifying the accuracy and completeness of lease calculations as agencies:
    - struggled to identify contracts that may contain leases
    - were parties to arrangements that were undocumented
    - did not formally document, approve, or maintain key lease accounting interpretations and assessments for individual lease contracts. This often made it difficult to determine whether the asset in a long-term contract was subject to a lease and should be recognised as a right-of-use asset (ROU) asset or as property, plant and equipment (PPE). For example, in certain jurisdictions, some government departments have historically leased land to government agencies without documentation. These agencies use the land and constructed significant public sector assets on it. The issue is whether the land should be recognised as an ROU asset or PPE, and if it is a lease what the lease term should be
    - had incomplete and/or inaccurate lease data held centrally (e.g. future market rent reviews, fixed rate increases, and lease incentives) which resulted in material adjustments to lease calculations
    - did not have information from lessors regarding the value of non-lease components
    - applied the standard incorrectly e.g. omission of fixed rent and/or market rent review increases, application of lease incentives and non-lease components
    - inconsistently applied the impairment requirements for ROU assets measured at cost subsequent to initial recognition.

    These issues were more prevalent when the standard was first introduced and have reduced since this time. However, the following areas still require significant judgement each time a new lease is entered, to calculate the lease liability to be recognised:

    - consideration of what constitutes a non-lease component versus a lease component or an ‘amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee’
    - estimation of stand-alone selling prices for non-lease components
    - allocation of ‘amounts payable by the lessee for activities and costs that do not transfer a good or service to the lessee.’

While this separation is not mandatory it is in most entity's interests to separate the lease components to reduce the liability, and the ongoing depreciation expense associated with the right-of-use asset.

- **Judgment and complexity in lease accounting:** ACAG found the standard inherently difficult to audit given the extensive judgment required in determining enforceability of leases, particularly intra-government leases, lease terms, including 'reasonably certain to extend' and 'no more than an insignificant penalty'.

  There are often practical challenges for determining whether a lease exists. One of the criteria is whether the lessee receives the substantial economic benefits. In the public sector, for leases between departments and agencies, as both entered into the arrangements with the aim of providing services to the public it is difficult to assess who received substantially all of the benefits. For example, in social housing both parties enter into these arrangements with the aim of providing social housing. It is difficult to assess which party receives substantially all the benefits from the arrangement.

These areas continue to cause interpretation challenges.

The main audit challenge for subsequent measurement of leases is the accounting for lease modifications. ACAG found that these requirements are not well understood or applied by public sector agencies due to the complex concepts in the standard. The specific challenges we have noted are set out in our response to question 5.

General Matter for comment 3

Are the requirements in the best interests of the Australian economy?

ACAG is unable to comment on whether the proposals are in the best interests of the Australian Economy.

SECTION 2 – NFP AND PUBLIC SECTOR TOPICS FOR COMMENT

Topic 1 – Application of AASB 16 by NFP and public sector entities

1. In respect of NFP and public sector entities:

   (a) are the ongoing costs of applying AASB 16 and auditing and regulating its application significantly greater than expected?

   (b) are the benefits to users significantly lower than expected?

   (c) overall, do you have any comments about whether AASB 16 results in financial statements that are more useful than financial statements prepared under the previous Standard AASB 117 *Leases*?

Please explain the reasons for your views on the above matters. Examples to illustrate your responses are also most helpful.

1(a) ACAG has found the costs of auditing operating leases for lessees under AASB 16 are generally higher than under AASB 117, especially for agencies with a significant number of leases. This is because AASB 16 introduces more complex ongoing accounting and auditing requirements for leases compared to AASB 117. These include the review and accounting of:

- changes to the lease term
- changes to ROU assets and lease liabilities resulting from changes in lease payments due to an index or rate
- changes to leases as a lease modification or as a separate lease (including impacts from changes in the discount rate)

- annual impairment assessments (for jurisdictions opting for the cost model subsequent to initial recognition) or undertaking revaluations (for jurisdictions opting for revaluation model) of non-concessionary ROU assets. The one ACAG Office that supports the revaluation model for valuing ROU assets arising out of non-concessionary leases, are of the view that fair value is necessary to meet the market value concept under AASB 1049. This is despite the AASB staff's position (as outlined in [Agenda paper 14.1 (M172)]) which states that adoption of fair value of ROU asset would not resolve the divergence between the GFS and reporting framework under Australian Accounting Standards. Therefore, this jurisdiction believes a clarification in this regard will be helpful.

The exceptions for low-value and short-term leases have been effective in managing some of these costs.

We have found agencies often struggle with the requirements of the standard, particularly lease modifications, leading to increased audit costs for entities with material leases.

1(b) AASB 16 (based on IFRS 16) was designed for the private sector, with the changes from AASB 117 primarily focused on the information needs of investors. In the public sector, the users and their information needs differ from those in the private sector, as they focus on decisions related to providing resources to the entity rather than returns on investments. Our understanding is that public sector users did not specifically request these changes. While the new requirements may provide some additional transparency, it is unclear whether the benefits of recording operating leases on the balance sheet have been fully realised by users of the public sector's financial statements.

ACAG has found that while the users understand the concept of lease liability, they often struggle to understand the concept of ROU asset and the classification of lease payments in the statement of cash flows.

ACAG recommends the AASB consult with both preparers and users to determine whether the information on operating leases in individual agencies' financial statements is used or relied upon by users.

1(c) Refer to the response for question 1(b).

Topic 2 – Determining the lease term

Regarding determining the lease term, do you have any comments about:

2. the application of the requirements in practice by NFP and public sector entities?

3. whether differences in application exist in practice in the NFP and public sector?

4. whether the current requirements and guidance in AASB 16 for determining the lease term are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

2. ACAG has identified the following issues in the application of the lease term.

Interpretation of 'insignificant penalty'

In its agenda decision from November 2019, the IFRS Interpretations Committee noted that when applying paragraph B34 of IFRS 16 to determine the enforceable period of a lease, an entity must consider the wider economics of the contract (and not only termination payments as stated in the contract), and whether each of the parties has the right to terminate the lease without the other party's permission with no more than an insignificant penalty.

Determining whether a penalty for terminating a lease is 'insignificant' involves a high level of judgment and can be challenging to apply in practice to the specific terms and conditions of lease agreements. Due to this level of judgment, there are variations in how this is applied in practice. For example, one jurisdiction is encountering diverse views when interpreting 'insignificant penalty' for buildings with options to terminate at 'market value.' Some interpret the penalty as contractual payments and other lost assets (per the IFRIC Agenda Decision), while others consider the penalty on a wider economic basis, looking at wider economic gains and losses.

This jurisdiction is also currently facing challenges interpreting ‘insignificant penalty’ in the context of social housing with options to terminate at ‘market value’. For example, a government department provided a government grant to an operator to construct a building that is then used (by that operator under the direction of the government department / lessee) for government purposes, with a termination clause. Under the termination clause, the operator can terminate the agreement at any time if there is a repayment of the initial government funding and the government’s share of the fair value increase in property. This interpretation is crucial in determining the non-cancellable period. If the repayment of the government grant is considered an ‘insignificant penalty’ because the provider is repaying funding, then the lease term would be considered nil.

The IFRIC Agenda decision was developed for private sector entities. It is unclear in a NFP context whether ‘insignificant penalty’ extends beyond financial penalties and economic incentives to include the impact on an agency’s service objectives.

Determining whether there is a lease and related lease term

Assessing whether a NFP public sector entity is reasonably certain to exercise an option can be challenging. Beyond uncertainties in funding, which are subject to government budgetary approval process, there are other specific factors and circumstances within the public sector that contribute to this challenge. Government policy directions or objectives may affect an entity’s operations, such as where an entity should locate its operations, and how it should conduct them. Since government directions can often be released and take immediate effect, this can create challenges for preparers of financial statements to conclude that the entity will reasonably exercise the extension options until the time for exercising the options approaches.

Therefore, ACAG suggests the AASB provides additional guidance on how to interpret ‘insignificant penalty’ and ‘reasonable’ certainty over lease extension options including their application in the NFP public sector context.

In one jurisdiction, some departments have historically leased land to other government agencies without supporting documentation or with lease agreements for a fixed period. In the latter case, at the end of the term the lessee has the option to continue to occupy the premises on a monthly basis with the approval of the landlord. The agencies use the land and constructed significant public sector assets on it. The issues that arise are:

- whether the land should be recognised as an ROU asset or PPE for the agency
- if it is a lease, what is the lease term as the lease term cannot be indefinite.

The departments have historically rolled forward the lease agreements when they expire, indicating their intention to continue the lease for a foreseeable period. Should the lease term be equal to the lease term mentioned in the agreement or should it be the useful life of the asset constructed, as the termination will result in more than an insignificant penalty as the lessee has constructed significant structures on the leased land and it may disrupt public services?

3. ACAG is unable to comment on whether there are application differences between the NFP public and NFP private sectors.

4. Refer to the response for question 2.

Topic 3 – Lease modifications

Regarding the accounting for lease modifications, do you have any comments about:

5. the application of the requirements in practice by NFP and public sector entities?
6. whether differences in application exist in practice in the NFP and public sector?
7. whether the current requirements and guidance in AASB 16 for lease modification are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

5. ACAG has found that the lease modification requirements are not well understood or applied by public sector agencies due to the complex concepts in the standard. ACAG has noted specific challenges in determining whether arrangements contain new leases or are a lease modification. Some issues ACAG has encountered, where we believe that additional guidance is needed, include:

    - **Master / umbrella agreement that cover the lease of many individual items with one monthly payment** – when new assets were included in the master / umbrella agreement, the agency interpreted that the lease modification provisions (including using an updated discount rate) applied as the payment changed, without understanding that these changes relate to a new item / lease and should not affect the existing ROU asset and lease liability. While initial AASB 16 training often discussed modifications and lease to lease agreements, the above situation (more common in the public sector, for example under public, private partnership arrangements) was not directly covered.
    - **Intra-government lease contracts that contain a continuous supply of assets (i.e. assets that are planned to be upgraded or constructed in future years)** – agencies interpreted that the lease calculations should be updated each year for the new assets constructed and made available for use. However, since the new assets are not available at the lease commencement, their payments should be accounted for as a separate lease and excluded from the existing lease liability and ROU asset.

    While not necessarily unclear within the standard, due to the general complexity of accounting for lease modifications or other adjustments we have also noted differences in accounting for the following scenarios:

    - **'New' contracts signed** – agencies accounting for these as a separate lease rather than as a lease modification (extension of lease term), despite being for the same asset. In this regard, often before the old lease ends, the lessee and the lessor enter into a new lease agreement for the same premises which begin post the balance sheet date. The question that arises at the balance sheet date is whether this new contract should be accounted for as a modification of the old lease (with the ROU asset and the lease liability updated for the term of the new lease agreement) or accounted for as a separate lease. This often brings into question whether the lease term determined at inception was correct or has not taken into consideration the nature of the asset, the entity's dependency on that asset and application of paragraph B34 of AASB 16.
    - **Changes in rental payments under variable payments** – agencies interpreting that the lease modification provisions (including using an updated discount rate) applied, without understanding that the variable lease payments should be accounted for under the remeasurement provisions. Initial AASB 16 training often did provide specific details on this issue, or make it clear what to do when the next year's lease rental increased.
    - **Adjustments for lease modifications** – agencies putting adjustments through profit or loss rather than adjusting the ROU asset when required.

6. ACAG is unable to comment on whether there are application differences between the NFP public and NFP private sectors.

7. ACAG believes it would be beneficial to include additional guidance and examples on lease modifications, taking into account some of the challenges and examples noted above.

Topic 4 – Measurement of lease liabilities – determining an incremental borrowing rate

Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about:

8. the application of the requirements in practice by NFP private sector entities, including how these entities are currently determining the incremental borrowing rate in practice?

9. whether differences in application exist in practice in the NFP private sector?

10. whether the current requirements and guidance in AASB 16 for the measurement of lease liabilities are sufficient for NFP private sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

8. ACAG is unable to comment on the practices of NFP private sector entities.

9. ACAG is unable to comment on the practices of NFP private sector entities.

10. ACAG is unable to comment.

Topic 5 – NFP public sector concessionary leases

Regarding NFP public sector concessionary leases, do you have any comments about:

11. whether there are any reasons to remove the current accounting policy choice to measure initially concessionary ROU assets at either cost or fair value?

12. whether the temporary accounting policy choice for NFP public sector entities should be made permanent?

13. whether the disclosures prepared in accordance with paragraphs Aus59.1 and Aus59.2 of AASB 16 are sufficient in providing useful information to financial statement users regarding concessionary leases when the ROU assets are measured at cost?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

11. The majority of ACAG jurisdictions have not identified any reasons to remove the current accounting policy choice as it is functioning effectively and the factors supporting its adoption remain present.

    The choice allows central regulatory bodies to decide whether they provide public sector agencies with a choice or mandate the measurement base. In practice, treasuries have mandated concessionary leases be measured at cost both on initial recognition and subsequent measurement.

    The accounting policy choices means that NFP public sector can avoid the complexities of fair valuing leased assets such as:

    - identifying market participants (private sector or public sector) or how much they are willing to pay
    - specialised assets and those with restrictions
    - dealing with variable and contingent rentals, early termination provisions etc.

ACAG does not believe that the concessionary leases component of the IPSASB's Leases project adequately addresses the issues raised above. ACAG raised concerns on the IPSASB's proposals to account for concessionary leases in IPSASB Exposure Draft ED 84 'Concessionary Leases and Right-of-Use Assets In-Kind' (Amendments to IPSAS 43 and IPSAS 23) and IPSASB Exposure Draft ED 88 'Arrangements Conveying Rights over Assets (Amendments to IPSAS 47 and IPSAS 48)'.

However, while acknowledging there may be costs associated with fair valuing complex ROU assets including challenges to fair value these in a non-revaluation year, one jurisdiction supports fair value approach as:

- in their view fair value (CRC) is conceptually about current cost accounting i.e. showing the current cost of service delivery not the historic cost, so that asset users can set fees and charges accordingly. To lose this information would remove this price signal and potentially increase the financial burden on future generations
- the value of resources received by a public sector organisation is important for users' understanding and informed decision making, whether that user be the government, Parliament, public sector or community. This aligns with the expectations of AASB 1058 as it relates to assets provided free of charge
- there are other examples, such as volunteer services or complex intangible assets that are transferred whose fair value may be difficult to determine, but there is no similar exception for those types of assets, so a narrower exception for concessionary leases does not seem justified
- if fair value is not adopted for concessionary leases, then it could give rise to an anomaly where the lessor grants a concessionary finance sublease (therefore derecognising the asset) and the lessee choses the cost option and recognises the asset at a nominal consideration. Therefore, the fair value of the asset is not shown in the agencies' financial statements. This has the potential of omitting useful information for the users
- the cost versus benefit argument may not be justifiable as determining fair value for a number of non-financial physical assets is equally complex
- the bigger challenge currently faced is capability. Some preparers perceive the fair value approach is the fair value of the underlying asset, not the right to use the asset through the lease arrangement. Greater clarity and guidance is required by standard-setters on this
- providing an option on a permanent basis does not align with the IPSASB's approach.

12. The majority of ACAG jurisdictions recommend making the temporary accounting policy choice permanent, with one jurisdiction supporting the fair value approach for the reasons outlined in question 11.

13. Disclosures on concessionary leases measured at cost are important for financial statement users to understand the impact of these arrangements. ACAG is not aware of any issues raised by preparers on the sufficiency of these disclosures.

Topic 6 – Sale and leaseback arrangements

Regarding sale and leaseback arrangements, do you have any comments about:

14. the application of the requirements in practice by public sector entities?

15. whether differences in application exist in practice in the public sector?

16. whether the current requirements and guidance in AASB 16 for sale and leaseback arrangements are sufficient for public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

14. One jurisdiction has encountered arrangements where the 'leaseback' period is rent-free under the 'lease' contract. These arrangements are often bundled into one or more contracts that include the sale price. This jurisdiction found the standard is unclear about whether any of the total proceeds should be considered 'lease payments' in these circumstances or how to differentiate the components of the sale price. Additionally, paragraph 101 of AASB 16 is unclear about whether it applies to the buyer-lessor, the seller-lessee or both. This has led to different interpretations by the agency and the audit team. This jurisdiction believes additional guidance is required when there is nil or nominal consideration for the ‘leaseback’, as the current guidance is insufficient.

    The other jurisdictions have either not encountered sale and leaseback arrangements or have not encountered related issues in applying the requirements.

15. ACAG is not aware of any difference in application. The majority of ACAG jurisdictions have not encountered any major sale and leasebacks since the new standard was introduced.

16. Refer to the response in question 14.

Topic 7 – Other matters

17. Are there any other NFP and public sector matters that should be brought to the attention of the AASB as it undertakes a PIR of AASB 16?

If so, please provide your views on those matters, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

The following issues have been encountered by some jurisdictions.

<u>Lessor accounting – Inclusion of non-cash consideration in the net investment in a lease</u>

AASB 16 does not explicitly set out whether lease payments include forms of non-cash consideration, while other standards such as AASB 15 and AASB 1058 (AASB 15.66 and AASB 1058.BC61) require entities to measure any non-cash consideration at fair value in determining the transaction price in respect of a contract.

In the NFP public sector non-cash consideration, such as works-in-kind may be paid under agreements that contain a lease. This is common in at least one jurisdiction where the public sector offer 99-year leases of land, along with rights to develop the land. Some of the challenges include:

- distinguishing whether non-cash consideration is directly related to granting the right to use an underlying asset or whether it is a developer contribution (e.g. upgrading infrastructure within or outside of the lease boundary). This could also apply to certain levies (cash consideration) to be made under the arrangement
- whether non-cash consideration is considered a fixed payment included in the ‘gross investment in a finance lease’. Determining the value of non-cash consideration that will be delivered at inception requires an estimate. The value of what is delivered will often differ to the amount estimated at inception, creating a ‘true-up’ entry. In contrast, if the non-cash consideration was considered a ‘variable lease payment’ it would be excluded from the ‘gross investment in the lease’ as it does not depend on an index or rate.

ACAG believes it would be beneficial if the AASB considers issuing additional guidance on how non-cash consideration should be accounted for by lessors and lessees at the point of initial recognition and measurement of lease liability and lease payments included in the net investment in the lease (paragraphs 27 and 70 of AASB 16).

Accounting for development arrangements on leased land

Another challenge in accounting for these development arrangements is determining the timing of lease commencement. The private sector will be granted differing levels of access to the underlying asset (land) in situations where there is a long-term land lease and the developer is constructing an asset on the land. For instance, construction licenses are often issued, granting the developer rights to begin building on the land, but a formal lease is not issued until the development is complete.

We've noted differing judgements being applied in these circumstances and believe additional guidance or examples may help in determining when lease commencement has occurred in complex scenarios such as detailed above.

Lessor accounting – accounting for variable lease payments in a finance lease

The lessee requirements in AASB 16 contain specific requirements for subsequently adjusting the lease liability due to changes in an index or a rate (paragraph 16.42b, with additional details in paragraphs BC188-190). While AASB 16 provides guidance for lessors on how to treat variable lease payments that depend on an index or rate at initial recognition (paragraph 70(b)), it does not address how to account for these payments in subsequent years when the cash flows change due to variations in the index or rate. Although the lessor requirements in AASB 16 remain largely unchanged from AASB 117, the removal of minimum lease payment and contingent rent concepts in AASB 16 now mean it is unclear whether lessors need to remeasure their lease income when the cash flows change due to index or rate variations in the same way as a lessee or recognise the income in the period it occurs (similar to approach for recognising contingent rent under AASB 117) or account for the variable receipts as an embedded derivative.

ACAG has seen this applied differently in practice and believe it would be helpful to provide guidance on how these changes should be accounted for.

Perpetual leases / In-substance purchases (finance leases)

The public sector has numerous land grants (e.g. Deeds of Grant in Trust (DOGIT) and reserve land) between the state government, public sector entities and local government.

Occasionally, issues arise regarding whether the land should be accounted for under AASB 116 or AASB 16. These issues mainly pertain to the technical difference between freehold land and leasehold land – even if in-substance the leasehold land is economically the same as freehold land aside from some valuation differences because of their different legal nature.

Generally, these assets are accounted for under AASB 116, using the various valuation options for subsequent measurement, and the various options under AASB 16 for initial measurement (i.e. fair value or cost such as peppercorn).

We note the IASB decided not to provide guidance distinguishing a lease from a sale or purchase of an asset.

AUSTRALASIAN COUNCIL OF AUDITORS GENERAL

3 September 2025

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IASB Request for Information *Post-implementation Review of IFRS 16 Leases*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on IASB Request for Information *Post-implementation Review of IFRS 16 Leases.* The views expressed in this submission represent those of all Australian members of ACAG, unless specifically identified.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the Request for Information.

Overarching feedback

The Australian public sector applies AASB 16 'Leases' which incorporates IFRS 16 'Leases' as issued by the IASB. ACAG found IFRS 16 has generally met its objective of requiring lessees to recognise leases on the balance sheet, with clear core principles and effective exemptions for low-value and short-term leases. The transition provisions also worked well, providing significant cost relief for entities implementing the standard.

The submission notes areas where additional guidance or examples could be provided to provide more clarity to preparers and auditors and drive greater consistency in the application of IFRS 16.

The ongoing costs of auditing operating leases for lessees under IFRS 16 are generally higher than under IAS 17, particularly for entities with a significant number of leases.

While including leases on balance sheet does provide more transparent information on leases and helps comparability between entities, it is unclear whether the benefits have been realised by users of the public sector's financial statements.

Notwithstanding the issues raised above, the costs of implementing any proposed changes should be considered when making decisions about any amendments to AASB 16.

Once again, thank you for the opportunity to comment on this post-implementation review. I hope you will find ACAG's comments, helpful when assessing whether the effects of applying the requirements are as intended.

Yours sincerely

Rachel Vagg
Chair
ACAG Financial Reporting and Accounting Committee

Attachment

IASB SPECIFIC MATTERS FOR COMMENT

Question 1 – Overall assessment of IFRS 16

(a) In your view, is IFRS 16 meeting its objective (see page 9) and are its core principles clear? If not, please explain why not.

(b) In your view, are the overall improvements to the quality and comparability of financial information about leases largely as the IASB expected? If your view is that the overall improvements are significantly lower than expected, please explain why.8

(c) In your view, are the overall ongoing costs of applying the requirements and auditing and enforcing their application largely as the IASB expected? If your view is that the overall ongoing costs are significantly higher than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.

The *Effects Analysis on IFRS 16* describes the expected likely effects of the Standard, including benefits and implementation and ongoing costs.

1(a) IFRS 16 is meeting its objectives of lessees recognising leases on balance sheet. ACAG has generally found that the core principles are clear and are being applied.

The exemption for low value and short-term leases is working well in practice and helps to reduce costs. The transition provisions also worked well, providing significant cost relief for entities implementing the standard.

1(b) IFRS 16 was designed for the private sector, with the changes from IAS 17 primarily focused on the information needs of investors. In the public sector, the users and their information needs differ from those in the private sector, as they focus on decisions related to providing resources to the entity rather than returns on investments.

While the new requirements may provide some additional transparency, it is unclear whether the benefits of recording operating leases on the balance sheet have been fully realised by users of the public sector's financial statements. ACAG has found that while the users understand the concept of lease liability, they often struggle to understand the concept of right-of-use (ROU) asset and the classification of lease payments in the statement of cash flows.

ACAG has found the costs of auditing operating leases under IFRS 16 are generally higher than under IAS 17, especially for entities with a significant number of leases. The exceptions for low-value and short-term leases have been effective in managing some of these costs.

