

IFRS INTERPRETATIONS COMMITTEE
POTENTIAL AGENDA ITEM REQUEST

I. Subject

IFRS 16 ‘**Example 6A**’ illustrates a voyage charter which the number of the loading port (Rotterdam) and the discharging port (Sydney) is each determined to be one. However, in the shipping industry, there are many cases with multiple loading ports (or discharging ports) under voyage charter, a typical business model. This request addresses whether the customer has the right to direct the use of the ship in accordance with IFRS 16 in the case above.

II. Background

- Customer has entered into a contract to purchase raw material (“the Coal”) of the same type with the sellers in three different regions (“X”, “Y” and “Z”). The purchase quantity of each contract is determined throughout the contract period.

At the same time, Customer has entered into a voyage charter contract for a five-year period with the ship owner (“Supplier”) to deliver the Coal to region “S”. Also, the loading quantity of each voyage is 100 tons (full cargo capacity of the ship).

Purchase regions	Type of cargo	Purchase quantity per year	Purchase price per ton(Coal)
X	Coal	<i>1,000 tons</i>	USD 100
Y	Coal	<i>700 tons</i>	USD 110
Z	Coal	<i>300 tons</i>	USD 120
Total		<i>2,000 tons</i>	

- The timing of each voyage is not predetermined in the contract, but the contract requires that the ship should depart for shipping as soon as the loading or discharging is complete. Customer does not have a right to change the timing of the voyage.
- In order to execute the Coal purchase contracts, Customer and Supplier have predetermined the loading port to “X”, “Y” and “Z”, and the discharging port to “S” for voyage charter contract. Also, Supplier holds a protective right not to sail in a war or war-risk place.
- Considering the Coal purchase contract, Customer establishes annual and quarterly cargo shipment plan, designates the location of shipment of cargo for each voyage, and notifies Supplier. Then, Supplier provides a shipment service, which is loading cargo from the loading port (“X”, “Y” or “Z”) and discharging cargo at the discharging port (“S”) for each voyage based on the notified shipment plan.

- Detailed information of loading ports, discharging port, delivery distance and freight of the above contracts are as follows:

Type of cargo	Loading port	Discharging port	Shipment distance (period) per voyage (※)	Freight per ton
Coal	X	S	1,500Km (15 days)	USD 15
	Y	S	2,000Km (20 days)	USD 20
	Z	S	2,500Km (25 days)	USD 25

(※) In general, in the shipping industry, shipment distance and shipment period are directly correlated with each port.

- Annual shipment plan (the number of voyages, total shipment quantity, total shipment distance and total freight for each year) are as follows:

Voyage	Number of voyages per year(※)	Total shipment quantity per year	Total shipment distance (period) per year	Total Freight per year
X → S	10	1,000 tons	15,000Km (150 days)	USD 15,000
Y → S	7	700 tons	14,000Km (140 days)	USD 14,000
Z → S	3	300 tons	7,500Km (75 days)	USD 7,500
Total	20	2,000 tons	36,500Km (365 days)	USD 36,500

(※) The order of voyages can be changed, but the number of voyages and their gross shipment quantities do not change.

- Excluding those described above, other factual information and relationship of rights and obligations are the same as in IFRS 16 'Example 6A'. In brief;
 - There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.
 - Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship.
 - Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract. Also, Customer did not design the asset (the ship).

III. Issue

In this case, does Customer have the right to control the use of the ship in accordance with IFRS 16?

● Views

View 1: Customer does have the right to control the use of the ship

- As illustrated in IFRS 16 'Example 6A', in order for the contractual rights related to how and for what purpose the asset is used to be predetermined, Customer shall not have any rights to change the how and for what purpose the asset is used during the period of use.
- In this case, within the scope of contractual constraint condition, Customer can designate a loading port ("X", "Y" or "Z") to each voyage throughout the period of use. Therefore, it is fair to consider Customer has the right to change how and for what purpose the asset is used.

IFRS 16	Reference
B25	A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

View 2: Customer does not have the right to control the use of the ship

- The loading port being determined to be a single port is a simple illustrative example in IFRS 16 'Example 6A'. In the case of the voyage charter contract above, how and for what purpose the asset is used is predetermined which is consistent with IFRS 16 'Example 6A' as three loading ports are specifically predetermined under the contract and cannot be changed to other ports.

- Not like the 'Example 6B' illustrated in IFRS 16, Customer does not have a right to freely determine the port within the scope of right to use excluding contractual protective rights (world-wide ports excluding war or war-risk place). Therefore, Customer is not entitled to change how and for what purpose the asset is used.

- As illustrated in IFRS 16.B29, an entity shall not consider decisions that are predetermined before the period of use. Accordingly, Customer's action of establishing cargo shipment plan, designating the loading port for each voyage within the scope of predetermined condition (location, quantity, timing, etc.) and notifying this to Supplier in order to execute the Coal purchase contract is not a right to change 'how and for what purpose the asset is used'. In other words, it is analogous to an action of individuals simply implementing decisions made by a board of directors as described in IFRS 16 BC120.

