
IFRS[®] Interpretations Committee meeting

Date	March 2023
Project	Definition of a Lease—Substitution Rights (IFRS 16)
Topic	Comment letters
Contacts	Rafal Markowski (rmarkowski@ifrs.org)

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Introduction

1. This paper reproduces comment letters on the IFRS Interpretations Committee's tentative agenda decision 'Definition of a Lease—Substitution rights (IFRS 16)' published in November 2022.

Name: Sounder Rajan SP

M no 237299

Place: Chennai

Subject: Comments on Tentative Agenda Decision and comment letters: Definition of a Lease—Substitution Rights (IFRS 16)

- 1) I welcome the opportunity provided for sending comments on Tentative Agenda Decision and comment letters: Definition of a Lease—Substitution Rights (IFRS 16)
- 2) I support initiative of Accounting Standards Board of ICAI to extend the timeline and provide clarifications.
- 3) My view

Facts of case

a customer enters into a 10-year contract with a supplier for the use of 100 similar new assets—batteries used in electric buses. The customer uses each battery together with other resources readily available to it (each battery is used in a bus that the customer owns or leases from a party unrelated to the supplier).

applying the requirements in paragraphs B14–B18, it is determined that the supplier has the practical ability to substitute alternative assets throughout the contract term such that the condition in paragraph B14(a) exists.

if a battery were to be substituted, the supplier would be required to compensate the customer for any revenue lost or costs incurred while the substitution takes place. Whether substitution is economically beneficial for the supplier at a point in time depends on both the amount of compensation payable to the customer and the condition of the battery. At inception of the contract, it is expected that the supplier would not benefit economically from substituting a battery that has been used for less than three years but could benefit economically from substituting a battery that has been used for three years or more.

Assessment:

In the fact pattern described in the request, each battery is specified. Even if not explicitly specified in the contract, a battery would be implicitly specified at the time it is made available for the customer's use. Therefore, the Committee observed that, unless the supplier has the substantive right to substitute the battery throughout the period of use, each battery is an identified asset.

In the fact pattern described in the request, the condition in paragraph B14(a)—the supplier has the practical ability to substitute alternative assets throughout the period of use—is assumed to exist. The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier's substitution right is not substantive throughout the period of use.

Therefore, the Committee concluded that, in the fact pattern described in the request, each battery is an identified asset. To assess whether the contract contains a lease, the customer would then apply the requirements in paragraphs B21–B30 of IFRS 16 to determine whether, throughout the period of use, it has the right to obtain substantially all the economic benefits from use, and direct the use, of each battery.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Conclusion:

- a) Supplier has right to substitute asset
- b) Supplier has right to use alternative assets

Facts missing:-

- a) Fact to be considered is customer requires 100 batteries and what is the available quantity with supplier including buffer for the customer to use is more important information which is missing to assess whether substantive right is material and available always
- b) Next important fact missing is whether all 100 buses of customer will run simultaneously or will not be running which will help to identify whether substantive right is material and available always
- c) Further critical information missing is what is the economic life of the battery and what is the useful life of the battery. As customer usage and way of usage, climate of usage, quantity of bus, quality of routes all becomes important to assess whether battery can be used for 3 years

Facts critical: -

- a) Contract is for 10 years and useful life of battery is more important to assess how substantive rights would play a role
- b) Past record of quality of supplier's battery is not available to assess ratio of battery which would require replacement within 3 years or more than 3 years and past trend of what has been replaced would give better picture to assess the probability of exercising substantive rights

Basis these information only conclusion can be reached

I concur that views stated above are my individual opinion and not of any organization where I am working or not of any committee or organization I am connected with.

Regards

Sunder Rajan

M No 237299

Jan 30, 2023

IFRS Foundation
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London E14 4HD,
United Kingdom

SOCPA Comments on *Tentative Agenda Decision, Definition of a Lease—Substitution Rights (IFRS 16)*

Dear Colleagues,

The Saudi Organization for Chartered and Professional Accountants (SOCPA) appreciates the efforts of the IFRS Interpretations Committee (Committee) and welcomes the opportunity to comment on the *Tentative Agenda Decision, Definition of a Lease—Substitution Rights (IFRS 16)*.

