

STAFF PAPER

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Project	Definition of a Lease—Shipping Contract (IFRS 16)		
Paper topic	Initial Consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about whether a particular shipping contract contains a lease applying IFRS 16 *Leases*.
2. The objective of this paper is to:
 - (a) provide the Committee with a summary of the matter;
 - (b) present our research and analysis; and
 - (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
 - (a) background information (paragraphs 5–7);
 - (b) outreach (paragraph 8);
 - (c) staff analysis (paragraphs 9–35); and
 - (d) staff recommendation (paragraphs 36–38).

4. There are three appendices to this paper:
 - (a) Appendix A—proposed wording of the tentative agenda decision.
 - (b) Appendix B—submission.
 - (c) Appendix C—excerpt from IFRS 16 (paragraph B31).

Background information

5. We have reproduced the main facts we considered in our analysis, based on the fact pattern described in the submission together with responses from the submitter to questions about the fact pattern:
 - (a) the customer enters into a contract with a ship owner (supplier) for the use of a ship for a five-year period to transport coal to region ‘S’. The ship is explicitly specified in the contract and the supplier does not have substitution rights. The ship is therefore an identified asset as described in IFRS 16.
 - (b) the customer has exclusive use of the ship throughout the five-year period of use—the customer therefore has the right to obtain substantially all the economic benefits from use of the ship throughout that period.
 - (c) the ship will be used to transport coal for the customer from three different regions, X, Y and Z based on the customer’s coal purchase agreements with external suppliers in those regions. The customer has agreed to purchase a fixed quantity of coal per year from each region, which cannot be changed throughout the five-year period.
 - (d) the shipping contract specifies:
 - (i) the loading quantity of the ship per voyage (ie the capacity of the ship of 100 tons);
 - (ii) a consecutive voyage condition (ie continuous shipment except for ship inspection and repairs);
 - (iii) the three types of voyage: X to S; Y to S; and Z to S;

- (iv) the shipment distance and duration per type of voyage; and
 - (v) the price per ton of coal transported per type of voyage.
- (e) during the period of use, the customer determines annual and quarterly shipment plans. The customer has the right to determine the order of voyages throughout the period of use (ie to determine from where the ship sails for each voyage). In doing so, the customer is required to adhere to the terms of the shipping contract that require the continuous shipment of 100 tons coal during the period of use.
- (f) the supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship (for example, the supplier has the right not to sail in war-risk areas). The customer is prohibited from hiring another operator for the ship during the period of use.
- (g) the customer did not design the ship or any specific aspects of it.
6. The submitter asks whether, applying IFRS 16, the customer has the right to direct the use of the ship throughout the period of use. In the fact pattern submitted, if the customer has that right to direct the use, then the contract contains a lease.
7. Appendix B to this paper reproduces the submission and outlines two views as to whether the customer has the right to direct the use of the ship throughout the period of use.

Outreach

8. We decided not to perform outreach on this submission for a number of reasons:
- (a) The shipping industry engaged extensively with the Board during the development of IFRS 16. Information from the industry helped the Board develop Illustrative Examples 6A and 6B accompanying IFRS 16—those examples illustrate the application of the definition of a lease requirements to shipping contracts. Because of that engagement, we concluded that we already have sufficient information about the main types of shipping contracts to be able to perform our analysis of the fact pattern described in

the submission. We are also aware that contracts similar to the one described in the submission are common in a number of jurisdictions, including Korea, Japan, Norway and Singapore.

- (b) On receiving the submission, we contacted organisations that represent the shipping industry. We informed them of the question received and that we would welcome any input that they might have in advance of the Committee’s discussion.

Staff analysis—does the contract contain a lease?

The requirements in IFRS 16

- 9. Appendix A to IFRS 16 defines a lease as ‘a contract, or part of a contract, that conveys to the right to use an asset (the underlying asset) for a period of time in exchange for consideration’.
- 10. Applying paragraph 9 of IFRS 16, an entity assesses whether a contract is, or contains, a lease at contract inception. Paragraph 9 states:
 - A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.
- 11. Paragraphs B9–B31 set out application guidance on the definition of a lease.
- 12. Paragraph B9 states:
 - To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs B13–B20) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
 - (a) the right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs B21–B23); and

(b) the right to direct the use of the identified asset (as described in paragraphs B24–B30).