While the IASB expected there will be marginal costs, these expectations were from a private sector perspective, rather than the public sector. ACAG is therefore not clear if these costs were greater than expected. ACAG found:

- a significant number of public sector entities did not have sophisticated systems in place to manage and track leases, with some having large lease portfolios (some across vast geographic locations) with relatively small finance teams
- entities often struggle with the requirements of the standard, particularly lease modifications, leading to increased audit costs for entities with material leases.

The above issues resulted in numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

Key issues identified by ACAG during implementation include:

- **Completeness and accuracy of lease calculations:** auditors faced challenges in verifying the accuracy and completeness of lease calculations as entities:
  - struggled to identify contracts that may contain leases
  - were parties to arrangements that were undocumented
  - did not formally document, approve, or maintain key lease accounting interpretations and assessments for individual lease contracts. This often made it difficult for long-term contracts to determine whether the asset was subject to a lease and should be recognised as a ROU asset or as property, plant and equipment (PPE)
  - had incomplete and/or inaccurate lease data held centrally (e.g. future market rent reviews, fixed rate increases, and lease incentives) which resulted in material adjustments to lease calculations
  - did not have information from lessors regarding the value of non-lease components
  - applied the standard incorrectly e.g. omission of fixed rent and/or market rent review increases, application of lease incentives and non-lease components
  - inconsistently applied the impairment requirements for ROU assets measured at cost subsequent to initial recognition.

  These issues were more prevalent when the standard was first introduced and have reduced since this time. However, the following areas still require significant judgement each time a new lease is entered, to calculate the lease liability to be recognised:

  - consideration of what constitutes a non-lease component versus a lease component or an ‘amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee’
  - estimation of stand-alone selling prices for non-lease components
  - allocation of ‘amounts payable by the lessee for activities and costs that do not transfer a good or service to the lessee.’

  While this separation is not mandatory it is in most entity’s interests to separate the lease components to reduce the liability, and the ongoing depreciation expense associated with the right-of-use asset.

- **Judgment and complexity in lease accounting:** ACAG found the standard inherently difficult to audit given the extensive judgment required in determining enforceability of leases, particularly intra-government leases, lease terms, including ‘reasonably certain to extend’ and ‘no more than an insignificant penalty’.

These areas continue to cause interpretation challenges.

The main audit challenge for subsequent measurement of leases is the accounting for lease modifications. ACAG found that these requirements are not well understood or applied by entities due to the complex concepts in the standard. The specific challenges we have noted are set out in our response to question 2(b).

Question 2 – Usefulness of information resulting from lessees’ application of judgement

(a) Do you agree that the usefulness of financial information resulting from lessees’ application of judgement is largely as the IASB expected? If your view is that lessees’ application of judgement has a significant negative effect on the usefulness of financial information, please explain why.13

(b) Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.

(c) If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain:

(i) what amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or

(ii) what additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs).

The *Effects Analysis on IFRS 16* describes the expected likely effects of the Standard, including benefits and implementation and ongoing costs.

2(a) ACAG expects that there is likely to be diversity in accounting by lessees as:

- the terms 'reasonably certain' and 'no more than an insignificant penalty' are subject to a significant amount of judgement and can often be difficult to apply in practice to the individual terms and conditions of lease agreements resulting in diverse accounting treatments
- lease modifications, are quite complex and often difficult to understand. As a result, we have found entities have interpreted these requirements incorrectly requiring adjustments to their financial statements.

Whether this diversity impacts the usefulness of the information is best answered by preparers and users of the financial statements.

2(b) As stated in question 2(a), ACAG has identified issues with the consistent application of lease modifications and the terms 'reasonably certain' and 'no more than an insignificant penalty'.

Lease modifications

ACAG has found the lease modification requirements are not well understood or applied by entities due to the complex concepts in the standard, leading to inconsistent interpretations and material adjustments to financial statements. ACAG has noted specific challenges in determining whether arrangements contain new leases or are a lease modification. Some issues ACAG has encountered, where we believe that additional guidance is needed, include:

- **Master / umbrella agreement that cover the lease of many individual items with one monthly payment** – when new assets were included in the master / umbrella agreement, the entity interpreted that the lease modification provisions (including using an updated discount rate) applied as the payment changed, without understanding that these changes relate to a new item / lease and should not affect the existing ROU asset and lease liability. While initial IFRS 16 training often discussed modifications and lease to lease agreements, the above situation (more common in the public sector, for example under public, private partnership arrangements) was not directly covered.
- **Intra-government lease contracts that contain a continuous supply of assets (i.e. assets that are planned to be upgraded or constructed in future years)** – entities interpreted that the lease calculations should be updated each year for the new assets constructed and made available for use. However, since the new assets are not available at the lease commencement, their payments should be accounted for as a separate lease and excluded from the existing lease liability and ROU asset.

While not necessarily unclear within the standard, due to the general complexity of accounting for lease modifications or other adjustments we have also noted differences in accounting for the following scenarios:

- **'New' contracts signed** – agencies accounting for these as a separate lease rather than as a lease modification (extension of lease term), despite being for the same asset. In this regard, often before the old lease ends, the lessee and the lessor enter into a new lease agreement for the same premises which begin post the balance sheet date. The question that arises at the balance sheet date is whether this new contract should be accounted for as a modification of the old lease (with the ROU asset and the lease liability updated for the term of the new lease agreement) or accounted for as a separate lease. This often brings into question whether the lease term determined at inception was correct or not taking into consideration the nature of the asset and the dependency of the entity on that asset and application of paragraph B34 of IFRS 16.

- **Changes in rental payments under variable payments** – entities interpreting that the lease modification provisions (including using an updated discount rate) applied, without understanding that the variable lease payments should be accounted for under the remeasurement provisions. Initial IFRS 16 training often did provide specific details on this issue, or make it clear what to do when the next year's lease rental increased.
- **Adjustments for lease modifications** – entities putting adjustments through profit or loss rather than adjusting the ROU asset when required.

Insignificant penalties

Determining whether a penalty for terminating a lease is 'insignificant' involves a high level of judgment and can be challenging to apply in practice to the specific terms and conditions of lease agreements. Due to this level of judgment, there are variations in how this is applied in practice. For example, ACAG has seen diverse views when interpreting 'insignificant penalty' for buildings with options to terminate at 'market value.' Some interpret the penalty as contractual payments and other lost assets (per the IFRIC Agenda Decision), while others consider the penalty on a wider economic basis, such as repayment of a government grant not being an insignificant penalty, and looking at wider economic gains and losses.

Reasonable certainty over lease extension options

Assessing whether an entity is reasonably certain to exercise an option can be challenging due to the significant judgement involved as some entities are interpreting reasonably certain at a higher threshold than others for similar circumstances. This could have a material effect on ROU asset and lease liabilities.

2(c) ACAG believes it would be beneficial for the IASB to provide additional guidance and practical examples on lease modifications and the terms 'reasonably certain' and 'no more than an insignificant penalty', taking into account some of the challenges and examples noted above. This would help entities apply these concepts to the individual terms and conditions of lease agreements, potentially reducing diversity and improving consistency in their key judgments.

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

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

ACAG does not have any specific comments on lease-related cash flows (whether presented as operating or financing) as the primary focus for public sector entities is on their operating activities. Additionally, presenting the interest portion of the lease payments as a financing activity is not relevant for most NFP public sector entities as they do not generally borrow funds for service delivery.

Question 4 – Ongoing costs for lessees of applying the measurement requirements

(a) Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected? If your view is that the ongoing costs are significantly higher than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.

(b) If your view is that the ongoing costs are significantly higher than expected, please explain how you propose the IASB reduce these costs without a significant negative effect on the usefulness of financial information about leases.

4(a) ACAG has found the costs of auditing operating leases for lessees under IFRS 16 are generally higher than under IAS 17, especially for entities with a significant number of leases. This is because IFRS 16 introduces more complex ongoing accounting and auditing requirements for leases compared to IFRS 17. These include the review and accounting of:

- changes to the lease term
- changes to ROU assets and lease liabilities resulting from changes in lease payments due to an index or rate
- changes to leases as a lease modification or as a separate lease (including impacts from changes in the discount rate)
- annual impairment assessments of ROU assets.

The exceptions for low-value and short-term leases have been effective in managing some of these costs.

The accounting for the above changes can be complex and the standards are unclear in some areas, such as indexation and market rent review combinations. This is made more difficult as many entities do not have leasing software and rely on spreadsheets. This requires ongoing review and monitoring to ensure the models are robust.

ACAG has also found that the lease modification requirements are not well understood or applied by entities due to the complex concepts in the standard, leading to inconsistent interpretations and material adjustments to financial statements. Question 2(b) contains details on the issues ACAG has identified.

4(b) ACAG does not have any specific suggestions. As all the requirements work together, any changes may impose costs from introducing a change to the framework.

Question 5 – Potential improvements to future transition requirements

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

(a) users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows; and

(b) preparers can appropriately reduce their transition costs when implementing new requirements for the first time.

ACAG believes that the transitional provisions and exemptions in IFRS 16 have been effective. The inclusion of the modified retrospective approach, along with various simplifications and practical expedients, has provided significant cost relief for entities implementing the standard without the loss of information for users. Additionally, the extended lead time before the standard's implementation was beneficial.

ACAG recommends evaluating the option to use the modified retrospective approach and the decision not to mandate comparatives on a case-by-case basis for each new standard.

Question 6.1 – Applying IFRS 16 with IFRS 9 to rent concessions

(a) How often have you observed the type of rent concession described in Spotlight 6.1?

(b) Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

(c) If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

6.1(a) ACAG has not frequently observed this type of rent concession in the public sector.

6.1(b) ACAG is not aware of any rent concession issues.

6.1(c) Not applicable.

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

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

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

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

6.2(a) ACAG has not seen many major sale and leasebacks in the public sector and is not aware of any issues in practice.

6.2(b) ACAG has not seen many major sale and leasebacks in the public sector and is not aware of any issues in practice.

6.2(c) Not applicable.

Question 6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

(a) Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information?

(b) What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ significantly from those expected?

(c) If your view is that the IASB should improve the cost–benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution.

6.3(a) ACAG has no specific comments.

6.3(b) ACAG has no specific comments.

6.3(c) Not applicable.

Question 6.4 – Other matters relevant to the assessment of the effects of IFRS 16

Are there any further matters the IASB should examine as part of the post- implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

ACAG has identified the following matters that the IASB should example as part of the post-implementation review.

Lease incentives

In November 2019, as part of the Annual Improvements to IFRS Standards 2018-2020, the IASB deferred addressing the complexities and diverse views on lease incentives. ACAG recommends the IASB prioritise resolving these issues.

The underlying principle can be difficult to apply in practice given the various ways in which lessors may structure lease arrangements, and what they commonly refer to as lease incentives.

While most jurisdictions now have their own guidance and entities have established their accounting policies as to how to account for lease incentives (including where internal government 'leases' fail to meet the definition of a lease), issues faced on implementation included:

- confusion due to what the leasing profession would refer to as a lease incentive not actually resulting in a reduction to the ROU asset (for example rent-free periods or rent reductions because these are already effectively taken into account in determining the lease liability)
- how to account for fit-out, including whether the lessee or lessor control the fit-out, and difficulties determining whether the lease payments inherently include an amount to compensate for this, and should therefore result in adjustments to the ultimate lease related expenses recognised.

The standards as they currently stand continue to lack clarity about what comprises a lease incentive, and how to account for lease incentives at the point they are received. This lack of clarity is likely to result in inconsistent accounting treatments.

Lessor accounting – Inclusion of non-cash consideration in the net investment in a lease

IFRS 16 does not explicitly set out whether lease payments include forms of non-cash consideration, while other standards such as IFRS 15 (IFRS 15.66) requires entities to measure any non-cash consideration at fair value in determining the transaction price in respect of a contract.

ACAG has identified instances where non-cash consideration such as works-in-kind may be paid under agreements that contain a lease. This is common in at least one jurisdiction where the public sector offer 99-year leases of land, along with rights to develop the land. Some of the challenges include:

- distinguishing whether non-cash consideration is directly related to granting the right to use an underlying asset or whether it is a developer contribution (e.g. upgrading infrastructure within or outside of the lease boundary). This could also apply to certain levies (cash consideration) to be made under the arrangement
- whether non-cash consideration is considered a fixed payment included in the 'gross investment in a finance lease'. Determining the value of non-cash consideration that will be delivered at inception requires an estimate. The value of what is delivered will often differ to the amount estimated at inception, creating a 'true-up' entry. In contrast, if the non-cash consideration was considered a 'variable lease payment' it would be excluded from the 'gross investment in the lease' as it does not depend on an index or rate.

ACAG believes it would be beneficial if the IASB considers issuing additional guidance on how non-cash consideration should be accounted for by lessors and lessees at the point of initial recognition and measurement of lease liability and lease payments included in the net investment in the lease (paragraphs 27 and 70 of IFRS 16).

Accounting for development arrangements on leased land

Another challenge in accounting for these development arrangements is determining the timing of lease commencement. The private sector will be granted differing levels of access to the underlying asset (land) in situations where there is a long-term land lease, and the developer is constructing an asset on the land. For instance, construction licenses are often issued, granting the developer rights to begin building on the land, but a formal lease is not issued until the development is complete.

ACAG has noted differing judgements being applied in these circumstances and believe additional guidance or examples may help in determining when lease commencement has occurred in complex scenarios such as detailed above.

Lessor accounting – accounting for variable lease payments in a finance lease

The lessee requirements in IFRS 16 contain specific requirements for subsequently adjusting the lease liability due to changes in an index or a rate (paragraph 16.42b, with additional details in paragraphs BC188-190). While IFRS 16 provides guidance for lessors on how to treat variable lease payments that depend on an index or rate at initial recognition (paragraph 70(b)), it does not address how to account for these payments in subsequent years when the cash flows change due to variations in the index or rate. Although the lessor requirements in IFRS 16 remain largely unchanged from IAS 17, the removal of minimum lease payment and contingent rent concepts in IFRS 16 now mean it is unclear whether lessors need to remeasure their lease income when the cash flows change due to index or rate variations in the same way as a lessee, or recognise the income in the period it occurs (similar to approach for recognising contingent rent under IAS 17) or, account for the variable receipts as an embedded derivative.

ACAG has seen this applied differently in practice and believe it would be helpful to provide guidance on how these changes should be accounted for.

INSTITUTE OF PUBLIC ACCOUNTANTS®

5 September 2025

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
VICTORIA 8007

Submitted via email: standard@aasb.gov.au

Dear Dr Kendall

Invitation to Comment (ITC) 55 Post-Implementation Review of AASB 16 *Leases*

The Institute of Public Accountants (IPA) welcomes the opportunity to provide comments on the above ITC.

General Comment

Overall, IPA is of the view that the costs and benefits of the leases Standard are largely as the IASB expected. That is, the Standard has met its objective and its core principles are clear and improve the quality and comparability of financial information about leases, while the initial implementation cost was higher compared to the on-going costs of applying the requirements.

IPA notes the costs are disproportionately higher for SMEs and NFP entities, which have less resources to invest in understanding the requirements, make the necessary judgements (for which there are many) and developing the necessary IT systems to account for the leases. We also think the ongoing costs of applying the requirements disproportionately affect SMEs and NFP entities compared to the larger and better resourced entities.

Despite the above, IPA is of the view that the benefits of improved quality of financial information for leases outweigh the initial and on-going costs of applying the Standard. That is, the Standard requires a lessee to initially recognise all leases (operating and financial leases) on the balance sheet, and subsequently account for them through the profit and loss and balance sheet. This essentially accounts for the substance of a lease as an entity's financial obligation that is associated with the lease assets and liabilities. Such information is useful to users in assessing an entity's assets and liabilities and how management finances and manages its assets in delivering the entity's objectives. The Standard, therefore, increases the transparency and quality of financial information on leases.

To reduce the disproportionate cost to SMEs and NFP entities in applying the requirements, IPA recommends that the IASB and AASB provide guidance in areas where these entities find challenging when applying judgment. For examples, determining the lease term, Incremental borrowing rates, discount rates and interest rates implicit in a lease and variable lease payments, including those that are linked to Consumer Price Index.

Further details of our comments on the above are contained in the related questions in Attachment 1.

SPECIFIC COMMENT
Our responses to the specific questions in the ITC are in Attachment 1.

For any questions relating to this submission, please contact Vicki Stylianou, Group Executive Advocacy and Professional Standards, Institute of Public Accountants at vicki.stylianou@publicaccountants.org.au.

Yours sincerely

Vicki Stylianou
Group Executive, Advocacy & Professional Standards
Institute of Public Accountants

Attachment 1 – IPA's responses to ITC 55 specific questions

SECTION 1: AASB GENERAL MATTERS FOR COMMENT

Q1. Are there any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 Leases?

IPA is not aware of any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 .

Q2. Does the application of the requirements in AASB 16 result in major auditing or assurance challenges?

As stated in IPA's comment to Question 1 of "Section 3: IASB Request for Information", the cost of implementing the leases Standard was high as an entity needed to:

- Apply the new accounting model to many contracts
- Apply significant judgment to determine the discount rates and lease terms and
- Implement IT solutions to capture the data and perform the necessary calculations for the lease accounting.

These implementation costs were disproportionately higher for SMEs and NFP entities, which have less resources to invest in understanding the requirements, experience in make the necessary judgements (for which there are many) and developing the necessary IT systems to account for the leases.

IPA's observations are that the larger and well-resourced entities were better able to apply the requirements of AASB 16, and therefore better able to address any auditing or assurance challenges that arise. In contrast, SMEs and NFP entities were likely to have more auditing or assurance challenges, particularly in evidencing that the data and IT systems that capture the data and perform the necessary calculations for the lease accounting are accurate and consistent.

Q3. Are the requirements in the best interests of the Australian economy

IPA is of the view that overall, AASB 16 improves financial reporting by requiring a lessee to initially recognise all leases (operating and finance leases) on the balance sheet, and subsequently account for them through the profit and loss and balance sheet. This essentially accounts for the substance of a lease as an entity's financial obligation associated with the lease asset and liabilities. Such information is useful to users in assessing an entity's assets and liabilities and how management finances and manages its assets in delivering the entity's objectives. The standard, therefore, increases the transparency and quality of financial information on leases.

SECTION 2: NFP AND PUBLIC SECTOR TOPICS FOR COMMENT

Topic 1: Application of AASB 16 by NFP and public sector entities

Q1. In respect of NFP and public sector entities:
(a) are the ongoing costs of applying AASB 16 and auditing and regulating its application significantly greater than expected?
(b) are the benefits to users significantly lower than expected?
(c) overall, do you have any comments about whether AASB 16 results in financial statements that are more useful than financial statements prepared under the previous Standard AASB 117 *Leases*?

The correct initial recognition and subsequent accounting of leases under AASB 16 requires the collection and input of accurate data for the necessary calculations. This data capture, calculation and associated disclosures are greater under the current AASB 16 than the previous AASB 117. Consequently, there would still be ongoing costs in applying AASB 16 and auditing and regulating its applications. Given in general, the resources of NFP and smaller entities are less compared to larger private sector entities, these costs would have a disproportionately greater impact on NFP and smaller entities. However, these costs would be considerably less compared with the costs in the initial application of AASB 16. However, IPA is of the view that the accounting requirements for leases under AASB 16 result in financial statements that are more useful than financial statements prepared under the previous AASB 117. Therefore, the ongoing costs would justify their accounting treatment.

Topic 2: Determining the lease term

Regarding determining the lease term, do you have any comments about:
Q2. the application of the requirements in practice by NFP and public sector entities?
Q3. whether differences in application exist in practice in the NFP and public sector?
Q4. whether the current requirements and guidance in AASB 16 for determining the lease term are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

Determining the lease term requires an understanding and application of the generally accepted accounting principles of what constitutes “significant” for determining “insignificant penalty” and “reasonable” certainty to exercise an option to extend a lease.

As per IPA’s comment to Questions 1(c) and 2 of “Section 3: IASB Request for Information”, SMEs and NFP entities are likely to have less resources and experience in understanding and applying the requirements, compared to the larger entities. Consequently, a lessee’s application of judgment by SMEs and NFP entities may find it challenging in determining the lease term. Consequently, IPA recommends that the AASB develop further guidance in their area. We also commend the AASB in its simplification of lease accounting for the proposed Tier 3 reporting entities.

Topic 3: Lease modifications

Regarding the accounting for lease modifications, do you have any comments about:
Q5. the application of the requirements in practice by NFP and public sector entities?
Q6. whether differences in application exist in practice in the NFP and public sector?
Q7. whether the current requirements and guidance in AASB 16 for lease modification are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

As per IPA's comment to Question 4 of "Section 3: IASB Request for Information".

Topic 4: Measurement of lease liabilities – determining an incremental borrowing rate

Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about:
Q8. the application of the requirements in practice by NFP private sector entities, including how these entities are currently determining the incremental borrowing rate in practice?
Q9. whether differences in application exist in practice in the NFP private sector?
Q10. whether the current requirements and guidance in AASB 16 for the measurement of lease liabilities are sufficient for NFP private sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

As per IPA's comment to Question 2 of "Section 1: AASB General Matters for Comment", SMEs and NFP entities are likely to have less resources to invest in understanding the requirements and experience in making the necessary judgements in accounting for the leases. This extends to determining the incremental borrowing rate. Given these challenges, it is likely there would be differences in applying the requirements in the NFP private sector.

Topic 5: NFP public sector concessionary leases

Regarding NFP public sector concessionary leases, do you have any comments about:
Q11. whether there are any reasons to remove the current accounting policy choice to measure initially concessionary ROU assets at either cost or fair value?
Q12. whether the temporary accounting policy choice for NFP public sector entities should be made permanent?
Q13. whether the disclosures prepared in accordance with paragraphs Aus59.1 and Aus59.2 of AASB 16 are sufficient in providing useful information to financial statement users regarding concessionary leases when the ROU assets are measured at cost?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

IPA have no comments on this topic.

Topic 6: Sale and leaseback arrangements

Regarding sale and leaseback arrangements, do you have any comments about:
Q14. the application of the requirements in practice by public sector entities?
Q15. whether differences in application exist in practice in the public sector?
Q16. whether the current requirements and guidance in AASB 16 for sale and leaseback arrangements are sufficient for public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

IPA have no comments on this topic.

Topic 7: Other matters

Q17. Are there any other NFP and public sector matters that should be brought to the attention of the AASB as it undertakes a PIR of AASB 16?

If so, please provide your views on those matters, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

IPA has no further comments.

SECTION 3: IASB REQUEST FOR INFORMATION

Question 1—Overall assessment of IFRS 16

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

IPA is of the view that:

(a) The core principles in the leases standard are sufficiently clear and the Standard has achieved its objective of ensuring that lessees and lessors provide relevant leases information that faithfully represents those transactions. This is because, the Standard requires lessees to:

- Recognise all lease assets (as right-of-use assets) and lease liabilities in the statement of financial position, irrespective of whether it is an operating or financial lease
- Recognise the depreciation of leased assets and interest on lease liabilities over the lease term in the statement of profit or loss and
- Classify the cash payments in the statements of cashflows.

(b) The overall improvements to the quality and comparability of financial information about leases are largely as the IASB expected in that it reduced the need for investors and analysts to adjust amounts reported by lessees. While this is important, it is less relevant to IPA members who are small-to-medium enterprises (SMEs) and not-for-profit (NFP) entities. Instead, the leases Standard improves financial reporting for IPA members by requiring a lessee to initially recognise all leases (operating and financial leases) on the balance sheet, and subsequently account for them through the profit and loss and balance sheet. This essentially accounts for the substance of a lease as an entity's financial obligation that is associated with the lease assets and liabilities. Such information is useful to users in assessing an entity's assets and liabilities and how management finances and manages its assets in delivering the entity's objectives. The Standard, therefore, increases the transparency and quality of financial information on leases.