Our comments on the 2 questions raised in the request received by the IFRS Interpretation committee are given below.

- a. The level at which to evaluate whether a contract contains a lease – by considering each asset separately or all assets together – when the contract is for the use of more than one similar asset.***

SOCPA agrees with the conclusion in the tentative agenda decision and believes the principles in paragraph B12 and B32 of IFRS 16 address this. As detailed in paragraph B32, the assessment whether a contract contains a lease should be made for each asset, if the customer (lessee) can benefit from the use of the asset on its own or together with other resources readily available to the customer (lessee) and the underlying asset is neither highly dependent on, nor highly interrelated with, other assets in the contract.

- b. How to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights – i.e. The supplier:***

- i. has the practical ability to substitute alternative assets throughout the period of use; but***
- ii. would not benefit economically from the exercise of its right to substitute the asset throughout the period of use***

Based on the fact pattern in the request received by the IFRS Interpretation committee, it would be clear that the supplier has the practical ability to substitute alternative assets throughout the period of use. However, the question is whether the supplier would benefit economically from the exercise of its right to substitute the asset throughout the period of use.

Paragraph B14 of IFRS 16 states:

“a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier’s right to substitute an asset is substantive only if both of the following conditions exist:

- (a)
- (b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).”

In the tentative agenda “The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier’s substitution right is not substantive throughout the period of use.”

While the committee’s conclusion in the tentative agenda is a word for word interpretation of the current IFRS 16, SOCPA sees an anomaly in this conclusion. In the fact pattern, the total term of the contract is 10 years, and the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. The concern here is whether the committee’s conclusion is supported by paragraph B14(b), i.e., is it sufficient to comply with paragraph B14(b) when the absence of lessor’s economic benefit is only for a part of the lease term. What about the length of such absence? For example, what if the scenario stated that the supplier is not expected to benefit economically from exercising its right to substitute a battery for one month? Would it still be interpreted to conclude that the supplier’s substitution right is not substantive throughout the period of use?

SOCPA believes this area requires further study. If there were 2 similar transactions, in one of which the supplier is expected to benefit economically from exercising its right to substitute an asset anytime during the contract term, and in the other the supplier is not expected to benefit economically from exercising its right to substitute an asset for only a part of the contract term - should the two transactions be accounted for by the customer (lessee) differently? i.e. In one instance the contract does not contain a lease and in the other the contract contains a lease.

SOCPA understands IFRS 16 was introduced to increase visibility of companies’ lease commitments and better reflect economic reality. It seems that the tentative agenda conclusion and the current IFRS 16 when applied to the fact pattern in the request and the scenarios detailed above do not reflect the economic reality of the transactions.

SOCPA agrees that the requirements in paragraphs B13–B19 of IFRS 16 set a high threshold for a customer (lessee) to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The inclusion of paragraph B14(b) perhaps strengthens this, but in reality, the assumption implied in the standard that a customer (lessee) have access to information relating to a supplier’s (lessor’s) ability to economically benefit from the exercise of its right to substitute the asset needs further consideration.

Even if the assumption about the customer’s access to the lessor information is held, there is still a case for the contract to be split into 2 different periods that should be accounted for separately; i.e. a period in which paragraph B14 is fulfilled and a period in which paragraph B14 is not met.

Based on our observations, we believe the IASB should review paragraph B14 and determine if it assists to increase visibility of companies’ lease commitments and better reflect economic

reality of transactions or if there is an alternative approach that needs to be considered. Therefore, we believe that the current principles and requirements in IFRS 16 **do not** provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease in the fact pattern described in the request. Consequently, the Committee **should decide the addition of** a standard-setting project to the work plan.