13. Although an entity would assess all aspects of the definition and related requirements when assessing whether a contract contains a lease, in this case the submitter’s question is about only one aspect—the right to direct the use of the ship throughout the five-year period of the contract. This is because, in the fact pattern described in the submission, it has already been determined that:

- (a) the ship is an identified asset. The ship is explicitly specified in the contract and the supplier does not have the right to substitute the specified ship (paragraphs B13–B14 of IFRS 16); and
- (b) the customer has the right to obtain substantially all the economic benefits from use of the ship throughout the five-year period of use. This is because the customer has exclusive use of the ship throughout that period (paragraph B21 of IFRS 16).

Right to direct the use of the identified asset

14. Paragraph B24 of IFRS 16 states:

A customer has the right to direct the use of an identified asset throughout the period of use only if either:

- (a) the customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs B25–B30); or
- (b) the relevant decisions about how and for what purpose the asset is used are predetermined and:
 - (i) the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
 - (ii) the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what

purpose the asset will be used throughout the period of use.

15. Applying paragraph B24 and the steps in the flowchart in paragraph B31 (see Appendix C to this paper), the customer first assesses whether it or the supplier has the right to direct how and for what purpose the asset is used throughout the period of use. The customer makes this assessment applying paragraphs B25–B30. If neither party to the contract has the right to direct how and for what purpose the asset is used throughout the period of use, then the customer would apply paragraph B24(b)—in that case, how and for what purpose the asset is used has been predetermined.

16. Paragraph B25 explains the right to direct how and for what purpose the asset is used:

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.

17. Accordingly, in determining whether it has the right to direct how and for what purpose the ship is used, the customer considers whether it has the right to *change* how and for what purpose the ship is used during the five-year period of use.

18. Paragraph BC120 explains why the Board considered decisions about how and for what purpose an asset is used as important in determining which party controls the use of the identified asset. Paragraph BC120 states:

In the [Board]’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...

19. Paragraph B26 includes examples of such decision-making rights:

Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:

(a) rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from retail space);

(b) rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);

(c) rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used); and

(d) rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

Decisions determined before the period of use

20. Decisions that are predetermined and cannot be changed during the period of use do not affect the assessment of whether the customer or supplier has the right to direct the use of an asset (unless those decisions relate to the design of the asset).

Paragraph B29 states:

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 service.

21. Paragraph B29 explains that if the customer's rights relate only to specifying the output of an asset before the period of use (and thus it has *no* ability to change how and for what purpose the asset is used during that period), then it has the same rights as any customer that purchases goods or services—and thus the contract would not contain a lease. However, in contrast (and as required by paragraph B25), if the customer has any ability to change how and for what purpose the asset is used throughout the period of use, then it has rights beyond those of a customer purchasing goods or services and consequently has the right to direct the use of the asset.
22. In the fact pattern described in the submission, the customer did not design the ship (or any specific aspects of it). Consequently, the customer does not consider decisions that are predetermined (and cannot be changed) when assessing whether it or the supplier has the right to direct the use of the ship.

Applying the requirements on the right to direct the use to the fact pattern described in the submission

23. The terms and conditions of the shipping contract are such that the some of the decisions about how and for what purpose the ship is used are predetermined, but not all. For example, the contract specifies that, throughout the period of use:
 - (a) the ship can be used only to transport coal from three particular regions (X, Y and Z) to one destination (S);