(c) However, the cost of implementing the leases Standard was high (as expected), as an entity needed to:

- Apply the new accounting model to many contracts
- Apply significant judgment to determine the discount rates, lease terms and other inputs for the calculation of the necessary lease information to be reported and
- Implement IT solutions to capture the data and perform the necessary calculations for the lease accounting.

While these costs are high for many entities, they are disproportionately higher for SMEs and NFP entities, which have less resources to invest in understanding the requirements, make the necessary judgements (for which there are many) and developing the necessary IT systems to account for the leases. We also think the ongoing costs of applying the requirements disproportionately affect SMEs and NFP entities compared to the larger and better resourced entities. This is despite our agreement that the overall ongoing costs of applying the requirements and auditing and enforcing their application are largely as the IASB expected.

On balance, IPA is of the view that the benefits of improved quality of financial information for leases outweigh the initial and on-going costs of applying the Standard. It is for this reason that IPA supports the simplified lease accounting by the standard-setters. In particular, the Australian Accounting Standards Board's (AASB) proposed simplified reporting for smaller (Tier 3) entities, which encompasses the simplified accounting and disclosures for leases.

Question 2—Usefulness of information resulting from lessees' application of judgement

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

IPA is of the view that:

(a) The usefulness of financial information from a lessee's application of judgement is largely as the IASB expected. However, this usefulness is predicated on an entity being able to understand the requirements so that judgement can be applied correctly and consistently across the entity's leases. Consistent with our response to Q1, SMEs and NFP entities are likely to have less resources and capacity to do so compared to the larger entities. Consequently, a lessee's application of judgment by SMEs and NFP entities may result in a significant negative effect on the usefulness of financial information where the entity does not have the necessary resources to comply with the requirements.

(b) Overall, the requirements in leases Standard do provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently for entities that have experience in accounting for finance leases. However, where entities that traditionally have only operating leases, in particular SMEs and NPE entities, there is a considerable learning of the requirements to be applied correctly and accurately. This is because every input for the leased asset and leased liability calculations require judgement. For examples, judgements are required for determining the:
   - Lease term – in particular where the lease includes clauses relating to penalties and an option to extend a lease
   - Incremental borrowing rates, discount rates and interest rates implicit in a lease and
   - Variable lease payments, including those that are linked to Consumer Price Index.

   The incorrect application of judgement in any of the above may change the amount of leased assets and leased liabilities recognised initially and their subsequent accounting.

(c) To improve the usefulness of financial information, the IASB could provide more guidance, especially for SMEs, on the key matters and/principles to consider when applying judgement in the example areas outlined in (b). IPA notes that it is not within the remit of the IASB to set standards for the NFP sector. However, we think that the guidance sought for SMEs could be written in a manner that would allow the NFP sector to apply.

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

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

Overall, IPA is of the view that the required classification and presentation in the statement of cash flows are useful and the improvements to the quality and comparability of financial information about lease-related cash flows that lessees present and disclose are largely as the IASB expected. However, preparers and users, especially the SMEs and NFP entities, may find the required classification and presentation in the statement of cash flows complex and difficult on the initial implementation of the leases Standard.

Question 4—Ongoing costs for lessees of applying the measurement requirements

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

IPA is of the view that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected for the larger entities. However, for SMEs and NFP entities, the ongoing costs are significantly higher than expected, especially in remeasuring the carrying amount of the lease liability to reflect any reassessment or lease modification, unless a lease modification is accounted for as a separate lease. The complexity involved in a reassessment or lease modification has resulted in some SMEs and NFPs adopting business practices, where there is a modification to an existing lease, the entity enters into a new lease for the modified terms and accounts for it as a new lease. The practice thereby eliminates the need for the entity to remeasure the carrying amount of lease liability to reflect any reassessment or lease modification. Additionally, many of the SMEs and NFP entities would not have IT solutions that cater for a reassessment or lease modification. These entities, instead, would need to capture the data in another IT application, such as a spreadsheet and then manually reconcile the two IT systems.

Consistent with our comments in Q1 above, we think that there is merit in retaining the reassessment or lease modification requirements. However, IPA supports the simplified lease accounting by the standard-setters. In particular, the AASB's proposed simplified reporting for smaller (Tier 3) entities, which encompasses the simplified accounting and disclosures for leases.

Question 5—Potential improvements to future transition requirements

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

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

IPA is of the view that the transition requirements provided sufficient flexibility to allow an entity to select the transition provisions that are appropriate to their circumstance. That is, the Standard permits a lessee to elect to apply the Standard either "fully" retrospectively or retrospectively (without stating comparative financial information). The Standard also includes simplifications and practical expedients to provide cost relief for entities implementing the Standard.

Question 6.1—Applying IFRS 16 with IFRS 9 to rent concessions

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

Rent concessions occur more often for NPF entities than they do for SMEs. IPA notes that a lessee can account for a rent concession in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under that contract resulting in partial extinguishment of the lessee's liability under either:

- IFRS 9 *Financial Instruments* to the extinguished part of the lease liability or
- Lease modification requirements under IFRS 16

Both methods are difficult to navigate and apply for SMEs and NFP entities. We therefore recommend the IFRS Interpretations Committee consider undertaking a narrow-scope standard-setting project to clarify how a lessee distinguishes a lease modification under IFRS 16 or an extinguishment under IFRS 19.

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

(a) How often have you observed difficulties in assessing whether the transfer of an asset in a sale and leaseback transaction is a sale?
(b) Have you observed diversity in seller–lessees' assessments of the transfer of control that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?
(c) If your view is that the IASB should act to help seller–lessees determine whether the transfer of an asset is a sale, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

IPA supports the requirement that the gain or loss a seller-lessee recognises on a completed sale in a sale and leaseback transaction should reflect the amount of the gain or loss that relates to the rights transferred to the buyer or lessor. We also agree with the IASB's rationale for this accounting, so as to restrict the amount of the gain recognised on the sale of the asset in a sale and thereby reduce the incentive to structure such a transaction to achieve a preferred accounting outcome.

However, some SMEs and NFP entities that enter into a sales and leaseback find the calculations complex and the accounting challenging. This is particularly when there is a partial gain or loss in a sale and leaseback transaction, where the accounting is inconsistent under the requirements of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16. Additionally, some NFP entities found it challenging to account for when an asset is sold or transferred for nominal consideration.

Question 6.3—Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

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

Refer to IPA's comments for Question 6.2.

Question 6.4—Other matters relevant to the assessment of the effects of IFRS 16

Are there any further matters the IASB should examine as part of the post- implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

IPA has no further comments.

Stevenson McGregor Rugers

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Dr Keith Kendall
Chair - Australian Accounting Standards Board
PO BOX 204 Collins Street West
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Dear Keith

Re: ITC 55 – Post-implementation Review of AASB 16 *Leases* ('AASB 16')

Stevenson McGregor Rugers ('SMR') is pleased to provide comments on the AASB's Invitation to Comment on the Post-implementation Review of AASB 16 Leases ('PIR'). Our detailed responses are set out in Appendix A to this cover letter.

We have a deep interest in the development of AASB 16 for both public and private sector reporting. We are very supportive of the IASB's and AASB's activities in undertaking this Post-implementation Review as a critical element of the standard setting process.

Overall, we agree that the introduction of AASB 16 has resulted in improvements to the quality and comparability of financial information about leases. However, there are several areas of AASB 16 that are unnecessarily complex and as such, we believe there are opportunities to make some adjustments to the requirements without diminishing the benefits of AASB 16.

If you have any questions concerning our comments please contact Warren McGregor at +61 417 340 664 or Sean Rugers at +61 421 057 493.

Signed on behalf of Warren and Sean

Yours sincerely

S Rugers

Sean Rugers
Director
6 September 2025

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Appendix A – Responses to AASB questions

Section 1: AASB General Matters for Comment

Q1. Are there any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 *Leases*?

1. We aren't aware of any ongoing regulatory issues that impact adversely on the application of AASB 16. There was some initial focus on how best to deal with the consequences of lease contracts becoming a capital activity rather than an operating activity wherever the statutory numbers were being used to drive a calculation that required that distinction. This was largely internal management reporting, like budget funding requests, but at times it impacted on regulatory measures. Our understanding is that these matters are largely settled in the private sector.

Q2. Does the application of the requirements in AASB 16 result in major auditing or assurance challenges?

2. We have not observed major auditing or assurance challenges although it should be noted that there are several areas of complexity when applying the standard, that present a risk to individual audit teams if there isn't a clear understanding of the requirements of the standard. These areas are summarised as follows:
    2.1. Calculation complexity – complexity can create an overreliance on system outputs, as it can be hard to replicate calculations accurately in a spreadsheet environment.
    2.2. Testing of portfolio decisions depends heavily on how comprehensive the documentation is of how the requirements have been applied.

Q3. Are the requirements in the best interests of the Australian economy?

3. Yes, for the following reasons:
    3.1. While not all user groups are utilising the enhanced information about leases, there are sufficient benefits to capturing lease contracts on the balance sheet and enhancing disclosures about material lease contract arrangements.
    3.2. Companies of all sizes typically realise benefits from managing leases using a system. While the lease accounting calculations are inherently complex, capturing the underlying lease information in a system will allow management to more effectively manage the contractual requirements of each lease contract.

3.3. For public sector entities, AASB 16 results in a more consistent presentation with AASB 1059 Service Concession Arrangements (AASB 1059). Control through ownership, regulation and right of use are all presented on balance sheet in a reasonably consistent manner.

Section 2: NFP and Public Sector topics for comment

Topic 1: Application of AASB 16 by NFP and public sector entities

Q1. In respect of NFP and public sector entities:

Q1(a) Are the ongoing costs of applying AASB 16 and auditing and regulating its application significantly greater than expected?

4. Yes, the higher costs than expected result from the fact that leases are generally non-standard and are therefore inherently complex. The level of judgement required is not easy to capture sufficiently in a system and therefore in many cases, judgement decisions on individual leases are captured outside of the system. This is partly because the judgement involved is not limited to the application of a policy position by the finance function – it involves input from property teams, asset managers and treasury functions which may not understand the accounting requirements that can be different to the natural commercial decision making processes that they may otherwise adopt.

Q1(b) Are the benefits to users significantly lower than expected?

5. Overall no, although it would be important to note that the P&L presentation of depreciation and interest is less relevant in a NFP context, particularly with regard to property leases. There may be opportunities within IFRS 18 to address this though with the development of better ways for finance teams to communicate to users the nature of lease costs and how they are managed by the business.

Q1 (c) Overall, do you have any comments about whether AASB 16 results in financial statements that are more useful than financial statements prepared under the previous Standard AASB 117 Leases?

6. Yes, presenting lease contracts on the balance sheet is just as important for NFP and public entities as it is for private sector entities. Lease contracts are complex and represent an indebtedness of a business that should be captured by the accounting process to ensure there is a full measurement of an entity's contractual obligations on their balance sheet.

Topic 2: Determining the lease term

Regarding determining the lease term, do you have any comments about:

Q2. The application of the requirements in practice by NFP and public sector entities?

7. No specific comments to add

Q3. Whether differences in application exist in practice in the NFP and public sector?

8. Yes, there are differences in application but there is sufficient guidance available to cover most of the issues that develop in practice. The challenges that arise particularly in the public sector, have more to do with being able to specifically define the relationship between different public sector participants, rather than the specific application of the provisions in the leasing standard.

9. A good example of this has been the accounting for leased commercial office space across the State Government sector. In many States, there is a central co-ordinating agency that enters a head lease with a non-Government lessor. There are differing commercial arrangements that may apply as to whether the central co-ordinating agency is doing that on behalf of another agency or is then entering into a formal sub-lease arrangement with the other agency. This has led to at least 3 different accounting treatments for similar types of arrangements (noting there are genuinely different commercial arrangements that exist and could justifiably result in different outcomes).

Q4. Whether the current requirements and guidance in AASB 16 for determining the lease term are sufficient for NFP and public sector entities?

10. Yes, particularly considering that relevant public sector agencies will also supplement the published AAS guidance with their own policies and practice notes to deal with particular issues that arise in practice.

Topic 3: Lease modifications

Regarding the accounting for lease modifications, do you have any comments about:

Q5. The application of the requirements in practice by NFP and public sector entities?

11. No comments to add

Q6. Whether differences in application exist in practice in the NFP and public sector?

12. No differences in application noted

Q7. Whether the current requirements and guidance in AASB 16 for lease modification are sufficient for NFP and public sector entities?

13. No comments to add

Topic 4: Measurement of lease liabilities – determining an incremental borrowing rate

Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about:

Q8. The application of the requirements in practice by NFP private sector entities, including how these entities are currently determining the incremental borrowing rate in practice?

14. We don't have direct experience with assisting NFP private sector entities with determining the incremental borrowing rate, although given our broader experience working with private sector entities, we would expect that it would be a difficult exercise to establish an incremental borrowing rate for an entity that does not have any borrowings.

Q9. Whether differences in application exist in practice in the NFP private sector?

15. No comments to add.

Q10. Whether the current requirements and guidance in AASB 16 for the measurement of lease liabilities are sufficient for NFP private sector entities?

16. No comments to add

Topic 5: NFP public sector concessionary leases

Regarding NFP public sector concessionary leases, do you have any comments about:

Q11. Whether there are any reasons to remove the current accounting policy choice to measure initially concessionary ROU assets at either cost or fair value?

17. While it is an accepted rationale that fair value accounting will generally give rise to more relevant and reliable information, it is often very difficult to determine a commercial market rental in order undertake the measurement of a lease, particularly for unique or specialised buildings. Therefore, there may be more limited circumstances under which a Fair Value accounting policy choice is feasible, although this is not in itself a reason to remove the policy choice from being available.

18. In addition, while it is valid to require that any "grant" component of a below market lease should be accounted for, it can be difficult to isolate whether a below market lease is only a grant element, or if it incorporates other things. For example, if a below market lease is provided to a NFP such that the recipient is better able to deliver services to the lessor, the entity is furthering its' objectives, but there is also a co-incidence of purpose affecting this transaction that should be considered and should not always result in income being recorded by the NFP entity.

Q12. Whether the temporary accounting policy choice for NFP public sector entities should be made permanent?

19. Yes, unless there is any substantive work planned to further investigate this issue, making the policy choice permanent would give preparers more certainty of the requirements that will apply to these arrangements.

Q13. Whether the disclosures prepared in accordance with paragraphs Aus59.1 and Aus59.2 of AASB 16 are sufficient in providing useful information to financial statement users regarding concessionary leases when the ROU assets are measured at cost?

20. Yes

Topic 6: Sale and leaseback arrangements

Regarding sale and leaseback arrangements, do you have any comments about:

Q14. The application of the requirements in practice by public sector entities?

21. We have not had any direct experience with the use of sale and leaseback transactions by public sector entities.

Q15. Whether differences in application exist in practice in the public sector?

22. None noted.

Q16. Whether the current requirements and guidance in AASB 16 for sale and leaseback arrangements are sufficient for public sector entities?

23. No comments to add.

Topic 7: Other matters

Q17. Are there any other NFP and public sector matters that should be brought to the attention of the AASB as it undertakes a PIR of AASB 16?

24. One matter that does regularly arise for public sector entities is the overlap in scope between AASB 1059 and AASB 16. We note in AASB1059.IG12-IG13 there are two tables presented which set out different types of arrangements for private sector participation in the provision of public sector services. We think this does a reasonable job of identifying the types of commercial arrangements and features that govern these types of contracts. While it is clearly stated that accounting outcomes will depend on the specific terms and conditions of any arrangement, we do find that in practice it can be challenging to determine which standard should apply and is often determined by assessing which parts of a commercial arrangement are considered to be the "provision of a public service" and which entity is responsible for delivering/managing the delivery of those services.

25. As a general statement, it seems like an appropriate outcome that contracts of a relatively short nature (8 – 15 years) would more likely be lease arrangements, with service concessions being more medium term (20 – 30 years). In practice, the length of the arrangement isn't directly relevant and so is not determinative of the outcome.

26. Therefore, we think it would be beneficial for the Board to consider certain types of arrangements (for example, bus contract arrangements) and assess whether the existing accounting policy application is resulting in optimal outcomes.

27. We would also make the observation that while there are some differences in measurement, in broad terms, each of AASB 1059 and AASB 16 should result in similar accounting treatment. In cases where it is clear that control of the asset exists, there can be a significant amount of effort in determining which standard is more appropriate to apply when the measurement differences may not be material.

Appendix B – Responses to IASB Request for information

Q1 – Overall assessment of IFRS 16

Q1(a). In your view, is IFRS 16 meeting its objective (see page 9) and are its core principles clear? If not, please explain why not.

28. Overall yes. IFRS 16 is meeting its objectives and the core principles are clear.

Q1(b). In your view, are the *overall* improvements to the quality and comparability of financial information about leases *largely* as the IASB expected? If your view is that the overall improvements are *significantly lower* than expected, please explain why.

29. Yes, in our view the overall improvements to the quality and comparability of financial information about leases are largely as the IASB expected.

Q1(c). In your view, are the *overall* ongoing costs of applying the requirements and auditing and enforcing their application *largely* as the IASB expected? If your view is that the overall ongoing costs are *significantly higher* than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.

30. In our view, the overall ongoing costs of applying the requirements are largely as the IASB expected. However, we have some concern that the reason for this is due to selective application of the requirements of the standard due to the complexity involved in applying them. We believe it is possible that some of this complexity may not necessarily lead to more relevant and reliable financial information for users. We note that if preparers are being selective in how the requirements are applied, the financial reporting outcomes may be less reliable than if the requirements were less complex and were applied more comprehensively by preparers.

31. Specifically in relation to systems – the overall requirement for companies to adopt systems is appropriate as it necessarily results in better record keeping. We have found in practice that to be effective, systems need to comprise both the collection and management of key lease contract information and the calculation methodology required for applying accounting judgements. Where costs are incurred that focus on managing complex lease contract information, this typically

leads to more accurate and consistent accounting application and flow on benefits to the business. If systems do not have the sophistication required to perform all of the necessary measurement adjustments, then adjustments are necessarily happening outside of the system, therefore mitigating the benefits.

32. For accounting judgements – there are several circumstances where there are combinations of strict requirements (ie not including variable payments like CPI and Market Rent Reviews) and judgement calls (on which a range of applications can be applied) resulting in a comingled outcome where there is insufficient transparency and comparability. Commercial terms that are negotiated in the market (particularly for real estate leases) shouldn't result in significant differences in the lease calculations unless there is a genuine principle about trying to capture the financial effect of market risk transfer between the parties.

33. As set out below in the response to Q2, we think that costs could be reduced if there was a focus on removing rigid measurement requirements that may counteract any benefit from applying accounting judgements, or that don't appropriately reflect the reality of how lease agreements may be negotiated in practice.

Q2 – Usefulness of information resulting from lessees' application of judgement

Q2(a). Do you agree that the usefulness of financial information resulting from lessees' application of judgement is *largely* as the IASB expected? If your view is that lessees' application of judgement has a *significant* negative effect on the usefulness of financial information, please explain why.

34. Our view is that there are a number of requirements in the standard that when taken together can be counterproductive to the objective of the usefulness of financial information. The simplest example of this is with regard to the exclusion from the lease liability measurement of variable payments arising from an index or rate (ie CPI linked leases or Market Rent Reviews (MRR)). While there are several lease contract features that may require the careful application of accounting judgement, the requirement to exclude variable lease payments arising from index or rate can have the effect of undermining the application and effect of those accounting judgements.

35. While CPI-linked price increases and MRR features are legitimate features of lease contract negotiation, the accounting requirements create a disproportionate impact on the overall measurement of the lease. Arguably, the measurement differences resulting from the differing treatment of these contract features creates more significant measurement differences than the application of judgement/estimates, which then limits the effectiveness of disclosures, and makes it harder for users to compare the leasing arrangements of similar companies.

36. In terms of the discount rate that is applied, for property leases it is almost always infeasible to apply the rate implicit in the lease due to the lack of sufficient information about the leased asset (which is most often a "partial asset"). IFRS16.BC161 states that it is likely that the Implicit Rate in the Lease and the Incremental Borrowing Rate is similar in many cases. However, the elements used to determine the incremental borrowing rate do not typically take into account differences in the lease payment profile. The lease term is adjusted for, but where payments relating to an index or rate are excluded, these are not typically adjusted for in the incremental borrowing rate determination.

37. The determination of the incremental borrowing rate could be amended to more accurately match which lease components are being excluded from the measurement calculation to mitigate the effect of their exclusion. This would better

align with the IASB's stated objective in IFRS16.BC160 that the discount rate reflects how the contract is priced.

38. Consider the following example calculations (note – the inception measurement values have been derived using the NPV excel formula using a 5% pa discount rate and annual cashflows):

Determining ROU Asset/lease liability measurement at inception of lease contract										
Discount rate for all scenarios - 5%										
Scenario 1 - 3% fixed increase each year of lease term										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cashflows used at lease inception	$ 100	$ 103	$ 106	$ 109	$ 113	$ 116	$ 119	$ 123	$ 127	$ 130
ROU Asset & Lease Liability @ inception	$874.76									
Scenario 2 - CPI increases throughout lease term										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cashflows used at lease inception	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100
ROU Asset & Lease Liability @ inception	$772.17									
Scenario 3 - 3% fixed increase with a Market Rent Review in year 6, fixed increase (3%) for remainder of term										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cashflows used at lease inception	$ 100	$ 103	$ 106	$ 109	$ 113	$ 100	$ 103	$ 106	$ 109	$ 113
ROU Asset & Lease Liability @ inception	$817.55									
Scenario 4 - 3% fixed increase with a Market Rent Review in year 6 (with a floor being the prior period rent), fixed increase (3%) for remainder of term										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cashflows used at lease inception	$ 100	$ 103	$ 106	$ 109	$ 113	$ 113	$ 116	$ 119	$ 123	$ 127
ROU Asset & Lease Liability @ inception	$862.63									

39. Clearly it is difficult to draw conclusions from a small set of examples, but the question that these examples pose is whether small adjustments in the commercial arrangements should result in relatively material differences in the measurement calculation. It should be noted that the effect of such variances could be evened out across large portfolios of lease contracts, but where entities have a small number of very material lease agreements, this effect can be amplified.

40. It is also acknowledged that over the course of each lease, the remeasurement requirements will narrow these differences but the question remains whether the initial measurement differences affect the comparability of lease information between similar companies.

41. Arguably an adjustment factor in the discount rate could be used to reflect that expected variable increases in lease payments have not been captured in the initial measurement.

Q2(b). Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.

42. Yes, in particular we would note the provisions in the standard that allow for the use of a portfolio approach. As a general statement, we have observed less application of portfolio groups than expected which we suspect diminishes the effective application of appropriate judgements.

Q2(c). If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain:

- **(i) What amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or**
- **(ii) What additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs).**

43. Our view is that the IASB could improve the usefulness of financial information resulting from lessees' application of judgement. This is best achieved by reconsidering the methodology for determining the lessee's incremental borrowing rate. We think it could be beneficial to introduce adjustment factors to the incremental borrowing rate that reflect lease or portfolio specific attributes of the contracts that are requiring definitive measurement adjustments (ie the exclusion of payments linked to an index or rate). Adding in such adjustment factors may serve to better mitigate the outsized impact such measurement adjustments ultimately have on the lease accounting.