- In shipping industry, a typical 'Voyage Charter' which is a contract between a shipowner and a charterer to provide the services of a ship for voyages to carry cargo between agreed loading and discharging ports generally have not been considered contain a lease in accordance with IAS 17 and IFRIC 4 paragraph 9. Therefore, this case is difficult to be classified as a contract that contains a lease when applying new IFRS 16. (IFRS 16 BC274, IFRS16 BC289)

IFRS 16 – Reference	
B29	In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in paragraph B24(b)(ii). Consequently, unless the conditions in paragraph B24(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.
BC30	A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.

IFRS 16 – Reference	
BC120	<p>In the IASB’s view, the decisions about how and for what purpose an asset is used are more important in determining control of the use of an asset than other decisions to be made about use, including decisions about operating and maintaining the asset. This is because decisions about how and for what purpose an asset is used determine how, and what, economic benefits are derived from use. How and for what purpose an asset is used is a single concept, ie ‘how’ an asset is used is not assessed separately from ‘for what purpose’ an asset is used. Decisions regarding operating an asset are generally about implementing the decisions about how and for what purpose an asset is used and are dependent upon (and subordinate to) those decisions. For example, a supplier’s operational decisions would have no effect on the economic benefits derived from use of an asset if the customer decides that the asset should not be used. In addition, if the supplier makes decisions about operating or maintaining an underlying asset, it often does so to protect its interest in that asset. The IASB observed that considering decisions about how and for what purpose an asset is used can be viewed as similar to considering the decisions made by a board of directors when assessing control of the entity. Decisions made by a board of directors about the operating and financing activities of an entity are generally the decisions that matter in that control assessment, rather than the actions of individuals in implementing those decisions.</p>
BC274	<p>Preparers provided feedback that it could be costly for them to reassess all of their existing contracts using the definition of a lease requirements in IFRS 16. The IASB observed that it envisages only a limited number of scenarios in which application of the lease definition requirements in IFRIC 4 would result in a different outcome from the application of the lease definition guidance in IFRS 16. The IASB identified a small population of contracts that would be classified as leases applying IFRIC 4 but as service contracts applying IFRS 16, and none for which the converse is expected to be true. The IASB expects that the consequence of an entity not reassessing its existing contracts applying the lease definition requirements in IFRS 16 would be the recognition of slightly more leases on transition to IFRS 16 than would otherwise be the case. On this basis, the IASB concluded that the costs of requiring entities to reassess existing contracts applying the lease definition guidance in IFRS 16 would not be justified.</p>
BC289	<p>The lessor accounting requirements in IFRS 16 are substantially unchanged from those in IAS 17. Consequently, the IASB decided that a lessor is not required to make any adjustments on transition and should account for its leases applying IFRS 16 from the date of initial application (except for intermediate lessors in a sublease - see paragraphs BC290 - BC291).</p>

Reasons for the IFRS IC to address the issue:

a) Is the issue widespread and has, or is expected to have, a material effect on those affected?

- Yes. Voyage charter contract is the most commonly used form of charter party in shipping industry. This is a contract between a shipowner and a charterer to provide the services of a ship for voyages to carry cargo between agreed loading and discharging ports. Voyage charter contracts in which multiple number of ports are predetermined are widely used in the shipping industry (especially in Korea, Taiwan, China, Japan, North America for stable long-term cargo delivery).

If this voyage charter contract does contain a lease, Customer and Supplier will have the following effects:

If this voyage charter contract does contain a finance lease, the sales, depreciation, and operating profit of numerous Suppliers in the world that provide shipment service by the contract will sharply decrease, and instead, non-operating profit (interest income) will increase due to collection of receivables.

Even if this voyage charter contract does contain an operating lease, the revenue structure of Supplier will be classified as rental income instead of revenue for shipment service. Furthermore, most of the major contracts (Voyage charter, Time charter, Bare Boat Charter) in the shipping industry will be classified as a lease, resulting in excessive disclosure requirements in relation to leases.

If this voyage charter contract does contain a lease, at the commencement date, Customer shall recognize a right-of-use asset and a lease liability.

b) Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

- Yes. Global shipping companies would apply IFRS 16 standards consistently in accounting for voyage charter contracts, increasing comparability.

c) Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?

- Yes. It can be resolved efficiently as the issue is related to the interpretation of B25, B29, BC30, BC120, BC274 and BC289 when applying IFRS 16.

d) Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process?

- Yes. We have specified the issues to be the interpretation of 'Predetermined' in IFRS 16 'Example 6A'.

e) Will the solution developed by the Interpretations Committee be effective for a reasonable time period?

- Yes. The issue does not relate to any of current or planned IASB projects.