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,



Dr. Ahmad Almeghames
Chief Executive Officer



Mr Bruce Mackenzie
IFRS Interpretations Committee

1 February 2023

Dear Bruce,

RE: Tentative Agenda Decision, ‘Definition of a Lease – Substitution Rights (IFRS 16)’

We are responding on behalf of PricewaterhouseCoopers to the IFRS Interpretation Committee’s (Committee’s) Tentative Agenda Decision (TAD), [‘Definition of a Lease – Substitution Rights \(IFRS 16\)’](#).

‘PricewaterhouseCoopers’ refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This response summarises the views of member firms who contributed to our consultation during the comment letter period.

Our response covers:

- 1) the level at which to evaluate whether a contract contains a lease;
- 2) whether an entity has a substantive substitution right throughout the period of use; and
- 3) other comments.

For any questions relating to this letter, please contact myself or [Marie Kling](#) (Global IFRS Leader for Financial Instruments).

Your sincerely,

A handwritten signature in blue ink that reads 'Pricewaterhouse Coopers'.

Henry Daubeney
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1) The level at which to evaluate whether a contract contains a lease

We agree that, by applying paragraph B12 of IFRS 16 to the fact pattern in the TAD, the customer would consider each battery as a potential separate lease component.

2) Whether an entity has a substantive substitution right throughout the period of use

The TAD states:

- “The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier’s substitution right is not substantive throughout the period of use.” (underline added for emphasis)
- “The Committee also observed that determining whether a supplier’s right to substitute an asset is substantive *throughout* the period of use requires judgement” (italic copied from the TAD)

We agree that, in the specific fact pattern described in the TAD, the supplier’s substitution right is not substantive throughout the period of use. However, the first bullet point above could be read to indicate that the economic benefit to the supplier must exist continuously throughout the period of use and that, if this condition is not met at any moment within the period of use, the right is not substantive.

Consider, for example, a scenario in which the supplier would economically benefit from substitution for an entire 10-year contract with the exception of only one day. Reasonable application of judgement would conclude that the supplier has a substantive substitution right throughout the period of use; whereas, because that single day is part of the period of use, we are concerned that the TAD could be read to indicate that the supplier does not have a substantive substitution right.

We do not believe that this is the Committee’s intention, and therefore clarification of the wording of the TAD is needed.

An interpretation that the economic benefit must exist continuously throughout the period of use would also seem inconsistent with:

- paragraph B16 of IFRS 16, which excludes future events from consideration only if they are not likely to occur; and
- Example 2 in the Illustrative Examples that accompany IFRS 16, in which the substitution rights are substantive if they allow the supplier to take advantage of changing circumstances that might not exist at the commencement of the contract.

Consequently, if the wording of the TAD is finalised without any changes, we are concerned that the application of the TAD would result in far fewer, if any, substitution rights being concluded as substantive, which would contradict the other requirements of IFRS 16 noted above.

In our view, there is judgement in determining (a) whether a supplier's right to substitute is substantive, and (b) whether it exists throughout the period of use. Although the TAD states that

judgement is required, it does not explain how the Committee applied such judgement to the fact pattern to reach its conclusion.

Therefore, we ask the Committee to address our concern by adding further explanation in the final agenda decision. For example, the first bullet point, at the start of this section, could be replaced with:

“The Committee observed that the condition in paragraph B14(b) does not exist for the first three years of the contract. This is because the supplier is not expected to benefit economically from exercising its right to substitute a battery during this time. Judgement is required to determine whether that period prevents the substitution right from being substantive and whether that right exists throughout the period of use. The Committee concluded that three years is a sufficiently substantial part of the lease term that – in this fact pattern – the supplier's substitution right is not substantive throughout the period of use.”