44. Any such adjustments should of course be carefully balanced if there are also changes to the measurement requirements themselves. The objective of the incremental borrowing rate should be more directly aligned with the intention of the rate implicit in the lease (which is often not able to be determined) such that it is more capable of resulting in a similar outcome.

Q3 - Usefulness of information about lessees' lease-related cashflows

Q3. Do you agree that the improvements to the quality and comparability of financial information about lease-related cash flows that lessees present and disclose are *largely* as the IASB expected? If your view is that the improvements are *significantly lower* than expected, please explain why.

45. Yes the improvements in the quality and comparability of financial information about lease-related cash flows are largely as the IASB expected.

Q4 Ongoing costs for lessees of applying the measurement requirements

Q4(a) Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are *largely* as the IASB expected? If your view is that the ongoing costs are *significantly higher* than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.

46. The ongoing costs of applying the measurement requirements is directly related to the sophistication of the lease accounting system that is used by an entity to prepare the lease calculations. In many cases, particularly with regard to a MRR, systems are not accurately incorporating the requirements into the calculations which then requires entities to perform certain measurement adjustments outside of the system, increasing both cost and risk of error as a result.

47. The principal reason for excluding the variable component of payments that depend on an index or rate is due to the costs involved in applying a forecasting technique or other forward looking information in the calculation. We would agree that the costs involved in applying any increase in future payments exceed any benefits from doing so.

48. However, in the case of CPI-linked increases and MRR provisions with no "floor" have the impact of using below market lease rental rates in the liability measurement, particularly for long dated lease contracts. Mechanics that are used to adjust the lease payments over the contract term (whether they are determined by fixed or variable means) are generally seen to be a mechanism to act as a proxy for the market rents that would otherwise apply, and are a practical way of adjusting the rent and without incurring costs associated with resetting to a market rate on a more regular basis. As a result, it would seem that the selected proxy for market that is negotiated by the participants in the lease agreement could be used in the determination of the lease payments as a more accurate measure of the way the lease contract should be measured.

Q4(b) If your view is that the ongoing costs are *significantly higher* than expected, please explain how you propose the IASB reduce these costs without a *significant* negative effect on the usefulness of financial information about leases.

49. We believe that making some adjustments to the way in which variable payments based on an index or rate are required to be excluded from the calculation could reduce some of the complexity of the measurement requirements and result in

payments that more accurately reflect the underlying commercial arrangement that has been negotiated by the parties. This would result in a reduction of costs and an improvement of the usefulness of financial information about leases.

50. As noted in the response to Question 2(c) above, any changes should be carefully balanced with other changes that may be considered with regard to the application of judgement to ensure that they work together to improve the benefits of the lease calculation.

Q5 – Potential improvements to future transition requirements

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

Q5(a) users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows; and

51. No comments

Q5(b) preparers can appropriately reduce their transition costs when implementing new requirements for the first time.

52. No comments

Q6 – Other matters relevant to the assessment of the effects of IFRS 16

Q6.1 Applying IFRS 16 with IFRS 9 to rent concessions

Q6.1(a) How often have you observed the type of rent concession described in Spotlight 6.1?

53. No

Q6.1(b) Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

54. No

Q6.1(c) If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

55. No comment

Q6.2 Applying IFRS 16 with IFRS 15 when assessing whether the transfer of an asset in a sale and leaseback transaction is a sale

Q6.2(a) How often have you observed difficulties in assessing whether the transfer of an asset in a sale and leaseback transaction is a sale?

56. Yes, there can often be significant difficulty due to the fact that fair value of a property is ultimately based on the market value of rent that can be obtained for that property. This means that an inherent part of the test that is being used to determine if a sale has occurred is a circular calculation.

Q6.2(b) Have you observed diversity in seller-lessees' assessments of the transfer of control that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

57. No not in relation to the transfer of control, although more guidance in relation to control over the residual rights of an asset, particularly when it relates to decisions to invest capital to refurbish or replace the asset that has been sold would be useful.

Q6.2(c) If your view is that the IASB should act to help seller-lessees determine whether the transfer of an asset is a sale, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

58. No comments

Q6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

Q6.3(a) Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information?

59. Yes, there is an important anti-abuse principle that requires specific guidance in this case.

Q6.3(b) What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ *significantly* from those expected?

60. None noted

Q6.3(c) If your view is that the IASB should improve the cost-benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution.

61. Yes, in relation to sale and lease back transactions an assessment is required of whether there are any above or below market features that would indicate a separate financing component. An above or below market element is identified by referencing either lease payments that are above market, or the fair value of the asset being above market. However, lease payments are integral to determining the market value of an asset so it seems illogical to conclude that there is an above/below market component by reference to the contracted lease payments since such payments are the basis for determining what a market participant will pay to acquire that asset.

Q6.4 – Are there any further matters the IASB should examine as part of the post-implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

62. A matter the IASB should examine is the exemptions provided by paragraph 5 of the standard. For both short-term and low-value leases, these exemptions are superfluous because of the materiality concept (bearing in mind that like items that are individually immaterial may be material in the aggregate). Their inclusion in the standard is disingenuous because they can result in material information about lease assets and liabilities being omitted from the financial statements, thereby impairing the quality of the financial information about leases that is provided to users of the financial statements. Such matters are better dealt with by entities

considering the specific attributes of the lease arrangements that they have rather than a blanket exclusion which affects entities in different ways relative to their own materiality thresholds and contractual arrangements.

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10 September 2025

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Invitation to comment 55 – Post-implementation review of AASB 16 *Leases*

Dear Keith

As one of the largest professional accounting bodies in the world, CPA Australia represents the diverse interests of more than 175,000 members working in over 100 jurisdictions and regions around the world, working in diverse roles across public practice, commerce, industry, government and academia throughout Australia, New Zealand and internationally. We welcome the opportunity to provide feedback on the above Invitation to comment 55 – Post-implementation review of AASB 16 Leases (ITC 55). We make this submission on behalf of our members and in the public interest.

In preparing our response to these questions, CPA Australia has undertaken extensive outreach to gather feedback across a wide spectrum of stakeholders. This has included:

- Joint research with the University of Melbourne, including
  - A benchmark analysis of a sample of Australian listed companies (**Attachment B**)
  - A Chief Financial Officers (CFO) roundtable held in Canberra (**Attachment C**)

  The research project is currently ongoing, and we will share further outputs including the final research report (expect in first half of 2026) as they become available

- Engagement with members of CPA Australia including the CPA Australia Reporting and Assurance Centre of Excellence

- 3 co-hosted roundtables with the Australian Accounting Standards Board (AASB), the New Zealand External Reporting Board (XRB) and Chartered Accountants Australia and New Zealand (CA ANZ).

In addition, our analysis draws on topics and concerns identified through our previous submissions, ensuring continuity and a robust evidence base. Taken together, this approach has allowed us to capture a comprehensive set of perspectives that reflect the practical challenges and implications of applying AASB 16 in the Australian environment.

CPA Australia has received diverse and contrasting views on the questions raised in ITC 55, that vary depending on the sector. Set out below are the high-level comments based on the feedback we have received:

- **Australian listed companies:** AASB 16 is generally considered to be working well overall. However, stakeholders have highlighted some areas of complexity that require simplification and additional guidance, including lease-term assessments, the distinction between reassessment and modification, lease definition issues (such as substantial substantive rights), sale-and-leaseback arrangements, cash flow disclosures, low-value leased assets, the use of implicit versus incremental borrowing rates, and lease incentives.

While the information arising from AASB 16 as part of financial statements is valued, its use in non-GAAP reporting has been inconsistent, and some considerations should be given to this also as part of the post-implementation review (PIR).

- **Non-listed for-profit entities:** We received mixed views from stakeholders representing this sector. Some indicated that the requirements work adequately, while others observed that the standard was complex, with disproportionate costs relative to the benefits.

  In particular, we noted the divergence between the IFRS for SMEs standard (third edition), which retains a simpler recognition and measurement model, and the equivalent requirements in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (AASB 1060), based on the full recognition and measurement requirements of AASB 16, that are applicable to Tier 2 entities in Australia. This divergence in recognition and measurement requirements between the IASB-issued IFRS for SMEs standard and its Australian equivalent (AASB 1060) should be considered further as part of this PIR.

- **Public sector NFP entities**: The feedback we received from stakeholders representing this sector was largely negative. Stakeholders reported that the requirements do not meet user needs, are costly to implement, and involve complex judgements and systems challenges. Applying the standard requires dedicated resources, placing a burden on taxpayers without delivering meaningful benefits. The main positive outcome noted was improved transparency over lease portfolios.

- **Private sector NFP entities**: Stakeholders representing this sector noted similar concerns to those raised by stakeholders representing public sector NFP entities. Stakeholders advised that the requirements do not meet user needs, are costly to apply, and create additional administrative and system burdens. As with the NFP public sector, the one significant benefit observed was greater transparency and clarity over lease portfolios.

Given the mixed views received from stakeholders, it is difficult to form a conclusive position on whether the requirements of AASB 16 are in the best interests of the Australian economy. While the standard has been viewed in a positive light by stakeholders representing the listed-entities sector and is also considered to provide some benefits in terms of lease transparency by other sectors, the feedback highlights significant challenges and costs, particularly for non-listed for-profit and NFP entities. The evidence points to areas where simplifications, clearer guidance, or sector-specific adjustments may be necessary to ensure the requirements remain proportionate and effective.

To address the concerns raised above, we make the following recommendations:

- **Establish a dedicated project to explore simplification of lease accounting requirements:** We recommend that the AASB establish a dedicated project to explore simplification of lease accounting requirements in challenging areas, for NFP private and public sector entities.

- **Consider Tier 2 entities as part of the AASB 1060 post implementation review:** We recommend that the AASB considers the implications of AASB 16 for Tier 2 NFP private and public sector entities as part of it's post-implementation review of AASB 1060.

Attachment A sets out CPA Australia's detailed responses to the questions in ITC 55. We have also included CPA Australia Research Report 1 (**Attachment B**) and a summary of the discussions from the CPA Australia Public Sector CFO Roundtable (**Attachment C**) to support the comments provided in this submission. Should you have any questions or wish to discuss further, please contact Ram Subramanian, Financial Reporting Lead at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

Elinor Kasapidis
Chief of Policy, Standards and External Affairs
CPA Australia

CPA AUSTRALIA

Attachment A: CPA Australia’s Response to ITC 55

SECTION 1: AASB GENERAL MATTERS FOR COMMENT

(1) Are there any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 Leases?

(2) Does the application of the requirements in AASB 16 result in major auditing or assurance challenges?

(3) Are the requirements in the best interests of the Australian economy?

As noted in our above cover letter, CPA Australia has obtained diverse and contrasting views from different sectors on the impact of AASB 16 on Australian financial reporting. Based on both our commissioned research and outreach activities, whilst the standard is considered to be working as intended by the Australian listed-entity sector, the views have been less positive from the NFP private sector and the NFP public sector. Limited feedback we have received from the for-profit public sector and non-listed private sector also indicate some concerns with the usefulness of the information from AASB 16, when compared against the costs associated with compliance with the standard.

Feedback indicates that the burden of AASB 16 falls disproportionately on small and medium-sized entities (SMEs) and non-listed for-profits. Larger entities typically have the systems, expertise, and resources to manage compliance, whereas SMEs face significantly higher relative costs due to less sophisticated systems, greater reliance on manual processes, and limited capacity to absorb ongoing remeasurement requirements.

Currently, SMEs preparing general purpose financial statements are required, through AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (AASB 1060), to apply the recognition and measurement requirements of AASB 16 in full, with some disclosure relief. We have heard that SMEs face relatively high implementation and ongoing costs in complying with AASB 16 and are seeking a more proportionate and simplified approach. In contrast to the recognition and measurement requirements of AASB 1060, the latest third edition of the IFRS for SMEs standard adopts a simplified model for lease accounting by retaining the operating versus finance lease distinction, thereby avoiding the complexities associated with recognising right-of-use assets and lease liabilities. This follows the IASB's conclusion that the information-value associated with IFRS 16 is not relevant to SMEs. We recommend that the AASB considers this divergence from the approach taken by the IASB for SME lease accounting as part of its upcoming post-implementation review of AASB 1060.

Our responses to questions included in Section 3 of ITC 55 provide our views on the impact of AASB 16 on financial reporting by Australian listed entities. Overall, the impact of AASB 16 is seen positively by preparers, users and auditors involved with financial reporting by Australian listed entities. However, some challenges have been identified that indicate there is scope for improving and simplifying the standard and developing and providing additional guidance.

When we consider feedback from stakeholders representing non-listed for-profit entities and the NFP private and public sector entities, the views diverge dramatically from those noted in the previous paragraph. The feedback we have obtained in relation to NFP private and public sector entities is set out in detail in our responses to the questions to Section 2 of ITC 55.

Given the mixed views we have received as noted above, it is difficult to form a view on whether the requirements are in the best interests of the Australian economy. Some significant concerns have been raised by NFP private and public sector stakeholders about the adverse costs/benefits balance of the standard, and recommendations have ranged from a full withdrawal of the standard to significant simplifications to the accounting for lease term, discount rate, lease definition, lease modification etc. We appreciate that the AASB adopts a transaction-neutral approach to standard-setting and in the absence of a suitable alternative, it may be necessary to consider significant simplifications to the standard to address the concerns raised by NFP private and public sector stakeholders.

SECTION 2: NFP AND PUBLIC SECTOR TOPICS FOR COMMENT

Topic 1: Application of AASB 16 by NFP and public sector entities

As noted in our above cover letter, CPA Australia has undertaken extensive outreach in gathering feedback from NFP entities in the public and private sectors. This has included a physical roundtable held in Canberra as part of the ongoing research we are undertaking in collaboration with the University of Melbourne, the three co-hosted roundtables (with the AASB, the XRB and CA ANZ) and other ad-hoc feedback as well.

Although the consultation refers to "NFP and public sector entities", we have gathered feedback and provided responses for private and public sector NFP entities, largely excluding public sector for-profit entities. Some respondents have indicated that public sector for-profit entities (e.g., AusPost) should be viewed similarly to private sector for-profit entities for the purposes of this consultation.

Based on the feedback received, AASB 16 has imposed significantly higher costs on NFP private and public sector entities than expected, while delivering lower benefits to users. Although AASB16 *Leases* has improved lease visibility in principle, in practice it has introduced high administrative burdens, requirements that rely heavily on professional judgement, and outcomes that often lack relevance for NFP private and public sector entities. Stakeholders consistently reported reduced readability of financial statements, distortions in reported results, and limited decision-usefulness, suggesting that AASB 16 has not made the financial reporting of lease information by lessees more useful than under the previous standard AASB 117 *Leases*.

This overarching concern is closely connected to other specific topics discussed below (e.g. lease terms, lease modification, incremental borrowing rates (IBR) etc.), where many of the detailed feedback points ultimately reflected the same underlying theme, i.e. that the costs of compliance often outweigh the benefits for NFP and public sector entities. We appreciate that overall, the principles behind the lease accounting requirements of AASB 16 are sound. Given the AASB's transaction-neutral approach to standard-setting and in the absence of other viable alternatives, we are unable to offer any suitable recommendations that would result in replacing AASB 16 in its entirety.

To address the concerns raised by NFP private and public sector stakeholders, we make two recommendations for consideration by the AASB:

- **Establish a dedicated project to explore simplification of lease accounting requirements:** We appreciate that the AASB adopts a transaction-neutral approach to standard-setting and in the absence of a suitable alternative, it may be necessary to consider significant simplifications to the standard to address the concerns raised by NFP private and public sector stakeholders. We recommend that the AASB establish a dedicated project to explore simplification of lease accounting requirements in challenging areas, for NFP private and public sector entities. Such an approach could help reduce compliance costs and administrative effort while enhancing the relevance and understandability of financial information for users. This is consistent with the principle that reporting requirements should remain proportionate to the needs of preparers and users in these sectors.

- **Consider Tier 2 entities as part of the AASB 1060 post implementation review:** Some SMEs have expressed similar concerns about the high cost of applying AASB 16 in full. We note that the third edition of the IFRS for SMEs standard does not include the lease accounting requirements of AASB 16 (IFRS 16). We recommend that the AASB considers the implications of AASB 16 for Tier 2 NFP private and public sector entities as part of it's AASB 1060 post implementation review.

For smaller private sector NFPs, we note the AASB is currently developing a simplified reporting standard that does not propose to require lease accounting that is based on the requirements in AASB 16. We believe this approach is appropriate and will alleviate some of the concerns that have been raised by private sector NFP stakeholders.
We provide further details in our responses to the Topic 1 questions below.

1a) In respect of NFP and public sector entities, are the ongoing costs of applying AASB 16 and auditing and regulating its application significantly greater than expected?

Based on the feedback received, the ongoing costs of applying AASB 16 in the NFP public and private sectors are significantly greater than expected, which is consistent with the feedback noted in ITC 55. While the standard has improved visibility of an entity's lease portfolio in some cases, stakeholders consistently highlighted that compliance requires substantial resources, creates unnecessary administrative effort, and often provides limited benefit to users of financial statements. There is a concern that the additional costs incurred for lease accounting by public sector NFP entities have to ultimately be borne by the Australian taxpayer. Some further detail around what we have received as feedback is provided below:

- **High resource burden and administrative cost:** Public sector participants at the Canberra roundtable highlighted that adopting AASB 16 has involved high implementation and ongoing costs, including reliance on multiple staff dedicated to lease accounting, manual tracking due to lack of funding for system upgrades, and resources allocated to dealing with additional queries from auditors (e.g. ANAO). Many described this as an administrative or bureaucratic burden, with costs disproportionate to the usefulness of the information. As an example, in the education sector, adoption of AASB 16 has required bespoke internal systems and simplified guidance for approximately 1,500 schools, but challenges remain due to high training costs and staff turnover.

- **Systems immaturity and reliance on manual processes:** The public sector participants further emphasised that applying AASB 16 without appropriate systems has led to inconsistent practices, error risks, and high reliance on consultants. Many continue to depend on manual Excel-based models, which heightens inefficiency and reduces comparability.

- **Unnecessary effort on assessments with limited value:** Local councils noted that they spent considerable time assessing embedded leases (e.g. waste management contracts) even when none were ultimately identified. Despite knowing the likely outcome, they were still required to complete the assessments, leading to wasted resources with little benefit for decision-making.

1b) In respect of NFP and public sector entities, are the benefits to users significantly lower than expected?

The benefits of AASB 16 for NFP private and public sector entities are seen as significantly lower than expected. While some stakeholders acknowledged that regulators of NFP public sector entities noted that lease disclosures can improve transparency and accountability by better identification of lease portfolios, stakeholders more broadly observed that the information value derived from AASB 16 did not justify the costs and complexities associated with applying the standard.

- **Some transparency and financial management benefits:** Some stakeholders identified benefits from AASB 16 for NFP private and public sector entities include better transparency and knowledge of leases held by entities and some discipline being brought to the management of leases through such transparency.

- **Limited user benefit:** It is generally considered that the costs associated with lease accounting under AASB 16 outweigh the benefits arising from it. Public sector NFP entities in general do not rely on debt financing but rather rely on budget appropriations and other income sources to fund their activities. Accordingly, the concept of acquiring a right-of-use (ROU) asset by debt financing through a lease contract does not align with the way in which many public sector NFP entities operate. We also understand that in many cases, the lease information on balance sheets is reversed out when presenting information for internal management purposes.

  In the NFP private sector (e.g. credit unions), lease liabilities were typically less than 1% of equity, yet entities faced significant complexity in undertaking present-value calculations and reconciliations. Local government stakeholders have also provided feedback that AASB 16 added complexity to financial statements without delivering meaningful benefits, as both preparers and users often struggled to understand and interpret the results.

- **Limited usefulness at whole-of-government and agency levels:** Government agencies observed that recognising office accommodation on departmental/agency balance sheets often provides little value when the same assets and liabilities are already captured in whole-of-government consolidated financial statements. For example, office accommodation in some States is centrally managed, and agencies can be moved between office locations at the discretion of the central body. Because of this substitution right, many of these arrangements do not meet the definition of a lease under AASB 16, making the recognition exercise at the departmental/agency level redundant and unhelpful to users.

- **Distorted results and ratios in local government:** Some council representatives noted that the financial information from AASB 16 often does not align with the economic reality of their lease arrangements. For instance, for long-term property leases, the lease accounting model often results in high interest and depreciation expenses at the start of the lease, exceeding the actual rental payments, leading to reported results appearing worse than the council's true operating cash position. This could also have an adverse impact on rate calculations based on annual expenditure, which can impact the rates a council sets for the year. Furthermore, lease liabilities inflate financial ratios such as the net financial liabilities ratio, which could suggest a council is in a weaker financial position than it actually is, undermining comparability across councils and potentially misleading stakeholders about financial capacity.

- **Complex and judgement-heavy requirements with limited user value:** For NFP private and public sector entities, the usefulness of financial statements under AASB 16 is diminished by requirements that are highly judgemental and resource-intensive, demanding significant effort without delivering equivalent benefits to users. These challenges are particularly significant because the operations of NFP private and public sector are different from the for-profit private sector, where lease accounting concepts such as debt financing and discount rates have more relevance. Some public sector respondents observed that determining lease terms requires a case-by-case analysis (e.g. contracts include break or extension options). Others highlighted difficulties in distinguishing between lease modifications and extensions, with different interpretations producing inconsistent outcomes. Inter-agency leases were also cited as problematic, as both the lessee and lessor agency are required to record the same arrangement, effectively duplicating effort without adding informational value. In addition, calculating IBR was viewed as particularly burdensome in the public sector, since many agencies do not borrow funds and the discount rates generated are less meaningful for decision-making purposes.

1c) In respect of NFP and public sector entities, overall, do you have any comments about whether AASB 16 results in financial statements that are more useful than financial statements prepared under the previous Standard AASB 117 Leases?

Stakeholders generally considered that AASB 16 has not resulted in financial statements that are more useful than those prepared under AASB 117 for NFP private and public sector entities. While the standard has improved lease visibility in principle, its application in these sectors has created more confusion than clarity. Respondents highlighted reduced readability, limited relevance of lease recognition, knowledge gaps leading to inconsistent application, distortions from the financing effect, and budgeting mismatches. Collectively, these issues suggest that the benefits for users have been significantly lower than expected.

- **Reduced readability and clarity, obscuring useful information for users:** AASB 16 was widely described as adding complexity without enhancing reporting quality in the NFP private and public sector entities. Users of public sector financial statements are primarily interested in operating expenditure, yet the lease accounting model obscures actual spending patterns and makes financial statements harder to interpret. In some cases, this has reduced the visibility of useful information rather than improving it.

- **Lease recognition often lacks relevance and limited decision-usefulness in practice:** Most leases in the NFP private and public sectors involve office accommodation or community facilities, where recognising a lease liability and a ROU asset was seen as disconnected from operational realities. In some cases, the majority of an entity's reported assets and liabilities were dominated by lease balances, overstating the significance of a single long-term arrangement and masking the entity's underlying financial position. Similarly, feedback from the credit union sector highlighted that lease liabilities are typically immaterial (often less than 1% of equity), yet the standard requires disproportionate effort. These organisations continue to base decisions on cash flow expenses, reflecting the limited decision-usefulness of AASB 16 outcomes.

- **Knowledge gaps, inconsistent application, and user confusion on lease cash flow presentation:** Local governments highlighted that staff often have limited understanding of AASB 16, leading to mechanical application and inconsistent interpretations both within departments and across agencies. Senior management also reported difficulty interpreting the presentation of lease cash flows, where actual payments differed from reported outflows because a part of the outflow was classified as finance costs. This principal–interest split was viewed as confusing, requiring additional explanation and administrative effort, which in turn increases compliance costs.