- (b) the ship transports 100 tons of coal on each voyage; and
 - (c) the voyages must be scheduled to run continuously.
24. Nonetheless, within the scope of its right of use specified in the contract, the customer has the right to determine the order of voyages throughout the period of use (ie the customer has the right to determine from where the ship transports coal for each voyage and, thereby, determines the exact timing of each shipment). The customer's right to determine from where the ship transports coal is a decision-making right about how and for what purpose the ship is used—in other words, that right affects the economic benefits to be derived from using the ship (paragraph B25). The customer retains that right so that it is able to maximise the economic benefits it derives from use of the ship throughout the period of use.
25. Alternatively, if the customer were to give up that right (and, for example, predetermine within the contract the timing and order of all voyages throughout the five-year period of use without any ability to change the order of voyages), such a change to the terms and conditions would affect the economic benefits to be derived from use—it would allow the customer no flexibility, for example, to deal with situations in which a coal supplier is unable to deliver 100 tons of coal to X, Y or Z as scheduled in the contract¹.
26. In addition, the examples of decision-making rights in paragraph B26 (see paragraph 19 of this paper) include 'rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship...)'. In our view, the customer's right to determine the order of voyages is a right to change where the output of the asset (in this case, the ship) is produced—ie it gives the customer the right to decide upon the starting point for the ship for each voyage. Therefore, that decision-making right grants the customer the right to change how and for what purpose the ship is used throughout the period of use. It is only when all relevant

¹ We note that the submitter explained that if a coal supplier were to notify the customer that it would be unable to deliver 100 tons of coal to, say, port X within a particular timeframe, the customer would then determine the quarterly or annual shipment plan to avoid shipments from port X in that timeframe and, to the extent possible, arrange shipments from ports Y or Z.

decision-making rights about how and for what purpose an asset is used are predetermined that an entity would consider the requirements in paragraph B24(b). If the customer retains any such decision-making rights (with all others being predetermined), then the customer has the right to direct the use of the asset.

27. Consequently, within the scope of its right of use, we conclude that the customer has the right to change how and for what purpose the ship is used throughout the five-year period of use because of its right to determine from where the ship transports coal for each voyage throughout the period of use. Accordingly, applying paragraphs B24–B30 the customer has the right to direct the use of the ship throughout that period of use.

Operation and maintenance decision-making rights

28. Paragraph B27 explains how an entity considers operation and maintenance decision-making rights when assessing the right to direct how and for what purpose an asset is used. Paragraph B27 states:

Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph B24(b)(i)).

29. Paragraph B120 explains the Board’s rationale in this respect:

...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...

30. Although the operation and maintenance of the ship are essential to its efficient use, the supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, the supplier's decisions are dependent upon the customer's decisions about how and for what purpose the ship is used. Therefore, applying paragraph B27, the supplier's operation and maintenance of the ship throughout the period of use does not affect the assessment of whether the customer has the right to direct the use of the ship.

Protective Rights

31. Paragraph B30 addresses protective rights:

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... 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.

32. The supplier's right not to sail in war-risk areas is a protective right—it protects the supplier's investment in the ship, the supplier's personnel and may also be required to ensure compliance with laws and regulations. Accordingly, the contractual restrictions regarding where the ship can sail define the scope of the customer's right to use the ship. Those decision-making rights do not affect the assessment of whether the customer has the right to direct the use of the ship.

Staff Conclusion

33. The customer has the right to direct the use of the ship (an identified asset) throughout the five-year period of use, and thus the contract contains a lease. This is because:
- (a) the ship is an identified asset. The ship is explicitly specified in the contract, and the supplier does not have the right to substitute the ship.
 - (b) the customer has the right to control the use of the ship throughout the five-year period of use because:
 - (i) the customer has the right to obtain substantially all the economic benefits from use of the ship throughout the five-year period of use. The customer has exclusive use of the ship throughout that period.
 - (ii) the customer has the right to direct the use of the ship because the conditions in paragraph B24(a) exist. The contractual restrictions specifying the destination of each voyage, the overall number of voyages and what the ship transports define the scope of the customer’s right to use the ship. Within the scope of its right of use, the customer makes the relevant decisions about how and for what purpose the ship is used because it decides from where the ship sails for each voyage throughout that period. The customer has the right to change those decisions throughout the five-year period of use.
34. Although the operation and maintenance of the ship are essential to its efficient use, the supplier’s decisions in this regard do not give it the right to direct how and for what purpose the ship is used.