3) Other comments

We ask the Committee to consider making two further improvements to the TAD:

- clarifying which parts of the analysis are applicable for both the lessee and the lessor, compared to the parts that are applicable for the lessee only; and
- reinforcing the importance of paragraph B19 of IFRS 16 for the lessee, given the high hurdle that is required in assessing if the substitution is ‘readily determinable’.



February 1, 2023

International Accounting Standards Board
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Committee Members:

Consejo Mexicano de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Tentative Agenda Decision (TAD) reached by the IFRS Interpretations Committee (the Committee) in its meetings in November 2022. That TAD deals with lessor substitution rights in the definition of a lease.

Set forth below you will find our comments on the conclusions reached in the TAD.

Overall comments

We agree with the conclusion reached by the Committee in the TAD that the principles and requirements in IFRS 16, *Leases*, provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Consequently, we agree with the decision not to add a standard-setting project to the work plan of the IASB.

Specific comments

Our local outreach indicated unanimous agreement that in the situation described, the guidance in IFRS 16 is sufficient.

IFRS 16 is clear that to consider a supplier's substitution right to be substantive, both of the following conditions must be met:

1. the supplier has the practical ability to substitute alternative assets throughout the contract; and
2. the supplier would benefit economically from such substitution.

In the facts of the described case, it is specified that, in relationship to the batteries, they do not meet the second condition, as a result of which, by not complying with both conditions, the substitution right is not substantive and therefore the contract contains a lease.

Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55-5433-3070 or me at (52) 55-5403-8309 or by e-mail at wbiese@cinif.org.mx or egarcia@cinif.org.mx, respectively.

Sincerely,



C.P.C. Elsa Beatriz García Bojorges
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano de Normas de Información Financiera (CINIF)



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Subject: comment on Tentative Agenda Decision and comment letters: Definition of a Lease—Substitution Rights (IFRS 16),

Dear colleagues,

I would like to thank you regard permitting such opportunity to comment on Tentative Agenda Decision and comment letters: **Definition of a Lease—Substitution Rights (IFRS 16)**, I value the efforts and the care which your professional committee contribute to improve the implementation of IFRS and the continuous discussion which not only improve the implementation of IFRS but also take into account situations which we may have in practice and would increase the area of judgement and complexity

Although I believe that my opinion is to agree with committee using same paragraphs of IFRS 16 relevant to the case, but I find that agreeing totally by taking the straightforward paragraphs related to presented fact pattern may make us loose opportunities for improvements related to situations that in substance need to be further deliberated after considering more analysis.

Accordingly I appreciate if more analysis and redeliberation in the fact pattern, through suggesting future project to discuss the issues related to my discussions in the attached response, if committee found same concerns are likely to have the material financial reporting consequences and are reasonably based

Kindly if you have inquiries do not hesitate to contact me on my email: shady@epg_network.com

Best regards ,

Yours sincerely

Shady Mehelba

Egyptian Pioneers Group
Member of UC&CS Global
Partner
CPA holder U.S.A
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Regarding the fact pattern's inquiries about the level at which to evaluate whether the contract contain a lease?

I agree with The committee' s conclusion basis using Par. B12 and guidance in Par. B32 ,and in context of the pact pattern , the lessee (customer as defined) can benefit from each asset(a battery) together with other resources and that each battery is neither highly dependent nor highly interrelated using other batteries in the same contract

As mentioned in basis of committee conclusion, Par. 12 indicated that such assessment is guided by Par.32. In Par.B32(b) the board indicated an example for the criteria of assets which are not interrelated or independent to account for as single lease component. the example indicated that preference of lessee may be not to inter a lease contract for asset without considering impact on the rights of use of other underlying assets "which was stated in the example in Par.B32(b) was as follow,

"For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets".

In the fact pattern *"a customer enters into a 10-year contract with a supplier for the use of 100 similar new assets—batteries used in electric buses"*.

I believe that The inquirer neither provided sufficient data for assessment, nor was clear whether the lessee position would be the same entering into lease in one battery or 100 batteries .