- **Financing effect distorts results:** This concern was also raised in our response to Question 1(b) above, where stakeholders noted that such outcomes reduce the representational faithfulness of reported results.

- **Identifying a lease - substantive substitution rights:** We understand that there is inconsistent application of whether a contract constitutes a lease agreement, in the context of substantive substitution rights. For example, when a local council leases garbage removal trucks from a third party, affixes their logo on the trucks and uses them as part of their refuse removal process, there is some inconsistency in how these contracts are treated. There may be some confusion around whether the trucks are under leasing arrangements or not, as the trucks can be substituted for different routes etc. There may also be instances where contracts are written to ensure substantive substitution rights are present, so the contracts are considered not to be lease contracts.

Topic 2: Determining the lease term

Summary and recommendation

The feedback received highlights that determining lease term under AASB 16 is one of the more challenging areas for NFP private and public sector entities. The requirements are viewed as overly complex, requiring significant professional judgement, often requiring case-by-case assessments that place a significant administrative burden on agencies with large or diverse lease portfolios. Inconsistent practices have emerged across entities, driven by both manual processes and the unique types of leases common in the public sector, such as community assets and entity-to-entity arrangements. Current requirements and guidance are seen as insufficient, exacerbating inconsistency and confusion. As a result, the usefulness of the outputs is limited, with stakeholders calling for greater clarity, practical examples, and simplified approaches that are better suited to the NFP private and public sector context.

As noted in our recommendation in Section 2 Topic 1 above, we support simplifying the standard to better align costs with benefits (for further details, please refer to that topic). In addition, given that a significant portion of feedback related to leases of land and buildings, we recommend that the AASB consider developing further guidance or practical expedients specifically for determining lease terms for such arrangements.

We provide further details in our responses to the Topic 2 questions below.

2) Regarding determining the lease term, do you have any comments about: the application of the requirements in practice by NFP and public sector entities?

3) Regarding determining the lease term, do you have any comments about: whether differences in application exist in practice in the NFP and public sector?

4) Regarding determining the lease term, do you have any comments about: whether the current requirements and guidance in AASB 16 for determining the lease term are sufficient for NFP and public sector entities?

Determining lease term is challenging for NFP and public sector entities, with requirements often seen as overly complex, requiring significant professional judgement, with insufficient guidance to support the requirements.

- **Application in practice:** Government agencies reported that assessing lease term requires significant professional judgement, especially where contracts include multiple break or extension options. For large lease portfolios, entities often need to invest significant effort and resources to review each lease individually and establish detailed accounting policies for different lease types. For example, an agency managing over 1,000 leases globally explained that this process is resource-intensive as the analysis and accounting have to be undertaken manually due to system constraints (as explained in our response to Section 2 Question 1(a) above), creating ongoing cost and resourcing challenges.

- **Differences in application:** Inconsistent practices were observed across entities. Some councils and government agencies adopt very conservative approaches, applying all possible lease-term extensions (which significantly inflates lease liabilities), while others justify minimal lease-term extensions that result in smaller balance sheet numbers. These differences partly arise because many agencies rely on manual processes due to immature data collection systems and limited funding for upgrades (as explained in our response to Section 2 Question 1(a) above), making consistent judgments difficult. They also reflect the unique types of leases commonly found in the public sector, such as community assets or government-to-government arrangements, which often lack private sector comparators. Together, these factors highlight the difficulties of applying private-sector concepts in the public sector context.

- **Adequacy of current requirements and guidance:** Stakeholders consistently felt that the current guidance is insufficient. Many referred to the lack of clarity on how to deal with "until further notice" arrangements, or how to distinguish between breaking a lease and exercising an extension. Reliance on requirements from different standards (e.g., AASB 15, AASB 9) and International Financial Reporting Interpretations Committee (IFRIC) agenda decisions adds to the complexity and increases the risk of inconsistent application. Feedback suggested that more practical examples, simplified requirements, and clearer wording would help reduce the burden and ensure more consistent application in the NFP and public sector context.

Topic 3: Lease modifications

5) Regarding the accounting for lease modifications, do you have any comments about: the application of the requirements in practice by NFP and public sector entities?

6) Regarding the accounting for lease modifications, do you have any comments about: whether differences in application exist in practice in the NFP and public sector?

7) Regarding the accounting for lease modifications, do you have any comments about: whether the current requirements and guidance in AASB 16 for lease modification are sufficient for NFP and public sector entities?

Feedback indicates that lease modifications are a complex area for NFP private and public sector entities, requiring significant judgement, frequent remeasurement, and reliance on costly, resource-intensive and inconsistent processes. The requirements and guidance around determining whether a contract provision leads to lease modifications or lease remeasurements are widely viewed as unclear. This has led to calls for simplification and clearer guidance to reduce unnecessary recurrent costs and inconsistent outcomes.

- **Application in practice:** Government agencies reported difficulty distinguishing between lease modifications and extensions of options, often requiring professional judgement and consultation with central authorities to reach a conclusion. Entities also reported confusion when rental payments changed under variable payment terms: some staff mistakenly treated these as lease modifications (including updating discount rates) instead of treating is a remeasurement under the standard. Similarly, under master or umbrella agreements covering multiple items, changes in payment due to adding new items were sometimes treated as modifications when recognising these as new leases may have been more appropriate. Moreover, annual CPI-driven remeasurements add recurring burden, often calculated manually or through expensive outsourced solutions.

- **Differences in application:** Inconsistent practices were observed across entities. Some finance teams recalculate leases as modifications but sometimes fail to derecognise the existing lease, resulting in overstated ROU assets and liabilities. Others adopt different treatments depending on internal policies or auditor advice, leading to divergent outcomes even for similar fact patterns. These inconsistencies are worsened by reliance on spreadsheets, multiple calculation methods, and costly outsourcing (often charged per lease), with staff turnover further reducing consistency in application.

- **Adequacy of current requirements and guidance:** Stakeholders viewed the current guidance as insufficient. The terminology around modifications versus extensions was described as adding unnecessary workload without providing commensurate user benefit. More practical examples, (e.g. carparks, variable payments, or umbrella agreements) were requested to reduce ambiguity and improve consistency. Some also suggested simplifying CPI-driven remeasurements by allowing forecast index movements to be incorporated upfront, with remeasurement only required if outcomes differ materially. The COVID-19 rent concession expedient was cited as an example of how targeted relief can make compliance more practical without undermining transparency.

Topic 4: Measurement of lease liabilities – determining an incremental borrowing rate

8) Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about: the application of the requirements in practice by NFP private sector entities, including how these entities are currently determining the incremental borrowing rate in practice?   ***9) Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about: whether differences in application exist in practice in the NFP private sector?***   ***10) Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about: whether the current requirements and guidance in AASB 16 for the measurement of lease liabilities are sufficient for NFP private sector entities?***

We note that Topic 4 Questions 8-10 focus only NFP private sector entities. However, most of the feedback we have received relates to NFP public sector entities and our below comments reflect this.
Feedback indicates that the measurement of lease liabilities and the determination of IBR are problematic for NFP private and public sector entities. Stakeholders noted that the requirements add significant complexity without delivering meaningful value for users, and current guidance is insufficient to ensure consistent or efficient application.

- **Application in practice:** Public sector agencies explained that calculating an IBR adds little value for decision-making, since many agencies do not borrow and future cash flow concepts tied to IBR are not relevant in their context. In practice, entities almost always default to IBR because the information needed to calculate the lessor's implicit rate (e.g. asset fair values or residual values) is rarely available. However, because many agencies do not have their own borrowing rate, they typically substitute proxies such as government financing authority rates, which are accessible but not necessarily reflective of the entity's risk profile.

- **Differences in application:** Inconsistencies are widespread across entities. Some agencies apply prescribed IBR parameters incorrectly, while others rely on bespoke consultant models or internal spreadsheets, producing divergent outcomes. In group situations, subsidiaries without credit ratings are often required to determine their own discount rates, which was viewed as artificial and unreflective of actual risk. Stakeholders suggested that a practical expedient should allow subsidiaries to use the group's rate in consolidated groups to improve consistency and reduce unnecessary effort.

- **Adequacy of current requirements and guidance:** Stakeholders generally felt that the requirements are too complex and not fit-for-purpose in the NFP private and public sectors. Errors such as incorrect indexations and unrecorded asset classes were reported, largely due to immature systems and reliance on error-prone spreadsheets. Heavy dependence on consultants further increases costs without necessarily outcomes. Feedback suggested that simplification is needed, for example, providing standardised discount rates or practical expedients. Some argued the public sector might have been better exempted from many of the IBR requirements altogether.

Topic 5: NFP public sector concessionary leases

11) Regarding NFP public sector concessionary leases, do you have any comments about: whether there are any reasons to remove the current accounting policy choice to measure initially concessionary ROU assets at either cost or fair value

12) Regarding NFP public sector concessionary leases, do you have any comments about: whether the temporary accounting policy choice for NFP public sector entities should be made permanent?

13) Regarding NFP public sector concessionary leases, do you have any comments about: whether the disclosures prepared in accordance with paragraphs Aus59.1 and Aus59.2 of AASB 16 are sufficient in providing useful information to financial statement users regarding concessionary leases when the ROU assets are measured at cost?

CPA Australia reiterates its previous recommendation made in our submission in response to ED 286 to make the exemption permanent. Feedback from stakeholders in response to the current consultation is also strongly supportive of retaining and making the exemption permanent. We understand many entities in the NFP public sector do not apply fair value to their concessionary leases. For the few that do currently opt to fair value their concessionary leases, the option should be made available on a permanent basis to continue doing so.

- **Application in practice:** Entities reported that the ability to choose between cost and fair value has been effective in practice. For example, perpetual land leases or in-substance land grants are sometimes recognised at fair value, but in other cases at cost, particularly where ongoing obligations exist to maintain the land. The option to use cost allows NFPs to avoid unnecessary complexities such as valuing assets with no active market, variable or contingent rentals, or early termination provisions.

- **Differences in application:** While some entities apply fair value for certain land arrangements, many rely on the cost model, particularly for peppercorn and concessionary leases. This reflects the fact that the public sector context is different from the private sector, where market-based valuations may be more meaningful. In practice, differences in application are driven less by inconsistency and more by the flexibility needed to address the unique nature of concessionary arrangements in the public sector.

- **Adequacy of current requirements and guidance:** Stakeholders strongly supported making the concessionary lease exemption permanent. They highlighted that applying fair value would impose very high costs, require specialised valuation expertise, and add an unnecessary administrative burden with little corresponding user benefit. Preparers also reported difficulties in measuring lease liabilities for peppercorn leases, as minimal or no payments leave them uncertain about how to recognise related assets and liabilities. Retaining and clarifying the exemption is therefore seen as essential to ensuring the standard remains fit-for-purpose in the NFP public sector context.

Topic 6: Sale and leaseback arrangements

14) Regarding sale and leaseback arrangements, do you have any comments about: the application of the requirements in practice by public sector entities?

15) Regarding sale and leaseback arrangements, do you have any comments about: whether differences in application exist in practice in the public sector?

16) Regarding sale and leaseback arrangements, do you have any comments about: whether the current requirements and guidance in AASB 16 for sale and leaseback arrangements are sufficient for public sector entities?

We received limited but important feedback on sale-and-leaseback arrangements, with stakeholders noting this is an emerging area of complexity as governments increasingly pursue alternative financing structures. In practice, these transactions often involve service components or embedded leases, making it difficult to determine whether a genuine sale has occurred and how the leaseback should be accounted for.

Additional concerns were raised about failed sale-and-leaseback arrangements, particularly the difficulty of disconnecting the financial liability from the underlying asset. Situations such as changes in useful life, asset replacement, or lease terms extending beyond the asset's life create uncertainty about whether reassessment is required and how to measure or derecognise the liability. Termination rights by either lessor or lessee raise similar questions about when a failed sale should be reclassified as a true sale and how related balances should be treated. Whilst feedback on this topic has been limited, the feedback we did receive noted that current requirements and guidance on sale and leaseback arrangements are insufficient, and further clarification and illustrative examples would be valuable to promote consistent application in the public sector.

Topic 7: Other matters

17) Are there any other NFP and public sector matters that should be brought to the attention of the AASB as it undertakes a PIR of AASB 16?

Stakeholders highlighted several additional matters that may be relevant for the AASB to consider as part of its post-implementation review of AASB 16 for the NFP private and public sectors:

- **Perpetual leases and in-substance purchases:** Public sector entities frequently deal with land arrangements, such as grants and reserves, that are economically like freehold ownership but legally structured as leases. These raise questions about whether such assets should fall under AASB 116 or AASB 16. While most are currently accounted for under AASB 116, clearer guidance would help avoid inconsistent treatment of these arrangements.

- **Materiality and exemptions:** Stakeholders noted that materiality remains an unresolved issue for public sector NFPs, with current exemption thresholds (low value leases and short-term leases) set too low to be meaningful. In practice, these thresholds often capture only minor items such as personal computers, while most lease value is concentrated in a small number of significant contracts (e.g. 20 leases covering around 90% of value of all leases held by the entity). As a result, entities still need to apply lease accounting to numerous low-value items, creating unnecessary burden. Stakeholders suggested clearer principles that explicitly allow immaterial leases to be disregarded while ensuring materially significant assets (such as land) are recognised.

- **Data collection challenges and maturity:** While some expected that processes and systems would gradually improve over time, the feedback received suggests that, in practice, systems and processes for data collection in the public sector remains immature. Initial implementation was hampered by poor-quality data, particularly for smaller leases such as fleet and IT equipment that were managed outside finance teams. Many agencies continue to face difficulties consolidating this information, often resorting to manual workarounds due to system and funding constraints. As a result, the anticipated benefits of improved governance and visibility have not been fully realised, and stakeholders stressed that data quality remains a significant barrier to effective application of AASB 16.

- **Education, guidance, and systems:** Agencies reported continued reliance on professional bodies for training, and highlighted the need for clearer guidance on exercising professional judgement. System limitations also remain, with many agencies lacking funding for upgrades. Current systems tend to handle property leases adequately but require manual workarounds for other types of leases, increasing cost and effort.

- **Stakeholder needs and future direction:** Participants questioned whether financial reporting for public sector entities is heading in the right direction, suggesting greater focus on service performance information rather than balance sheet-based financial information. Some suggested a stronger focus on reporting future commitments, rather than theoretical cash flow models, to provide more relevant and meaningful information to users.

SECTION 3: IASB REQUEST FOR INFORMATION

We note that the IASB has issued a Request for Information as part of its PIR of IFRS 16, with comments due by 15 October 2025. We are in the process of preparing a separate submission to the IASB, A draft of this submission is below.

We will provide a copy to the AASB once the final version has been submitted to the IASB.

CPA Australia's Response to IFRS16 PIR (Draft)

Question 1(a)

In your view, is IFRS 16 meeting its objective (see page 9) and are its core principles clear? If not, please explain why not

Yes, in relation to Australian listed entities, CPA Australia is of the view that IFRS 16 meets its objectives, and its core principles are clear. Feedback received from the outreach and research activities we have undertaken supports our view. As you will be aware, IFRS Accounting Standards form the basis for financial reporting by all sectors in Australia. Whilst feedback from our commissioned research and outreach has indicated that the objective of IFRS 16 is being met for financial reporting by Australian listed entities, significant concerns have been raised about its suitability for other sectors including the Australian not-for-profit private and public sectors. Given the focus of the IASB is standard-setting for the global capital markets, we have restricted our views in this submission to that segment.

As noted in our cover letter, our above views are underpinned by ongoing commissioned research in collaboration with the University of Melbourne. Research report 1 (**Attachment B**) provides insights into some aspects of the impacts of IFRS 16 on Australian listed entities. We have also gathered additional feedback through our outreach activities as noted in our cover letter.

The standard has also achieved its intended objective of enhancing the usefulness of information for users. However, perceptions of usefulness remain diverse across different stakeholder groups, while some embrace the standard in terms of recognising lease commitments on balance sheets, some stakeholders such as banks and financial analysts seeing it as irrelevant and perform reversing adjustments for their specific decision-making purposes. Further consideration could be given to whether the accounting requirements more closely align with information needs of diverse user groups.

Question 1(b)

In your view, are the overall improvements to the quality and comparability of financial information about leases largely as the IASB expected? If your view is that the overall improvements are significantly lower than expected, please explain why.

Overall, the evidence indicates that IFRS 16 has delivered on its objective of bringing many leases onto the balance sheet and improving quality and comparability. However, concerns remain regarding operational comparability in complex situations and the practical relevance of reported information for key users. We recommend that these issues be considered and addressed following the PIR to further enhance the usefulness of the standard.

CPA Australia commissioned research (**Attachment B**) indicates that IFRS 16 has largely achieved the IASB's objective of improving the quality and comparability of lease information.

Evidence from research:

Analysis of Australian firms from 2019–2024 (**Attachment B**) shows that the principle of lease capitalisation is both widely understood and consistently applied. Adoption rates rose sharply at transition, with 92% of firms recognising lease liabilities in 2020 compared with 42% in 2019. By 2024, 84% of firms continued to recognise lease liabilities across all sizes and industries. Lease liabilities are also economically significant, with the median firm reporting leases equal to 45% of total debt. Recognition levels have remained stable since adoption, suggesting that compliance costs have not deterred ongoing application. Taken together, these findings indicate that IFRS 16 has materially changed reporting practices, enhanced transparency, and strengthened comparability across firms and industries.

Concerns raised in feedback:

While the overall improvements are evident, in our outreach activities, stakeholders identified areas where challenges remain:

- **Comparability challenges:** Many lease accounting systems cannot fully address complexities such as lease modifications, variable payments, subleases, and sale-and-leasebacks. This often results in manual adjustments outside the system, increasing inconsistencies. Differences in system design (lease contract asset management vs. lease accounting) also lead to divergent outcomes, reducing comparability across the market.
- **Relevance for key stakeholders:** Some Australian banks routinely exclude IFRS 16 adjustments when monitoring debt covenant compliance, preferring to focus on future lease commitments. Similarly, many organisations reverse IFRS 16 adjustments in external market communications – for example, reporting EBITDA and cash flows on a pre-IFRS 16 basis for consistency with peers, competitors, and US-GAAP practice. This suggests that while the standard has improved statutory comparability, its decision-usefulness for key stakeholders is reduced in practice, as both preparers and users treat leases as ordinary operating costs rather than financing.

Question 1(c)

In your view, are the overall ongoing costs of applying the requirements and auditing and enforcing their application largely as the IASB expected? If your view is that the overall ongoing costs are significantly higher than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.

In the context of Australian listed entities, CPA Australia commissioned research (**Attachment B**) indicates that the auditing of lease-related requirements under IFRS 16 is not generally associated with unexpectedly high costs. As noted in the sample-based analysis in Research Report 1 of Key Audit Matters (KAM) (refer also to our response to Question 1(a)), leases were identified as a KAM in only 4% of audit reports across Australian listed companies. This suggests that lease accounting is not typically regarded as a significant source of audit complexity or cost. Where lease-related KAMs did arise, they were concentrated in consumer sectors with high exposure to retail premises and primarily related to economic significance or the exercise of professional judgment around matters such as discount rates. Importantly, the review did not reveal unforeseen areas of estimation uncertainty or judgement. These findings support the view that the auditing of financial information arising from IFRS 16 results in satisfactory outcomes overall and the standard is operating as intended and without undue burden.

Whilst the overall feedback has been positive, some concerns and areas for improvement have also been identified, particularly for smaller listed entities. The main concerns raised can be summarised as follows:

- **Contradictions in requirements:** Stakeholders noted that the standard demands highly precise calculations in some areas (e.g., discount rates) while allowing broad judgment in others (e.g., portfolio application). This inconsistency increases ongoing cost without necessarily improving the usefulness of the information.
- **Limited relevance to some users:** Feedback suggested that measurement outputs are often ignored or excluded by banks and internal management, who prefer to focus on future lease commitments or cash flows. Many of the responses we received focused on property leases, questioning whether the complexity and cost of maintaining compliance is justified by the decision-usefulness of the information, particularly for common office leases or multiple small landlord arrangements.
- **Higher relative cost on smaller listed entities:** Larger organisations are generally able to absorb IFRS 16 requirements with access to better systems and resources, while smaller entities face disproportionately high costs. Lease calculations relating to remeasurement are not as reliable with less sophisticated software solutions, forcing more manual intervention, and compliance costs represent a significant proportion of resources relative to firm size.
- **Complexity versus substance:** Some stakeholders have expressed a view that IFRS 16 transforms what are, in practice, straightforward rent payments into a complex series of accounting entries (right-of-use assets, liabilities, interest expenses, and amortisation costs). They view this as detached from the commercial substance of leases, particularly for smaller entities. Moreover, as noted above, banks and internal management often reverse or ignore the adjustments, focusing instead on cash flows. This raises some concern that the ongoing costs of complying with IFRS 16 are higher than anticipated, with some estimating compliance with IFRS 16 drives around 20% of audit fees.

- **Lack of a clear benchmark for costs:** Stakeholders noted that while most preparers agree compliance costs are higher than anticipated, it is difficult to assess whether these costs are truly "excessive" in the absence of a clear benchmark of what ongoing costs were expected to be. This lack of a reference point makes evaluation inconsistent and subjective.

In summary, our commissioned research suggests that from an audit perspective, IFRS 16 has not created greater-than-expected burdens. Nonetheless, stakeholder feedback through our outreach activities highlights genuine concerns about the uneven distribution of costs across different company sizes, the perceived disconnect between accounting complexity and economic reality, and the absence of clear cost benchmarks. We recommend that the IASB consider these issues in the PIR, particularly by:

- evaluating whether additional simplifications or reliefs are warranted for listed SMEs
- assessing whether the accounting requirements could be better aligned with the economic substance of leases in practice
- clarifying expectations about the appropriate level of costs to support consistent evaluation in future reviews.

Question 2(a)

Do you agree that the usefulness of financial information resulting from lessees' application of judgement is largely as the IASB expected? If your view is that lessees' application of judgement has a significant negative effect on the usefulness of financial information, please explain why.

We agree that, overall, the usefulness of financial information resulting from lessees' application of judgement is largely as the IASB expected. The exercise of judgement that results in IFRS 16-based lease accounting information has increased transparency and provided users with a clearer view of financial obligations relating to leases. Our commissioned research also indicates that recognition levels have remained high and stable, suggesting that preparers are exercising judgement consistently, resulting in information that is relevant and faithfully representative.

However, feedback received highlights that perceptions of usefulness vary considerably between different user groups:

- **Divergent stakeholder perspectives:** Some preparers and auditors view the information as burdensome or less relevant to decision-making, whereas others—such as credit rating agencies—value it highly, as it aligns with their long-standing practice of capitalising lease commitments. This suggests that usefulness depends on the stakeholder's perspective and objectives.
- **Banks and internal management:** As noted in our response to Question 1(b), some banks and internal management teams routinely exclude IFRS 16 information, focusing instead on cash flows and future lease commitments. This practice indicates that for certain key users, the usefulness of IFRS 16 arising from information may not be as high as expected.
- **Analysts and transaction-focused users:** Feedback also indicated that analysts often find the information more difficult to reconcile for comparability and valuation purposes, particularly in merger and acquisition scenarios. This adds complexity to their work and may reduce the perceived usefulness of the information.

Question 2(b)

Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.

We agree that, in general, IFRS 16 provides a clear and sufficient basis for entities to exercise appropriate judgement and apply the requirements consistently. Our commissioned research indicates that the principle of lease capitalisation is widely understood and consistently applied across firms, suggesting that the core framework is sound and workable in practice.