Question 1 for the Committee

Does the Committee agree with our analysis of the application of IFRS 16 summarised in paragraphs 33–34 of this paper?

Should the Committee add this matter to its standard-setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?²

35. Based on our analysis, we think the requirements in IFRS 16 provide an adequate basis for an entity to determine whether the shipping contract described in the submission contains a lease.

Staff recommendation

36. Based on our assessment of the Committee’s agenda criteria in paragraphs 5.16–5.17 of the Due Process Handbook (discussed in paragraph 35 of this paper), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend that the Committee publish an agenda decision that explains, more generally, how an entity applies the requirements in IFRS 16 on the right to direct how and for what purpose an asset is used.
37. We recommend this approach, rather than addressing the very specific fact pattern submitted. This is because we think it would be most helpful to stakeholders in obtaining a common understanding of how the requirements in IFRS 16 apply, particularly in situations in which some decisions about how and for what purpose an asset is used are predetermined whilst others are not.
38. Appendix A sets out the proposed wording of the tentative agenda decision.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

² Paragraph 5.16(b) of the *Due Process Handbook*

Appendix A—proposed wording of the tentative agenda decision**Definition of a lease—shipping contract (IFRS 16)**

The Committee received a request about whether the customer has the right to direct the use of a ship through the five-year term of a particular shipping contract. In the fact pattern described in the request:

- (a) there is an identified asset (the ship) applying paragraphs B13–B20 of IFRS 16;
- (b) the customer has the right to obtain substantially all the economic benefits from use of the ship throughout the five-year period of use applying paragraphs B21–B23 of IFRS 16; and
- (c) many, but not all, of the relevant decisions about how and for what purpose the ship is used are predetermined in the contract. The customer has the right to make and change the remaining relevant decisions about how and for what purpose the ship is used throughout the period of use.
- (d) the supplier operates and maintains the ship throughout the period of use.

The right to direct how and for what purpose an asset is used

Paragraph 24(a) of IFRS 16 specifies that a customer has the right to direct the use of an identified asset throughout the period of use if it has ‘the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs B25–B30)’.

For the customer to have the right to direct how and for what purpose the asset is used, within the scope of its right of use defined in the contract the customer must be able to change how and for what purpose the asset is used throughout the period of use (paragraph B25). In assessing whether that is the case, ‘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’ (paragraph B25).

Paragraph B26 includes examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used.

An entity does not consider decisions that are predetermined before the period of use (unless the customer designed the asset or specific aspects of it as described in paragraph B24(b)(ii))

(paragraph B29). Rights limited to operating or maintaining the asset do not grant the right to change how and for what purpose an asset is used (paragraph B27).

The Committee observed that, in the fact pattern described in the request, the customer has the right to direct how and for what purpose the ship is used throughout the five-year period of use. This is because, within the scope of its right of use defined in the contract, the customer makes (and can change) relevant decisions about how and for what purpose the ship is used throughout the five-year period of use. The predetermination in the contract of many of the decisions about how and for what purpose the ship is used defines the scope of the customer's right of use—within that scope, the customer has the right to make all the relevant decisions about how and for what purpose the ship is used that can be made throughout the period of use.

The Committee also observed that, although the operation and maintenance of the ship are essential to its efficient use, the supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used.

Consequently, the Committee concluded that, in the fact pattern described in the request, the customer has the right to direct the use of the ship throughout the five-year period of use.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine its accounting for the contract described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Appendix B—submission

We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request. This appendix does not reproduce excerpts from IFRS Standards that were included in section three (ie ‘III Issue’) of the submission—the relevant excerpts are embedded within the analysis in the paper.

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	<i>1,000 tons</i>	<i>15,000Km (150 days)</i>	USD 15,000
Y → S	7	<i>700 tons</i>	<i>14,000Km (140 days)</i>	USD 14,000
Z → S	3	<i>300 tons</i>	<i>7,500Km (75 days)</i>	USD 7,500
Total	20	<i>2,000 tons</i>	<i>36,500Km (365 days)</i>	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.

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)

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 project.

Appendix C—excerpt from IFRS 16 Leases (paragraph B31)

C1. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.