Some stakeholder feedback received however highlights that challenges remain in more complex areas of application as set out below:

- **Determination of lease term:** To assist with lease-term determination, stakeholders noted that the relevant IFRIC agenda decision has been relied upon to resolve ambiguities, such as how to define lease term when contracts lack explicit extensions. However, these clarifications are not always easily accessible, being included as separate literature on the IASB website.

  In practice, this has resulted in inconsistent application across entities. For example, there is diversity in the application of lease-term thresholds when assessing whether lease extensions are "reasonably certain." These differences can materially affect reported lease liabilities and ratios such as return on assets, undermining comparability.

  We also understand diversity exists in how retailers assess "reasonably certain" extension options, particularly for long retail leases. Different interpretations can materially affect reported assets, liabilities, and performance ratios, suggesting a need for clearer guidance.
  In short, while IFRS 16 provides a framework for determining lease term, its application remains highly judgemental and resource-intensive, Concerns remains in terms of inconsistent outcomes and limited comparability in practice, particularly for smaller entities. Feedback strongly supports the need for clearer, more integrated guidance and practical examples, particularly for land and building leases, to reduce complexity and ensure the requirements deliver meaningful and useful information.

- **Fragmentation of Guidance and Role of Agenda Decisions:** We note that IFRIC has already issued six separate agenda decisions relating to IFRS 16 since its introduction:
  i. Lease Term and Useful Life of Leasehold Improvements (Nov 2019)
  ii. Definition of a Lease (Dec 2019)
  iii. Sale and Leaseback with Variable Payments (Jun 2020)
  iv. Non-refundable VAT on Lease Payments (Apr 2021)
  v. Lessor Forgiveness of Lease Payments (Oct 2022)
  vi. Definition of a Lease—Substitution Rights (Apr 2023)

  The volume and breadth of these decisions indicate that preparers and auditors frequently encounter interpretative challenges in applying the standard. Relying on agenda decisions as the primary mechanism for clarification risks fragmenting the guidance, creating accessibility issues, and leading to inconsistent application. We therefore recommend that the IASB considers formally incorporating the substance of these agenda decisions into IFRS 16, either as practical expedients or integrated guidance, to improve clarity, consistency, and accessibility.

- **Lease modifications:** Preparers often confuse modifications with remeasurements, particularly for CPI-driven rent resets or umbrella agreements covering multiple assets. For example, some preparers incorrectly apply modification provisions and update discount rates when variable lease payments change, even though these should be treated as remeasurements. This lack of understanding adds unnecessary cost and inconsistency, highlighting the need for clearer guidance and practical examples.

  From an auditing perspective, modification versus remeasurement is also a recurring source of difficulty. This often leads to disagreements between preparers and auditors, giving rise to time and cost pressures. Regulatory issues in the Australian environment further compound the problem. Local legal practice often involves extending leases by amending the original contract rather than creating a new one, with resets every few years. This structure does not align neatly with the accounting requirements of IFRS 16, creating ambiguity in distinguishing between new leases and modifications. Such mismatches increase compliance costs and uncertainty, particularly for mid-sized entities.

  In short, stakeholders viewed the current lease modification requirements as complex and judgement-heavy, creating recurring compliance costs. They emphasised the need for simplification and clearer practical guidance to reduce burden while maintaining transparency.

- **Lease incentives:** We previously raised this matter in our 2019 submission to the IASB, highlighting concerns around the accounting for lease incentives under IFRS 16, particularly in relation to:
  1. whether lease incentives should be excluded from both the right-of-use asset and lease liability, or whether a separate lease incentive liability should be recognised (Issue 1 in our submission), and
  2. whether reimbursements for leasehold improvements should fall within the scope of the definition of lease incentives (Issue 2 in our submission).

  These uncertainties created the potential for inconsistent practices and undermined comparability, as evidenced by divergent interpretations amongst preparers and auditors. In response, the IASB's 2020 Annual Improvements amended Illustrative Example 13 by deleting the reference to leasehold improvements, primarily to avoid confusion. While this action removed a source of inconsistency in the example, it did not substantively address the underlying interpretative questions raised by stakeholders. Accordingly, the treatment of lease incentives continues to lack clarity, and diversity in practice may persist, warranting further consideration as part of the post-implementation review.

- **Low value leases:** Stakeholders noted that materiality remains an unresolved issue, with current exemption thresholds (USD$5,000 noted in the Basis for Conclusions for low value assets) set too low to be meaningful. In practice, these thresholds often capture only minor items such as personal computers, while most lease value is concentrated in a small number of significant contracts (e.g. 20 leases covering around 90% of value of all leases held by the entity). As a result, entities still need to apply lease accounting to numerous low-value items, creating unnecessary burden. Stakeholders suggested clearer principles that explicitly allow immaterial leases to be disregarded while ensuring materially significant assets are recognised.

- **Variable lease payments:** Current requirements prohibit the estimation of variable lease payments linked to consumer price index (CPI) or market rent reviews unless a floor exists. This can exclude substantial obligations from lease liabilities, reducing consistency and making like-for-like comparisons difficult.

Overall, we believe IFRS 16 sets out a sufficiently clear and consistent framework for judgement. However, complex areas, particularly around areas noted above, would benefit from more integrated and transparent guidance incorporated directly within the standard. This would help reduce reliance on a number of Agenda Decisions and promote more consistent application across all entities, including smaller and resource-constrained entities.

Question 2(c)

If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain: (i) what amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or (ii) what additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs)

See our response to Question 2(b) above.

Question 3

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

We acknowledge that overall, IFRS 16 has improved the quality and comparability of lease-related cash flows by requiring greater disclosure.

However, some stakeholders have raised concerns that some of the cash flow-related characteristics of certain leases. In particular, we understand there is inconsistency in how lease payments are classified in the cash flow statement, and the separation of cash flows into operating and financing categories results in useful information for decision-making purposes.

Some stakeholders have also observed that there is no clear distinction of cash flows now between assets that are essentially purchased through debt-financing (finance leases under IAS 17) and assets that are 'rented' for operational requirements (operating leases under IAS 17). From a user perspective, this treatment overcomplicates what is essentially a straightforward cost of doing business.

The IASB may wish to consider developing requirements that provide further clarity around cash flows relating to leases in its project on Cash Flows and Related Matters.

Question 4(a)

Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected? If your view is that the ongoing costs are significantly higher than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.

See our response to Question 1(c) above.

Question 4(b)

If your view is that the ongoing costs are significantly higher than expected, please explain how you propose the IASB reduce these costs without a significant negative effect on the usefulness of financial information about leases.

See our response to Question 1(c) above.

Question 5

Based on your experience with the transition to IFRS 16, would you recommend the IASB does anything differently when developing transition requirements in future standard-setting projects? If so, please explain how your idea would ensure: (a) users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows; and (b) preparers can appropriately reduce their transition costs when implementing new requirements for the first time.

Overall, feedback we have received indicates that the transition approach adopted for IFRS 16 worked well and provided an effective and appropriate balance between providing useful information for users and cost relief for preparers.

- **Transition choices:** The availability of both full retrospective and modified retrospective approaches was also seen as a positive. This allowed flexibility for entities, with most opting for the modified retrospective method, while those seeking greater comparability were still able to apply full retrospective transition.
- **Contextual challenges:** Some stakeholders noted that the onset of COVID-19 coincided with adoption, which diverted resources and meant there were competing and sometimes more important priorities for preparers, which may have led to some treating initial application of the standard as a compliance exercise. The real challenges only emerged later once entities had more capacity to engage with the requirements. It is therefore difficult to isolate whether any transition issues were due to the design of the transition provisions or the unusual circumstances of implementation.

- **Grandfathered contracts:** Additional feedback suggested that issues have since emerged where grandfathered contracts unexpectedly trigger reapplication of IFRS 16 due to subsequent modifications or renegotiations. Even minor changes in long-term contracts can cause material balance sheet impacts, adding significant judgement and complexity when historical data was not captured at transition. Stakeholders recommended that grandfathered contracts remain exempt from reapplication, or that immaterial modifications should not trigger full reassessment, to avoid disproportionate costs.

At this stage, we have not identified any additional suggestions other than the observations above, to assist the IASB in establishing transition provisions for future standards.

Question 6.1(a)

How often have you observed the type of rent concession described in Spotlight 6.1?

Question 6.1(b)

Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

Question 6.1(c)

If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

No further comments.

Question 6.2(a)

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

Question 6.2(b)

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

Question 6.2(c)

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

We have received limited feedback that indicates that sale-and-leaseback transactions are one of the more complex and judgement-heavy areas of IFRS 16, with difficulties in assessing whether transfers qualify as true sales, with diversity in practice leading to inconsistent recognition of gains, losses, and lease liabilities. These inconsistencies, arising in hybrid or partial asset transfers, undermine comparability and reduce the usefulness of reported information. Stakeholders recommended clearer, dedicated guidance within IFRS 16 itself, including criteria for assessing sales, treatment of subsequent modifications, and illustrative examples to improve consistency.
Some of the specific concerns raised include:

- **Whether transfer constitutes a sale:** Stakeholders observed they encountered difficulties frequently in assessing whether a transfer constitutes a true sale, noting IFRS 16 provides limited guidance on this point, leaving them reliant on the 'transfer of control' framework enshrined in IFRS 15. This has created uncertainty, particularly in hybrid or complex transactions (for example, where only part of a building or infrastructure asset is transferred).

- **Diversity in practice and impact:** Some entities conclude transactions are sales, while others treat them as failed sales (transactions that do not qualified as a 'sale' under IFRS 15), leading to inconsistent recognition of gains/losses and ROU assets/lease liabilities. Inconsistent approaches also arise from reassessments where "unit of account" questions are handled differently (e.g., entire asset vs. physically distinct components). This divergence undermines comparability and reduces the usefulness of reported information.

Stakeholders have recommended that the IASB develop clearer, dedicated guidance for sale-and-leaseback accounting, rather than relying on references to IFRS 15 and IFRS 9. Key areas for improvement include:

- Clarifying the criteria for assessing whether a transfer is a true sale or a failed sale, possibly by embedding principles similar to those used in IFRS 3 for valuing asset acquisitions as part of business combinations, which separate different transaction components.
- Providing guidance on how to treat subsequent events or modifications – i.e., whether and when reassessment or modification is required.
- Addressing conceptual inconsistencies between IFRS 15, IFRS 9 and IFRS 16, so preparers are not left unclear on which path to follow for specific fact patterns.
- Developing and providing further illustrative examples, including for partial asset transfers and hybrid arrangements (e.g., one floor of a building), to improve comparability in practice.

Question 6.3(a)

Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information?

Question 6.3(b)

What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ significantly from those expected?

Question 6.3(c)

If your view is that the IASB should improve the cost–benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution.

We have no further comments other than those provided in our response to Question 6.2 above.

Question 6.4

Are there any further matters the IASB should examine as part of the post-implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5

Based on feedback and observations, we suggest the IASB examine the following matters as part of the PIR of IFRS 16. These are some of the areas identified by our stakeholders as more challenging to apply as part of the IFRS 16 requirements:

- **Use of lease liabilities in performance metrics:** As noted in our commissioned research (Attachment B), among Australia's largest lease-intensive firms, most include lease liabilities in Return on Invested Capital (ROIC) calculations. However, a notable minority exclude them, which may lead to inconsistent or potentially misleading performance measures. Whilst we appreciate this would be considered 'non-IFRS' information, the inconsistent approaches taken to presenting IFRS 16-based information as part of financial ratios could have an impact on information presented as management performance measures under IFRS 18.
- **Interest rate implicit in the lease vs incremental borrowing rate (IBR):** Our research indicates that auditing the Standard is not generally associated with high costs (see our response to Question 1(c)). Leases were

identified as a Key Audit Matter (KAM) in only 4% of audit reports for Australian listed companies, concentrated mainly in retail sectors where lease exposures are significant. This suggests that, overall, the auditing of IFRS 16 is functioning as intended and does not impose an undue burden. The primary area where challenges arise is in the determination of discount rates (particularly IBR) which requires significant judgement and is often the focus of audit attention.

Beyond our research findings, stakeholders consistently noted that determining the IBR represents one of the more judgement-intensive aspects of applying the Standard, given that the implicit rate is rarely observable for property leases. Entities therefore default to using the IBR, which requires assumptions about credit risk, lease terms, and financing conditions. While workable, this approach creates variation across entities, as methodologies and inputs differ. Stakeholders also noted that although a portfolio-based approach to discount rates (e.g., using standardised rates for 3-, 7- or 15-year leases) could improve consistency, most systems are not equipped to support this, forcing companies into manual workarounds and increasing inconsistency in practice.

In short, while the Standard has not created widespread auditing challenges, the area of discount rate determination, particularly reliance on the IBR in the absence of practical implicit rates, remains one of the more complex and judgement-heavy aspect of assurance under the standard.

Attachment B

CPA Australia Leases Research Report 1

IFRS 16 *Leases*: A review of implementation and effectiveness

CPA AUSTRALIA

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Executive summary

This report provides an overview of the impact of adopting IFRS 16 Leases (IFRS 16) in Australia. The Australian version of IFRS 16 is AASB 16 Leases (AASB 16). The objective of this report is to assess whether IFRS 16 is achieving its intended goals, when applied by Australian listed companies. The report focusses on three key areas of IFRS 16 implementation in Australia:

a. Lease recognition: The frequency and magnitude of lease liability recognition following the adoption of IFRS 16;

b. Key Audit Matters: The frequency and nature of lease-related Key Audit Matters (KAMs) disclosed in 2024 audit reports; and

c. Management commentary: Whether firms include lease liabilities in the denominator (invested capital) when voluntarily reporting Return on Invested Capital (ROIC) in the management commentary section of annual reports.

Lease recognition

The data show a sharp increase in recognition, with the proportion of firms reporting lease liabilities, rising from 42% prior to IFRS 16 to approximately 90% post-adoption. This widespread recognition and economic materiality suggest that preparers have engaged with and operationalised the principles of IFRS 16. Moreover, the results indicate continued high level of compliance with the standard between 2021 and 2024, providing strong evidence that the standard's ongoing implementation costs are sustainable and in line with expectations.

Key audit matters

In relation to KAMs, leases were identified as a KAM in only four per cent of audit reports across the sample. The small proportion suggests that lease accounting under IFRS 16 is not a significant source of audit complexity or cost.

Management commentary

Finally, in relation to the reporting of ROIC, among the ten largest lease-intensive firms in Australia, 70% included lease liabilities in the ROIC denominator, consistent with the intention of IFRS 16 that leases are a source of funding and financial capital. This signals that many firms consider lease liabilities to be relevant and decision-useful for assessing financial performance, aligning with the objectives of IFRS 16. However, a notable minority (30%) excluded lease liabilities from the ROIC calculation. This practice has the potential to be misleading in relation to performance metrics.

Conclusion

Overall, the evidence presented in this report supports the conclusion that IFRS 16 is achieving its intended objectives. The only area highlighted where further refinement is warranted relates to the treatment of lease liabilities in voluntary performance metrics such as ROIC. Given that ROIC is a key performance indicator used widely by analysts and investors, we recommend that the IASB address this issue through further guidance or educational material in relation to management commentary, or in IFRS 18 and related standards.

Addressing this issue would help ensure that the benefits of IFRS 16 in the primary financial statements are not undermined by selective reporting practices in management commentary.

Background

There are two primary reasons for the University of Melbourne to undertake this current research project with the support of CPA Australia. Firstly, the research seeks to update previous research undertaken to understand impacts of the standard when it was issued. This initial research culminated in two research reports:

- Implementing AASB 16 Leases: are preparers ready?
- AASB 16 Leases: investor perspectives

Secondly, the current research project seeks to gather and present suitable empirical evidence to assist with the post implementation review of IFRS/AASB 16 being undertaken by the IASB/AASB.

This research report sets out findings from a benchmark analysis of listed companies that explores some potential disclosure impacts arising from the standard as described above. In addition to the findings from the benchmark analysis showcased in this report, the research project will also be informed by a series of roundtables to be conducted with various sector-based stakeholders to obtain further evidence of the impacts of the standard and opportunities for improvement. The aim of the research project is to make available further information to the standard-setters and other stakeholders as it becomes available, with a further report to be published in the first half of 2026.

Introduction

The adoption of IFRS 16 *Leases* (IFRS 16) marked a pivotal shift in lease accounting, with the central aim of bringing greater transparency and comparability to financial statements by requiring lessees to recognise almost all leases on the balance sheet. The current International Accounting Standards Board (IASB) post-implementation review (PIR) evaluates the extent to which the standard is meeting these objectives, particularly in relation to its core principles, the informational value it provides to users of financial statements, and the costs incurred in its application, audit, and enforcement.

This report draws on data from Australian listed entities following mandatory adoption of IFRS 16 (AASB 16) and analyses the following focus areas:

- Lease recognition: The frequency and magnitude of lease liability recognition following the adoption of IFRS 16;
- Key Audit Matters: The frequency and nature of lease-related Key Audit Matters (KAMs) disclosed in 2024 audit reports; and
- Management commentary: Whether firms include lease liabilities in the denominator (invested capital) when voluntarily reporting Return on Invested Capital (ROIC) in the management commentary section of annual reports.

In analysing these areas, we aim to address the following three components of Question 1 in the IASB's Request for Information:

a. Whether the core principles of IFRS 16 are clear and are being met in practice;

b. Whether the information provided about leases meets the needs of users; and

c. Whether the costs of applying, auditing, and enforcing the standard are as expected.

These and other findings are expanded on in the remainder of this report which is structured as follows. Section 1 documents the frequency and magnitude of lease liability recognition under IFRS 16 for Australian listed companies. Section 2 documents the frequency and nature of the designation of leases as a Key Audit Matter in the audit reports of Australian listed companies in 2024. Section 3 examines if management, for the purpose of reporting ROIC in the management commentary section of the annual report, include lease liabilities in the calculation of invested capital (i.e., the denominator of ROIC).

Section 1: Frequency and magnitude of lease liability recognition

The core principle of IFRS 16 is that lessees should recognise assets and liabilities arising from leases unless the lease is of low value or short-term. This approach represented a shift from the previous distinction between operating and finance leases under IAS 17 *Leases* (IAS 17), which allowed many lease obligations to remain off-balance sheet. IAS 17 drew a distinction between finance and operating leases, and only required recognition of assets and liabilities arising from finance leases.

To address whether the core principles of IFRS 16 are clear and are being met in practice we analysed the frequency and magnitude of lease liability recognition under IFRS 16 across the period from the year of adoption in 2020 to 2024 for a sample of Australian firms[1] across the following:

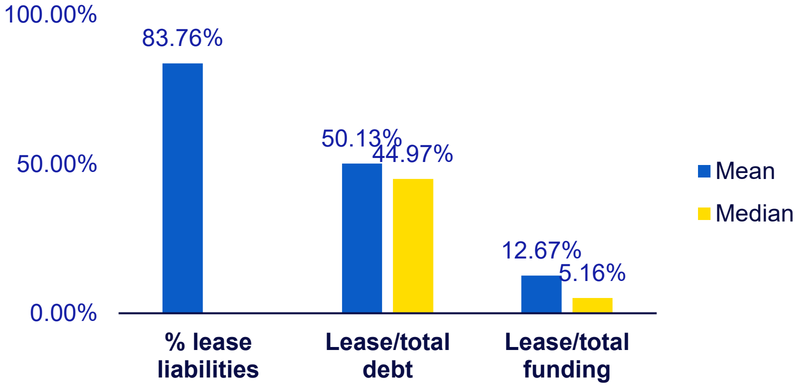
a. the frequency[2] and magnitude of lease liabilities recognised under IFRS 16 in 2024; and

b. yearly time-series of the frequency and magnitude of lease liabilities since the adoption of IFRS 16 in 2020.

Frequency and magnitude of leases liabilities – 2024 results

The following charts present the summary statistics for the sample as at 2024. The data these charts are based on are derived from Table 1 included in Appendix A to this report.

Chart 1 - Frequency and magnitude of lease liabilities recognised by Australia listed companies - full sample



[1] See Appendix D for the sample construction.

[2] The frequency of recognition is simply measured as the number of firms that have recognised a lease liability as a percentage of the total sample of firms. The two metrics we use to assess magnitude are: (1) the value of lease liabilities as a percentage of total debt. Where total debt is the sum of borrowings and lease liabilities. The descriptive statistics for this metric are based on the sample of firms that have debt > 0 and thus is bounded between 0 and 100%, and (2) the value of lease liabilities as percentage of total funding where total funding is total debt plus total shareholder equity.

Chart 2 - Frequency and magnitude of lease liabilities recognised by Australia listed companies - by entity size[3]

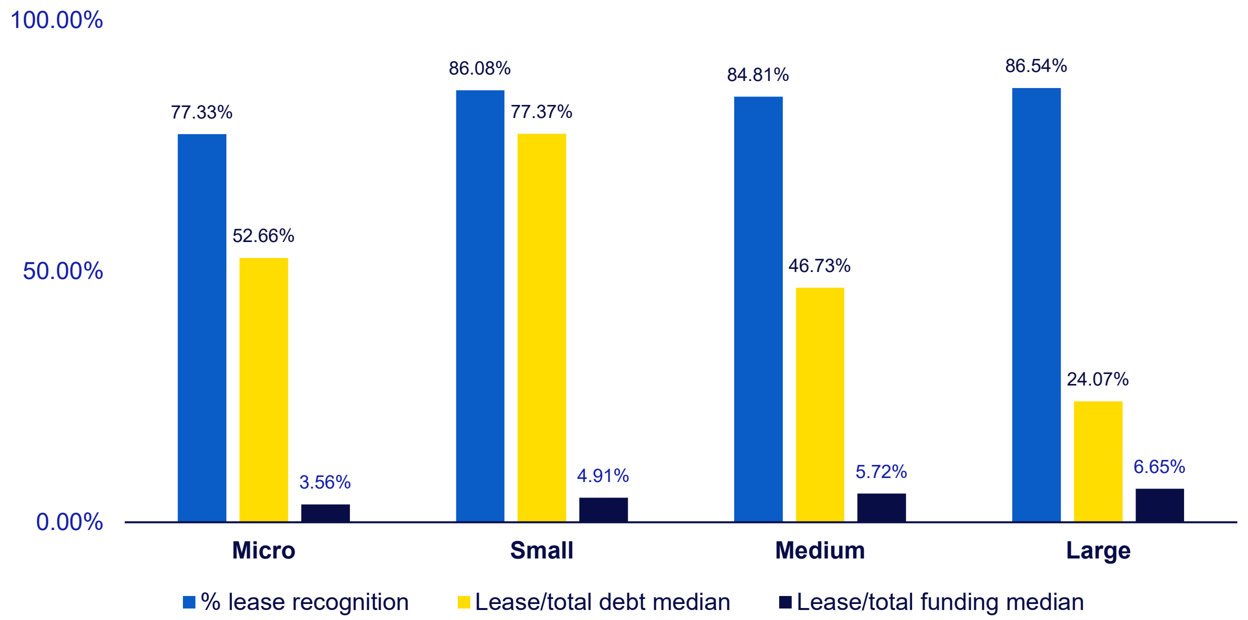
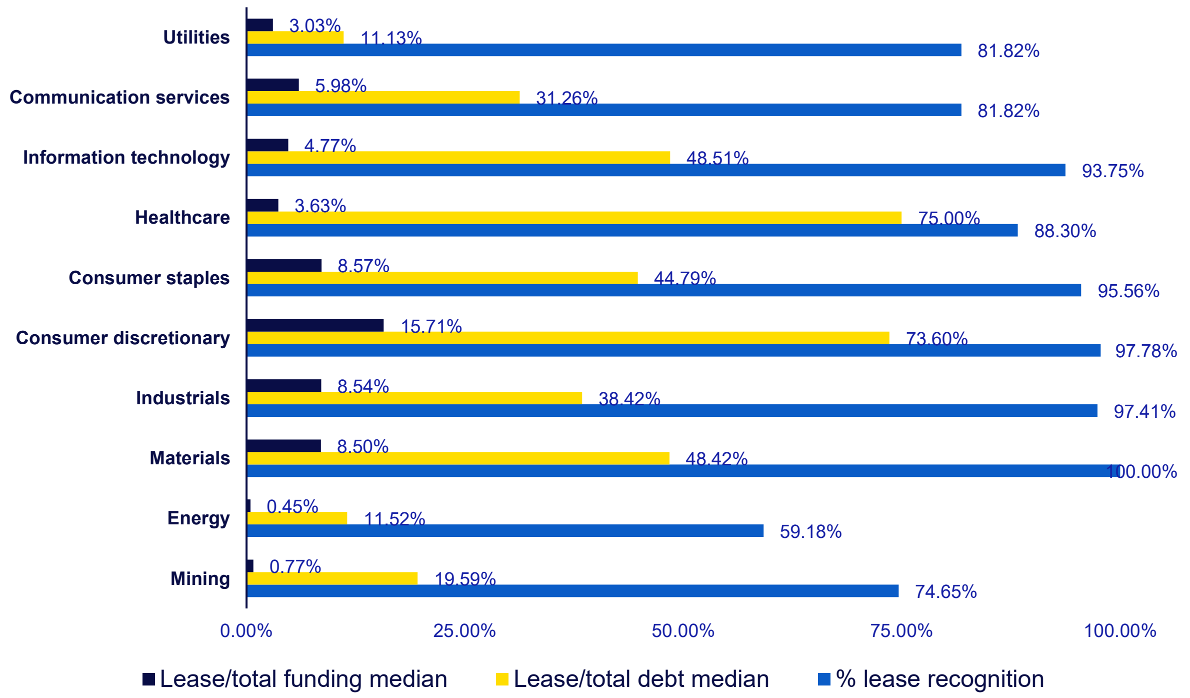


Chart 3 - frequency and magnitude of lease liabilities recognised by Australia listed companies - by sector



[3] Firm size categories, based on total assets, are defined as follows: Micro – less than $23 million; Small – $23 million to less than $102 million; Medium – $102 million to less than $593 million; Large – greater than $593 million.

Our findings strongly suggest that the core principle of IFRS 16, capitalisation of leases, is both widely understood and implemented in practice. By 2024, 84% of firms in our sample recognised lease liabilities (Chart 1 above). Importantly, lease recognition rates were consistent across firm size categories. Even among micro-cap firms, 77% recognised lease liabilities in 2024, and among small to large entities, this figure was 86% (Chart 2 above). All sectors have a high level of lease recognition with the lowest being in the mining (75%) and energy sectors (60%)[4] (Chart 3 above). This widespread application indicates that the principle of capitalisation is understood and applied not only by large entities with sophisticated accounting functions, but also by smaller entities where accounting resources may be more limited.

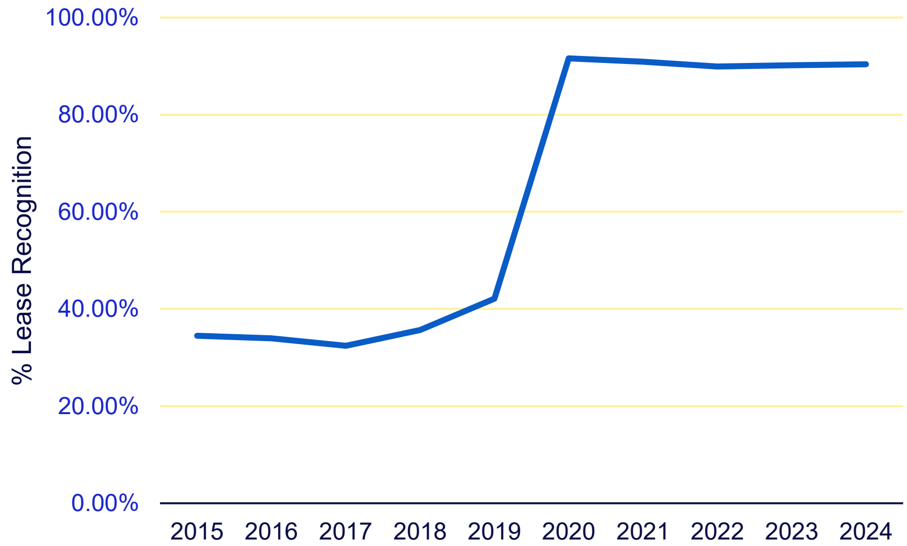
Moreover, the reported lease liabilities were economically material, as demonstrated by the magnitude of lease liabilities as a percentage of total debt for the median firm being 45%[5] (Chart 1 above).

Taken together, these findings support the conclusion that the core principle of lease capitalisation is not only clear but also being broadly applied consistently in practice. IFRS 16 is achieving its objective of bringing leases onto the balance sheet and improving the quality of financial statements.

Changes across time in the frequency and magnitude of lease liabilities

To provide insight into the impact of IFRS 16, we also undertook a time-series analysis of lease liabilities from 2016 to 2024.[6] The results are presented in Table 2 (see Appendix A), and graphically in Figures 1 and 2 below.

Figure 1 – % Lease Liability Recognition

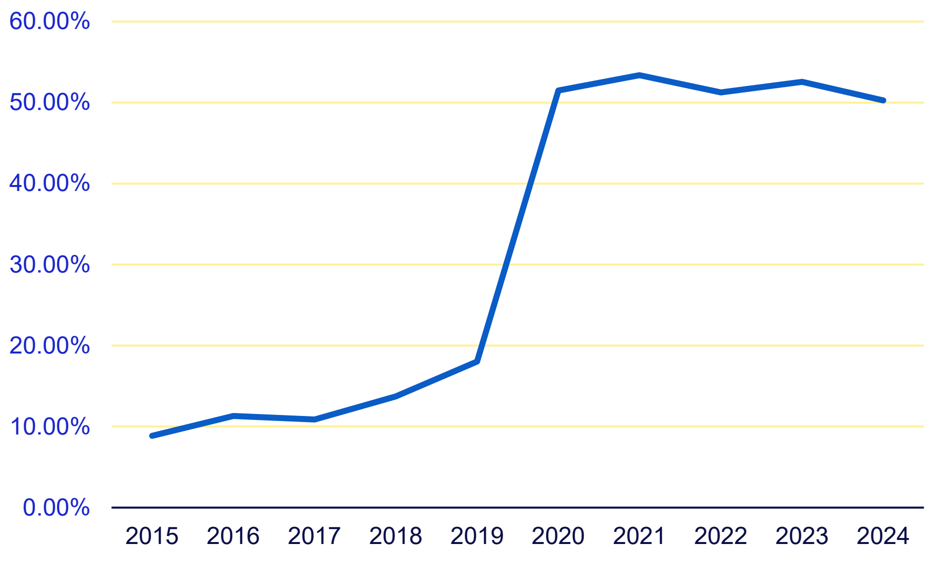


[4] The sector with the greatest level of lease liabilities is the retail sector, where, in Australia, prime locations in shopping centres are typically held by property investors and must be leased rather than purchased.

[5] The *variation* in the magnitude of leases as a % of debt financing is substantial. As reported in Table 1 panel A the 25th (75th percentile) is 14% (97%). This implies that for 25% of firms, leases are the primary or only source of debt financing (>97% of debt financing is from leases) and for another 25% of firms' leases are a very low source of debt financing (<14% of debt financing is from leases).

[6] The analysis is restricted to firms that existed in all years of the sample period. This restriction ensures that observed changes are attributable to the adoption and application of IFRS 16, rather than to firms entering or leaving the listed population due to new listings or delistings. The data are reported by calendar year, based on the financial year-end of each firm. IFRS 16 became mandatory for financial years beginning on or after 1 January 2019. As a result, the calendar year 2020, which includes both 30 June and 31 December year-ends, represents the first full year of adoption for most Australian firms.

Figure 2 – Lease Liability/Total debt



A clear pattern emerges when comparing the year of adoption, 2020, to the preceding year, 2019. The proportion of firms recognising lease liabilities increased significantly from 42% in 2019 to 92% in 2020. In addition to this increase in frequency, there was a material change in the magnitude of reported lease obligations. The average ratio of lease liabilities to total debt rose from 18% in 2019 to 51% in 2020. This shift demonstrates that for the average firm, the capitalisation of leases had a substantial effect on reported leverage. These findings suggest that IFRS 16 impacted a broad cross-section of firms and materially changed the presentation of financial obligations. As such, they provide support for the view that the standard improves both the transparency and comparability of financial information.

Looking at the years following initial adoption, from 2021 through 2024, the percentage of firms recognising lease liabilities remained stable. Similarly, the average ratio of lease liabilities to total debt did not exhibit any material decline. This ongoing consistency suggests that firms have continued to comply with the requirements of IFRS 16 without withdrawing from recognition over time. The absence of any reduction in recognition implies that the costs of applying and complying with IFRS 16 have not deterred firms from ongoing compliance with the Standard nor led firms to alter financing arrangements significantly.

Implications for standard-setting

These findings provide evidence that the ongoing costs of applying IFRS 16 are reasonable and appropriate; broadly consistent with the IASB's expectations. Two factors support this interpretation:

- First, compliance with IFRS 16 does not appear to deter the use of leases by either micro firms or firms for which lease liabilities represent only a small proportion of total debt. This suggests that even firms with limited resources or minimal lease exposure are able to comply with the standard without undue cost or burden.
- Second, the near-universal recognition of lease liabilities implies the presence of substantial scale economies. The widespread use of leases across firms likely facilitates the sharing or adoption of common systems, software, and accounting processes for lease recognition, thereby reducing the per-unit cost of compliance, particularly for property and buildings leases.

In addition, the consistently high level of lease liability recognition, along with the economically significant magnitude of lease liabilities for the typical firm, provides evidence that the information produced under IFRS 16 is materially relevant. This supports the view that the standard meets its objective of improving the faithful representation of financial position and performance by bringing lease obligations onto the balance sheet.

Finally, the significant variation in the extent to which firms use leases as a source of debt financing indicates that IFRS 16 contributes meaningfully to improving the comparability of financial information. By requiring the recognition of lease liabilities, IFRS 16 enables users to better assess and compare the total level of financial leverage and associated risk across different firms and industries.

Section 2: The frequency and nature of lease-related Key Audit Matters

The shift to on-balance sheet lease accounting was expected to improve the ability of users, especially investors, analysts, and creditors, to assess leverage, capital efficiency, and cash flow commitments. In this section of the report, we examine the frequency and nature of the designation of leases as a Key Audit Matter (KAM) in the audit reports of Australian listed companies.[7]

Audit reports offer a unique lens through which to observe the relative complexity and judgement involved in applying IFRS 16. Auditor's reports of listed entities in Australia are required to provide information about key audit matters (KAM). KAM are "those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period".[8] The audit report is required to include a description of each key audit matter that addresses why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter. This is the "Why Significant" section of the audit report.[9]

As KAMs are relative, if the costs and complexities of accounting for and auditing leases are larger than expected we should find an abnormal frequency of leases identified as a KAM. Furthermore, if the costs are larger than expected, the designated reasons for the KAM in the "Why Significant" section of the audit report should be for underlying reasons of judgment and uncertainty that were not expected.

Out of the full sample, only 4% of firms (17 companies) had an audit report in which leases were identified as a KAM subject matter. These firms are listed in Table 3 included in Appendix A. Across all firms, there were 955 individual KAMs reported in total; of these, only 17, or 2%, had leases as the subject matter. This makes lease-related KAMs relatively rare. The full list of KAM subject matters and their frequency is reported in Table 3 in Appendix A.

The results also showed a concentration for KAMs in certain sectors. Fifteen of the 17 firms with lease-related KAMs were in the consumer staples or consumer discretionary sectors. This may reflect the

[7] We sampled the full population of Australian listed entities (excluding mining, real estate and banking firms) with reporting periods ending in 2024. We categorised and classified the KAMs into subject matters based on the primary financial statement account that it related to (e.g., revenue, inventory, provisions, intangibles, leases). The details of the sample selection and methodology for classification of the KAMs is discussed in Appendix E. Overall, we have a final sample of 529 firms. We have classified 29 distinct KAM subject matters. As each audit report may have more than one KAM we have a total of 955 KAMs.

[8] ASA 701.8 *Communicating Key Audit Matters in the Independent Auditor's Report.* For audits of financial statements for periods ending on or after 15 *December 2016,* auditor's reports of all listed entities in Australia have been required to provide information about key audit matters.

[9] ASA 701.13. A full extract of an audit report with a lease as KAM is provided for illustrative purposes in Appendix B.

higher prevalence of leased assets in retail and franchise-heavy industries, where physical premises and equipment are commonly leased.

Taken together, these findings suggest that leases are not frequently regarded as a high-risk area requiring special audit focus. As such, there is no evidence from audit frequency that the cost and complexity of auditing lease-related disclosures under IFRS 16 has been greater than expected.

Additional analysis

To explore the audit rationale for identifying leases as a KAM, we reviewed the "Why Significant" sections of the audit reports for all 17 firms. (See extracts in Appendix C). The rationale provided by auditors typically centred on two factors: the economic significance of lease liabilities, both in volume and value, and the requirement for management to make key judgments and estimates. Among the 17 firms, the most commonly cited area of audit judgment was the determination of the incremental borrowing rate used to discount future lease payments. Other areas, though less frequently mentioned, included the accounting treatment of backdated rent variations, the assessment of renewal options contained within leases, and the handling of sub-lease arrangements, particularly in franchise models.

Overall, the review of audit report disclosures did not identify any unexpected sources of estimation uncertainty or judgment that would suggest IFRS 16 presents unforeseen challenges in practice. The findings provide further support for the conclusion that the auditing of IFRS 16 lease obligations is operating as intended and without undue burden.

Section 3: Computation of ROIC reported in management commentary

This section examines how companies treat lease liabilities when calculating Return on Invested Capital (ROIC) in the management commentary section of their annual reports. ROIC is widely regarded as a key performance measure for assessing the efficiency of capital use and value creation. The analysis focuses on whether lease liabilities recognised under IFRS 16 are incorporated into the denominator of ROIC, which reflects the total invested capital.

ROIC is a voluntary reported metric and, therefore, reflects the demand and needs of users. ROIC as following examples illustrate, is the most widely used metric to measure performance and productivity and thus the amount of value a company creates.[10]

> *"Underlying return on capital employed is an indicator of the Group's capital efficiency" (BHP, 2024, p18.)*
>
> *"ROC has been adopted as the principal measure of performance for the divisions. ROC focuses the divisions on increasing earnings and/or increasing capital productivity by managing existing assets efficiently" (Wesfarmers 2024 Annual Report, p.16)*

[10] At a conceptual level the definition of ROIC is:

$$ROIC = \frac{Profit}{Invested\ Capital}$$

> *"Underlying ROCE measures how efficiently we generate profits from investment in our portfolio of assets" (RIO Tinto, 2024, p.12)*

We examine if firms include or exclude lease liabilities in their definition of Debt for purposes of computing *Invested Capital* and *ROIC*. It is expected that lease liabilities would be included in the calculation as the objective of ROIC is to measure the returns on all capital invested in the business.

As outlined in the below Table4, the findings indicate that a significant majority, 70% of the sampled companies, include lease liabilities in the denominator of ROIC. This finding suggests that most firms consider lease liabilities to represent a meaningful component of financial capital. Their inclusion in invested capital supports a more accurate and reliable assessment of financial performance and capital efficiency, in line with the broader objectives of IFRS 16.

Table 4 – Australian companies examined to determine if leases included in computation of ROIC[11]

Company	Total Assets ($m)	Leases Liabilities ($m)	Lease liabilities / Total Funds	Lease included in ROIC?
Woolworths Group Limited	33,936	12,144	54.48%	Yes
Coles Group Limited	19,870	8,417	61.50%	Yes
Wesfarmers Limited	27,309	6,522	32.83%	No
Ramsay Health Care Limited	20,894	5,854	35.55%	No
Endeavour Group Limited	11,783	3,913	39.76%	Yes
BHP Group Limited*	102,362	3,116	4.46%	Yes
TPG Telecom Limited	19,094	2,205	12.62%	Yes
Woodside Energy Group Ltd	61,264	1,623	3.40%	Yes
Qantas Airways Limited	20,564	1,556	22.60%	Yes
Sonic Healthcare Limited	14,826	1,527	12.13%	No

*Numbers quoted are in US Dollars

However, a notable minority, 30% of the sample, exclude lease liabilities from their ROIC calculations. This practice raises concerns regarding the comparability and reliability of ROIC as a performance metric across firms. When lease liabilities are excluded, ROIC figures may be overstated, potentially presenting a distorted view of how efficiently a company uses its capital.

This inconsistency suggests that, while IFRS 16 has significantly improved the quality of financial statements, the effectiveness of lease information in management commentary and voluntary

[11] The information in Table 4 has been extracted from the publicly available 2024 Annual Reports

performance metrics remains uneven. The divergence points to a possible gap in guidance under IFRS 18 and IFRS Practice Statement 1. In particular, paragraph 121 of IFRS 18 requires management performance measures to faithfully represent financial performance, which may not be achieved when lease liabilities are selectively excluded from capital-based metrics.

To address this issue, we suggest that the IASB explore available educational avenues, such as through IFRS Practice Statement 1 *Management Commentary* (revised), or other educational material to provide clearer guidance on the appropriate treatment of lease liabilities in performance metrics disclosed in management commentary.

The issue is not limited to the consideration of IFRS 16, however. It also intersects directly with the reporting of management-defined performance measures and disclosures related to capital, as outlined in IFRS 18 *Presentation and Disclosure in Financial Statements* which becomes effective in Australia for annual reporting periods beginning on or after 1 January 2027.[12] Arguably, the exclusion of lease liabilities from invested capital in ROIC calculations may conflict with the objectives of IFRS 18. Specifically, such reporting may not provide users with an unbiased, representative, and faithfully presented view of a firm's financial performance.

Given the significance of ROIC to financial analysis and investor decision-making, we recommend that the IASB consider this issue as part of the post-implementation review of IFRS 18, if not addressed earlier.

We conclude that IFRS 16 is fulfilling its intended objective of improving information quality in the primary financial statements. Nonetheless, there is room for improvement in ensuring that this enhanced transparency is carried through to performance reporting in management commentary.

Conclusions and policy recommendations

The evidence presented in this report supports the conclusion that IFRS 16 has largely achieved its objectives. The requirement to recognise leases on the balance sheet has led to greater transparency and comparability in financial statements and has proven to be well-understood and applicable across a diverse range of entities. Auditors and preparers appear to be managing the judgements and estimates inherent in the standard without undue difficulty.

At the same time, our findings point to opportunities for improvement, particularly in the alignment of voluntary performance metrics with the principles of IFRS 16. Inconsistencies in the treatment of lease liabilities in metrics such as ROIC, despite their materiality, may undermine the comparability and reliability of management commentary. This is an area where further guidance or educational material in relation to management commentary, or in IFRS 18 and related standards would be beneficial.

Overall, we recommend that the IASB maintain the current scope and core principles of IFRS 16, which are being effectively applied in practice and provide additional guidance or examples to encourage the faithful representation of leases in management-defined metrics.

These measures would help ensure the full benefits of IFRS 16, going beyond the balance sheet to improve transparency, consistency and usefulness of financial reporting.

[12] See paragraphs 117–123 and 126–129.

Appendix A

TABLE SUMMARY

Table 1 – Frequency and magnitude of lease liabilities recognised by Australian Listed Companies in 2024

Panel A Full Sample

	Observations	P25	Mean	Median	P75
% Lease Liabilities	622		83.76%		
Lease/ Total Debt	562	13.51%	50.13%	44.97%	96.66%
Lease/ Total Funding	622	1.06%	12.67%	5.16%	14.94%

Panel B By Firm size

			Lease/ Total Debt			Lease/ Total Funding		
Size Category	Observations	Lease Recognition (%)	P25	Median	P75	P25	Median	P75
Micro	150	77.33%	11.70%	52.66%	100.00%	0.26%	3.56%	12.85%
Small	158	86.08%	19.58%	77.37%	100.00%	1.01%	4.91%	16.93%
Medium	158	84.81%	17.37%	46.73%	97.14%	1.25%	5.72%	14.77%
Large	156	86.54%	10.46%	24.07%	53.10%	2.14%	6.65%	15.55%

Panel C By Sector

		Lease/ Total Debt			Lease/ Total Funding		
GICS Sector	**Lease Recognition (%)**	**P25**	**Median**	**P75**	**P25**	**Median**	**P75**
Mining	74.65%	3.80%	19.59%	89.78%	0.02%	0.77%	4.06%
Energy	59.18%	0.00%	11.52%	35.52%	0.00%	0.45%	2.35%
Materials	100.00%	14.75%	48.42%	73.94%	4.47%	8.50%	13.98%
Industrials	97.41%	15.43%	38.42%	84.89%	3.57%	8.54%	16.95%
Consumer Discretionary	97.78%	36.83%	73.60%	98.29%	5.88%	15.71%	39.31%
Consumer Staples	95.56%	14.59%	44.79%	72.62%	2.14%	8.57%	21.31%
Health Care	88.30%	19.31%	75.00%	100.00%	1.30%	3.63%	12.83%
Information Technology	93.75%	16.45%	48.51%	100.00%	1.93%	4.77%	10.70%
Communication Services	81.82%	12.48%	31.26%	84.36%	1.49%	5.98%	14.99%
Utilities	81.82%	0.96%	11.13%	62.10%	0.36%	3.03%	8.25%
Mining	74.65%	3.80%	19.59%	89.78%	0.02%	0.77%	4.06%

%Lease Recognition is the % of the total sample of firms that recognize lease liabilities
Total Debt is Borrowings plus Lease Liabilities
Total Funding is Shareholders Equity plus Total Debt
P25 and P75 are the observations at the 25th and 75th percentile of the distribution. They imply that 25% of the sampled firms lie below (above) the 25th (75th) percentile observation respectively.
The sample is all Australian listed companies in 2024 excluding companies in the mining, finance and real-estate sectors.

Table 2 – Lease liability recognition across time

		Lease/ Total Debt	
Year	**Lease Recognition (%)**	**Mean**	**Median**
2015	34.52%	8.86%	0.00%
2016	33.98%	11.33%	0.00%
2017	32.42%	10.87%	0.00%
2018	35.69%	13.73%	0.00%
2019	42.09%	18.01%	0.10%
2020	91.60%	51.49%	49.87%
2021	90.89%	53.37%	50.40%
2022	89.95%	51.26%	45.72%
2023	90.21%	52.54%	46.55%
2024	90.36%	50.26%	44.88%

% Lease Recognition is the % of the total sample of firms that recognize lease liabilities
The sample is Australian listed companies that existed for the years from 2019 to 2024.

Table 3 – Frequency of KAMS by subject matter for Australian companies in 2024

KAM Subject Matter	Lease Recognition (%)	Median
Impairment	261	27.33%
Revenue	229	23.98%
Inventory	67	7.02%
Business Combinations	59	6.18%
Financial Instruments	48	5.03%
Intangibles	43	4.50%
Share Based Payment	38	3.98%
Going Concern	33	3.46%
Taxation	32	3.35%
Provisions	22	2.30%
PPE	19	1.99%
Leases	17	1.78%
Discontinued Operation	15	1.57%
Deferred Tax Asset	12	1.26%
Account Receivable	9	0.94%
Information Technology	8	0.84%
Equity Method	6	0.63%
Exploration Assets	6	0.63%
Biological Assets	5	0.52%
Contingent Liabilities	5	0.52%
Investment Property	5	0.52%
Expenses	4	0.42%
Related Party Transactions	4	0.42%
Cash	2	0.21%
R&D	2	0.21%
Grant	1	0.10%
Joint Venture	1	0.10%
Management Fee	1	0.10%
Trade Payables	1	0.10%
Total	**955**	**100.00%**

Appendix B

ILLUSTRATIVE AUDIT REPORT WHEN LEASES WERE DESIGNATED AS A KAM

Independent Auditor's Report
to the members of JB Hi-Fi Limited[13]

[…]

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial report for the current period. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[…]

Key Audit Matter	How the scope of our audit responded to the Key Audit Matter
Lease accounting **Refer to Note 16 of Right of use assets and lease liabilities** The Group holds right of use assets of $568.3 million and lease liabilities of $642.4 million. These balances are significant in the context of the Group's balance sheet as at 30 June 2024. In applying AASB 16 Leases, the Group is required to make a number of judgments and estimates as disclosed in Note 16, including: • Measuring the lease term (including judgements associated with lease renewal options and the accounting for leases in hold over). • Determining an appropriate incremental borrowing rate to be applied in the measurement of right of use assets and lease liabilities upon initial recognition of a lease and for certain lease modifications.	Our audit procedures included the following: • Understanding the Group's processes and key controls related to the accounting for leases. • Testing on a sample basis, movements in the right of use assets and lease liabilities and recalculating the interest and depreciation recognised in profit or loss. • Evaluating the judgements applied by management, including the probability of exercising renewal options. • Assessing the incremental borrowing rates adopted by management, by preparing an independent expectation of the incremental borrowing rates. • Evaluating the adequacy of the disclosures included in Note 16 to the financial statements.

[13] As extracted in the independent auditor's report of JB HI-FI Annual Report 2024

Appendix C

EXTRACTS FROM THE "WHY SIGNIFICANT" SECTION OF AUDIT REPORTS, WHEN LEASES WERE DESIGNATED AS A KEY AUDIT MATTER

XREALITY GROUP LIMITED

Right of use asset and lease liability

The group performed a reassessment of the calculations for the right-of-use asset and lease liabilities due to the flow on effect of higher sustained inflation and the impact on future rent increases. The right-of-use assets and lease liability calculations involves a degree of complexity and judgement around potential rent increases based on inflation. We considered in the persistent inflationary environment reviewing the right-of-use asset and lease calculations are a key audit matter due to the significant uncertainty around the current period of economic volatility. The value of the right-of use assets also forms part of our impairment assessment described above

JB HI-FI LIMITED

Lease accounting

The Group holds right of use assets of $568.3 million and lease liabilities of $642.4 million. These balances are significant in the context of the Group's balance sheet as at 30 June 2024. In applying AASB 16 Leases, the Group is required to make a number of judgments and estimates as disclosed in Note 16, including:

Measuring the lease term (including judgements associated with lease renewal options and the accounting for leases in hold over).

Determining an appropriate incremental borrowing rate to be applied in the measurement of right of use assets and lease liabilities upon initial recognition of a lease and for certain lease modifications.

SILK LOGISTICS HOLDINGS LIMITED

Assessment of Lease term and incremental borrowing rate under AASB 16 Leases

As at 30 June 2024 the Group has reported right of use assets of $283.7 million ($142.8 million at 25 June 2023) relating to property related leases. The estimated lease term of these properties and the incremental borrowing rate forms part of the assessment for determining the right of use asset and associated lease liability at the time of initial recognition. The accounting policy and the significant estimates and judgements in relation to determining the lease term are disclosed in Notes 2 and 3. In reassessing the lease term, the Group is required to determine whether there are significant events under their control which result in renewal options being required to be incorporated into the assessment. Where lease terms have been reassessed, the Group is required to determine an appropriate incremental borrowing rate to be applied in the calculation of right of use assets and lease liabilities.

GUZMAN Y GOMEZ LIMITED

Lease

The Group has a significant lease portfolio which includes leases for restaurant sites as well as office and other leases. As set out in Notes 15, 17 & 21 to the financial statements, at 30 June 2024 the Group has recognised lease liabilities of $239.5m, finance lease receivables of $126.4m and right-of-use assets of $93.8m. There were additions of $65.5m to lease liabilities, $24.3m to finance lease receivables and $36.9m to right-of-use assets during the year. Included in the lease portfolio are leases which are entered into for franchise restaurants with the Group as the head lessee, and sub-leases entered into with the franchisees under the same terms as the head lease. Where the sub-lease transfers substantially all of the risks and rewards of the underlying right-of-use asset, the sub-lease is classified as a finance lease and is recognised as a finance lease receivable. Alternatively, other sub-leases are classified as operating leases and recognised as right-of-use assets. For lease additions and modifications during the year, the Group applied significant judgement in determining the incremental borrowing rate {IBR}, including the calculation method, appropriate data utilised, and the determination of the lease term with extension options.

PREMIER INVESTMENTS LIMITED

Accounting for leases

The Group holds a significant volume of leases by number and value over retail sites as a lessee. The recognition and measurement of new and remeasured lease agreements executed during the year in accordance with AASB 16 Leases ("AASB 16") are dependent on a number of key judgements and estimates. These include:

The calculation of incremental borrowing rates;

The treatment of the option to extend the lease term under holdover; and

The impact of backdated rent variations.

Accordingly, given the significant judgements and estimates involved we considered this a key audit matter.

VIVA LEISURE LIMITED

Right Of Use Assets and Lease Liabilities

At 30 June 2024, the group recognized $255,307,160 in Right of Use Asset and $290,225,494 in lease liabilities. The group has numerous lease arrangements in place which requires certain judgments to be made at point of recognition and measurement. We focused on this area as a key audit matter given the significance of the balance and there is risk that the leases may not be accounted for in accordance with the requirements of AASB 16 Leases.

CARLY HOLDINGS LIMITED

Lease accounting

As at 30 June 2023, the Group has recognised a current lease liability of $346,770 and a non-current lease liability of $640,550 in relation to an office lease and vehicle leases. We determined lease accounting to be a key audit matter as it is material, important to the users' understanding of the financial statements and involved the most audit effort and communication with management.

RETAIL FOOD GROUP LIMITED

Lease accounting - estimate of lease arrears and assessment of recoverability of lease receivables ($61.7m)

The Group has a significant lease portfolio that includes sub-lease arrangements with franchisees where the Group has entered into the head lease agreement with the landlord. Where the franchise store sub-lease is assessed by the Group as a finance lease using AASB 16 Leases, the Group recognise a finance lease receivable. Following this, the impairment requirements of AASB 9 Financial Instruments apply to the net investment in these leases. The Group determined their expected loss provisioning amounts using a forward-looking expected credit loss impairment model. This involves significant judgement as the expected credit loss reflects information about past, current and future conditions. Overall, the relative size of balances has a significant financial impact on the Group's financial position and performance. We involved our senior audit team members in assessing this key audit matter

CHRYSOS CORPORATION LIMITED

PhotonAssay operating lease income

PhotonAssay operating lease income was a key audit matter due to:

The quantum of operating lease income earned during the year, which comprised 92% of total revenue and other income.

The judgement required in applying revenue recognition and lease accounting standards to the PhotonAssay leases.

To classify each lease the Group applies judgement to assess whether the agreements transfer substantially all the risks and rewards of ownership of the underlying PhotonAssay assets. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. Significant judgement is required to determine the lease term. Consideration is given to the non-cancellable periods and early cancellation penalties contained in the leasing arrangements. In assessing this key audit matter, we involved senior audit team members who understand the Group's business and industry.

INGHAMS GROUP LIMITED

Accounting for AASB 16 Leases – (right of use assets and lease liabilities amounting to $1,031.7 million and $1,138.4 million respectively)

AASB 16 Leases (“AASB 16”) is complex with specific lease-features driving different accounting outcomes, increasing the need for interpretation and judgement. AASB 16 Leases is a key audit matter due to the:

Relative materiality of the right of use assets and lease liabilities to the financial report.

Number of leases in the Group, including the individual nature of the lease agreements used to estimate the lease liability and right of-use asset.

A focus for us was the accuracy of multiple and varied inputs which may drive different accounting outcomes, including key dates, fixed and variable rent payments, renewal options and incentives. The key areas of judgement we focussed on was in assessing the Group’s:

Renewal options contained within leases. Assessing the Group’s determination of whether it is reasonably certain renewal options will be exercised impacts the measurement of the lease, therefore is critical to the accuracy of the accounting.

Grower contractual arrangements and the features of the underlying grower contracts against the definition of a lease under the accounting standards.

Incremental borrowing rates determined by the Group. These are meant to reflect the Group’s entity specific credit risk and vary based on each lease term. We involved our senior audit team members in assessing these areas

SONIC HEALTHCARE LIMITED

Lease accounting

Lease accounting was a key audit matter due to the:

financial significance of lease liabilities and right-of-use assets to the consolidated balance sheet; and

significant judgements required by the Group such as determining the lease term and the incremental borrowing rate

UNIVERSAL STORE HOLDINGS LIMITED

Accounting for leases

Accounting for leases was a key audit matter due to the size of right-of-use assets and lease liability balances included in the financial report and the judgement involved in determining the balances, including the incremental borrowing rate used for discounting, accounting for leases in holdover and treatment of lease incentives and modifications.

BAPCOR LIMITED

Accounting for leases

At 30 June 2024, the Group recorded right of use assets of $249.9 million and a lease liability of $288.6 million. Accounting for leases was a key audit matter due to the financial significance of right-of-use assets and lease liability balances and the judgement involved in determining these balances, including the incremental borrowing rate and option renewals.

BIOXYNE LIMITED

Accounting for leases

The Group has significant lease arrangements. AASB 16 Leases, has introduced new complexities in lease accounting, requiring significant management judgment and estimation. This includes determining the lease term, discount rates, and the classification of leases as either operating or finance leases. Given the material impact on the financial statements and the complexity involved, accounting for leases was identified as a key audit matter

ALTERRA LIMITED

Leases

The Group has continued to recognise right-of-use assets and lease liabilities in relation to its lease arrangements over office premises and Carpenters plantation site. The majority of the right-of-use asset and lease liability recorded relates to the long-term Carpenters lease. Accounting for leases is a key audit matter as the balances recorded are material and there are significant judgements involved in determining the appropriate lease payments necessary to be used in the calculation of the lease liability and right-of-use asset

OOH MEDIA LIMITED

Lease Accounting

The accounting requirements of MSB 16 Leases are inherently complex, where specific and individualised lease-features drive different accounting outcomes, increasing the need for interpretation and judgement. This increases our audit effort and is a key audit matter. We focused on:

High volume of leases - the Group has a high volume of individualised lease agreements required to be assessed in determining the lease liability and right-of-use asset. A focus for us was the completeness of the lease population and the accuracy of multiple and varied inputs which may drive different accounting outcomes, including key terms of the lease agreements, such as key dates, fixed rent payments, renewal options and incentives.

Complex modelling process - the Group developed a lease calculation model, which is largely manual and complex, and therefore is at greater risk for potential error and inconsistent application.

Relative magnitude - the size of balances has a significant financial impact on the Group's financial position and performance.

The most significant areas of judgement we focused on were in assessing the Group's:

Incremental borrowing rates used - these reflect the Group's entity specific credit risk and vary based on each lease term. The Group periodically engages an external expert to assist with determining each of the Group's incremental borrowing rates.

Lease terms where leases have renewal options - assessing the Group's judgement of whether it is reasonably certain renewal options will be exercised impacts the measurement of the lease, therefore is important to the accuracy of the accounting. We involved our senior audit team members in assessing these areas

COLLINS FOODS LIMITED

Accounting for Leases

The Group applies Australian Accounting Standard AASB 16 Leases in accounting for the Group’s portfolio of restaurant leases. As a result, Right-of-use assets and Lease liabilities are recognised in the balance sheet. We considered this a key audit matter given the financial significance of the related balances in the Group’s balance sheet and the critical judgements used in determining the lease term assumptions in the lease calculations, as well as the significant amount of audit effort in auditing the balances.

Appendix D

SAMPLE CONSTRUCTION FOR DESCRIPTIVE STATISTICS IN REGARD TO FREQUENCY AND MAGNITUDE OF LEASE LIABILITES

The starting population is all Australian listed entities over the period from 2016 to 2024. We removed entities missing data on total assets, total revenue, shareholders' equity, net statutory income, or a GICS sector. We also removed entities in the GICS Sectors: financials (GICS #40), real estate (GICS #60) and mining (GICS Industry 151040). Finally, we removed entities with totals assets less than $5 million.

The finance and real estate sectors were removed both because of their fundamental different business models to the typical firm (e.g. REITS and exchange traded funds) and the nature of the accounting is different. The mining sector was removed because of the predominance of Metals and Mining entities in the Australian economy

The size cutoffs in total assets are as follows. Micro (< $m23); Small (>$m23 and < $m101); Medium (>$101m and < $593m) and Large (> $m593).

Appendix E

METHODOLOGY FOR CLASSIFICATION OF KEY AUDIT MATTER SUBJECT MATTER

We classified the KAMs into subject matters based on the following three broad decision rules:

- First, if the subject matter was not an impairment and related to a specific primary financial statement account (e.g., revenue, receivables, inventory, provisions, leases) then that account was the category.
- Second, we had categories for any subject matter that related to impairments, and business combinations. The impairment category includes impairments regarding all assets.
- Finally, we had a range of subject matters that were relevant to the audit that may not directly affect a specific financial statement account (e.g., information technology, due to implementation of enterprise resource systems).

Attachment C

CPA Australia Public Sector CFO Roundtable
IFRS 16 *Leases*

Introduction

This report provides a summary of the CPA Australia Chief Financial Officers (CFO) roundtable held in Canberra on the implementation and impact of AASB 16 *Leases* across the Australian public sector. The roundtable brought together senior finance executives, CFOs from Commonwealth agencies and technical accounting experts to discuss the implementation of AASB 16 *Leases* in the context of the current ITC 55 released by the AASB. For consistency, the discussion in this report is structured under the topic headings identified in ITC 55 (Topics 1–7). Not all topics were discussed at the roundtable; accordingly, this report does not include sections for Topics 3 and 6 that were not discussed at the roundtable.

Topic 1: Application of AASB 16 by NFP and public sector entities

Key points

- **Misalignment with public sector operations and accountabilities:** AASB 16 is primarily designed for private sector use and does not align with the budget-driven accountability and operational realities of government agencies.
- **Lack of stakeholder interest:** Detailed lease disclosures and balance sheet recognition have not increased engagement from Ministers, parliamentary committees, or the public.
- **High complexity and cost:** Implementation and ongoing compliance are resource-intensive, requiring significant staffing, niche expertise, contract reviews and often external advisors.
- **Data and system challenges:** Many agencies and departments apply fragmented systems with reliance on spreadsheets and external workarounds.

Misalignment with Public Sector Operations and Accountabilities

Participants expressed significant concerns that AASB 16 has created a misalignment between the standard's objectives and the operational realities of public sector entities. The core principle of recognising lease assets on the balance sheet, while relevant to the private sector, was seen as much less relevant in the public sector.

Fundamentally, participants noted that public sector accountability is budget-driven, rather than balance-sheet-driven. Oversight bodies do not focus on the balance sheet, but on accountability for the spending of taxpayer funds: whether agencies spend within appropriations, achieve value for money and deliver services as intended. Many participants noted that AASB 16 forces recognition of assets and liabilities irrelevant to this accountability framework, creating a parallel set of numbers that need to be reconciled back to the budgetary view. Within agencies, executives rely on internal management reports that translate financial information back into budget terms, effectively undoing the adjustments required by AASB 16.

Participants noted that, because the funding of government agencies is primarily determined by government budget allocations, policy decisions and legislative frameworks, balance sheet measures have little influence on operational continuity or financing. In the public sector, the concept of "going concern" was described as a matter of political and policy decisions rather than financial viability.

Lack of Stakeholder Interest

Participants consistently expressed the view that the expanded lease disclosures and balance sheet recognition have not led to increased engagement or inquiries from their primary stakeholders, including parliamentary committees, ministers or the general public. Participants noted that the lack of user interest raises fundamental questions about the cost-benefit balance of implementing such a complex standard in the public sector context. Many participants noted that they had never been questioned about lease-related balance sheet items in high-level forums such as Senate estimates hearings.

The prevailing view of participants was that the complex accounting treatments required under AASB 16 were adding little value to the understanding of government spending. Concerns were expressed that the AASB 16 lease accounting model may be obscuring rather than clarifying the financial impact of leases for non-expert users of financial statements. Participants suggested that it has become more difficult for 'lay users' to understand the actual annual spending on leases, as the information is now spread across various parts of the financial statements, and requires significant accounting expertise to interpret. Many participants highlighted that the financial statements are already underutilised in government, suggesting that AASB 16 risks making financial reports even less accessible to non-specialists.

Some participants commented that balance sheet adjustments can misrepresent an agency's financial position, suggesting leverage or indebtedness where none exists. Obfuscation at a whole-of-government level also arises because of substantial inter-agency lease arrangements.

There was some acknowledgement that cataloguing leases provided agencies with a clearer view of commitments. Examples were provided of improvements to the scope of department and agency office and housing lease portfolios, as well as improvements to data quality**.** However, participants agreed this outcome could have been achieved more simply through enhanced disclosure of commitments, without adopting complex recognition rules.

High Complexity and Cost

Implementing and maintaining compliance with AASB 16 was identified as costing millions across agencies and departments (e.g., one department cited $3m+). It was noted by some participants that these costs were not anticipated in their appropriation and therefore required reallocation from service delivery. Challenges included the niche expertise required, extensive contract reviews to identify embedded leases and ongoing staffing for compliance. Several large agencies now employ multiple staff solely for lease accounting and reconciliation, and some agencies and departments rely on external advisors annually. Many participants noted that the standard has created permanent compliance costs with minimal practical utility.

There was a strong feeling that the focus on technical compliance with complex standards is distracting from more meaningful financial management and reporting activities that could better serve the public interest. A broader concern was also raised that this focus on technical compliance more generally could reduce the attractiveness of public sector accounting as a career path, potentially leading to a skills gap in the future.

Data And System Challenges

The roundtable discussion revealed significant challenges related to data management, systems integration and information flow in the implementation of AASB 16 for public sector entities. Most participants reported that their lease accounting solutions were not fully integrated with their Enterprise Resource Planning (ERP) systems. Agencies frequently resorted to using spreadsheets or standalone models, especially for non-property leases. This fragmentation of systems was reported to create duplication of effort and inefficiencies in data management and reporting processes.

Data quality was identified as a recurring problem, with property teams and business units often unaware of the accounting implications of their actions. Participants noted that operational teams frequently enter leases without appreciating the accounting requirements, leading to incomplete or inaccurate data being passed to finance. A key issue identified was the lack of understanding among those entering lease data about the model calculations that would be performed, leading to potential data quality issues. To address this, some agencies have moved towards a centralised model, with dedicated staff in central offices responsible for data entry to ensure quality. However, participants expressed frustration at having to invest resources in managing a reporting requirement rather than addressing more pressing operational risks, viewing it as a compliance exercise rather than a value-adding activity.

Topic 2: Determining The Lease Term

Key points

- **Judgement and subjectivity:** The requirement to exercise judgement in determining whether it is "reasonably certain" that lease extension options introduced a high degree of subjectivity.
- **Application of “Until Further Notice” agreements:** Difficulties are encountered in determining appropriate lease terms for arrangements that do not have a fixed end date, such as ongoing agreements with other government entities.
- **Need for additional guidance:** Public sector specific guidance on the determination of lease terms was seen as an area for improvement.

Judgement and Subjectivity

A primary concern expressed by participants was the high degree of judgement and subjectivity required in determining lease terms under AASB 16. The standard requires entities to consider all relevant facts and circumstances that create an economic incentive to exercise (or not exercise) extension options. The subjectivity has introduced challenges regarding consistency and added to audit costs as disagreements and inconsistencies across agencies are addressed.

Application of "Until Further Notice" Agreements

A particular challenge highlighted by several participants was the treatment of "until further notice" arrangements, which are common in inter-departmental and other public sector leasing scenarios. It was noted that although these forms of leases are common in government operations, as they allow flexibility and continuity of service; however, they are not specifically contemplated by the AASB 16 model, which leaves preparers with uncertainty in application. Similarly, the 12-month short-term lease exemption often fails in practice due to extension options and was not considered useful.

Need for additional guidance

Participants highlighted lease terms as one of the most challenging and problematic areas of the standard, with far-reaching implications for financial reporting, audit relationships and operational decision-making. There were calls for clearer, more prescriptive guidance on lease term determination in the public sector context. Participants suggested that illustrative examples specific to common public sector scenarios would help promote consistency and reduce audit disputes.

Topic 4: Incremental Borrowing Rate

Potential Simplification to Reduce Complexity

Participants expressed that the incremental borrowing rate (IBR) is an element that adds complexity to lease calculations without necessarily adding value in the public sector context. Although participants noted that the Department of Finance provides rates quarterly for agencies to use, which simplifies the process to some extent, the calculations remain complicated. Some participants viewed the IBR as arbitrary in the public sector context, suggesting the use of the government bond rate as a simpler alternative.

Topic 5: NFP Public Sector Concessionary Leases

Key points

- **Exemptions:** The current exemption from fair valuing concessionary leases should be made permanent.
- **Cost of Fair Value Assessments:** The sector already incurs a high cost to conduct fair value assessments across government.

Exemptions

There was strong support to retain the concessionary lease exemption on a permanent basis. Participants warned that requiring fair value would add cost and complexity without benefit to stakeholders. Participants highlighted the practical difficulties with fair valuing concessionary leases, particularly for unique or heritage properties. The lack of observable market data for many concessionary leases was seen as a major obstacle to reliable valuation. Notably, participants reported little to no stakeholder interest in detailed information about concessionary leases. The view was that current disclosures are sufficient for accountability purposes.

Cost of Fair Value Assessments

Participants noted the high costs associated with making fair value assessments in the public sector context. This prompted the questioning of whether fair value accounting generally adds value in the public sector. For example, valuing specialised assets was described as a hugely expensive exercise with no practical outcome. Extending fair value requirements to concessionary leases was expected to exacerbate this problem.

Topic 7: Other Matters

The need for guidance

Throughout the roundtable discussion, a recurring theme emerged regarding the need for more guidance on implementing AASB 16 in the public sector context. Participants consistently highlighted the challenges they faced in interpreting and applying the standard, which was primarily designed with private sector entities in mind. This lack of sector-specific guidance has led to inconsistencies in application, increased audit tensions, and a general sense of frustration among public sector finance professionals. Participants were keen to see more illustrative examples that reflect common public sector scenarios, covering areas such as embedded leases in service arrangements, modifications to complex government contracts and the treatment of subleases between government entities.

Materiality

Guidance on applying materiality concepts in the context of AASB 16 for public sector entities would be highly beneficial. Many participants noted that they were hesitant to apply materiality judgements due to potential audit disputes. Clear guidelines on how materiality should be considered in relation to lease accounting, particularly for entities with large volumes of relatively small leases, would help streamline the implementation process and focus efforts on significant items. Problematically, the practical expedient of the US$5,000 “low-value lease” exemption was seen as not useful. Disturbingly, in some cases, this threshold was being treated as a “ceiling” rather than a “floor” for materiality purposes.