Accordingly, I believe that There are not sufficient data to base reasonable ground in the fact pattern from which we can assess such conclusion which was concluded by committee, because the issue would depend on assessment and depend on examples and conditions to assess it as discussed in Par.B32 .

In reference to fact pattern, I encourage either that committee assist inquirer of the sent fact pattern by only providing criteria and example which was referred to in Par.B 32 only at this stage.

In addition, the committee may consider the issue for further guidance .for example . In practice, whether negotiating lease for one battery or number of batteries might have affected the contract price and would be dependent on negotiated quantity and may turn contract not to be benefit for the lessor if not with specific quantity.

Since right of use of asset is separate lease component require meeting both Par. B32(a) and B32(B). Consequently, I believe that for assessing that each battery is separate component, additional data are still required (relevant to Par. B32(b) which may not be available to committee as this point for such assessment.

In addition, why we did not consider the lessor position if likely to be expected from ordinary course of business in the assessment and example? accordingly and if such point was furtherly deliberated. I may encourage to add to the example attached to Par.B32(b) that such decision of considering the dependent or interrelation of assets should consider either lessee or lessor positions as follow: -

For example, the fact that **either** a lessee or **a lessor** could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets".

The indication may enhance such assessment and reduce variation in applying such guide paragraph

I believe that Committee may refer to assessment paragraph only for purpose of reaching conclusion regard fact pattern, if data for such assessment not adequate to reach to such conclusion, or may add such example in B.32 in its response of the fact pattern to highlight example to inquirer

Regarding the inquirer's query how to assess whether the contract contain a lease or not?

I agree with committee's conclusion and analysis with some points to be considered if committee decided to further add a project for such issue.

I agree that it was clear by applying Par.9 that there is right to control the use of the asset which was conveyed from lessor to lessee for identifiable asset for a period in exchange for consideration.

I Also agree with committee's conclusion as mentioned in tentative agenda decision, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. In addition ,Those years are part of the period of use as defined in appendix a IFRS 16 . Consequently, the supplier's substitution right is not substantive throughout the period of use.

And if committee would encourage more reliable basis for such conclusion, it might use what was indicated in basis of conclusion paragraph of IFRS 16 ,as In accordance to Board basis of conclusion Par 114 , same conclusion can be resulted from going through the paragraph , as follow :

"BC114 Substitution rights may not be substantive for a number of reasons. Some substitution rights are not substantive because the contract restricts when a supplier can substitute the asset. For example, if a contract states that a supplier can substitute the asset only on a specified future date or after the occurrence of a specified event, that substitution right is not substantive because it does not give the supplier the practical ability to substitute the asset throughout the period of use. Other substitution rights are not substantive even if the supplier contractually has the right to substitute the asset at any time. For example, if a supplier substitutes an asset for purposes of repair and maintenance, or if a supplier would benefit from substitution only in circumstances that are not considered likely to arise, those substitution rights are not substantive, regardless of whether those circumstances are specified in the contract".

This coincide with the purpose of IASB to exclude to issue guidance to distinguish which substitution rights are substantive in order to differentiate between cases in which no identified asset because the supplier rather than customer control the use of an asset and to identify substitution rights that do not change the substance of the contract because not likely or practically or economy feasible for supplier to exercise (Par. Bc(112))

1- Other circumstances that I encourage to have further deliberation and analysis (regarding the right of substitution' assessment

In reference to Par.B14(a), the Board indicated example "the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time". I believe that adjusting example in such paragraph by adding more guidance to include alternatives such as compensation , for example: adding as example " asset outsourced or amount of compensation that may be paid by supplier for forgone revenues(as in the fact pattern) rather than only having example of outsourced asset that are readily available within reasonable period of time" these variety of alternatives that reflect same substance of controlling of use of asset through benefits by lessee will align with the board's objective to enhance decision' making regard assessing the substitution rights substantivity

Accordingly, I encourage more deliberation to assess whether more clarifications or guide would be needed for Par.B14(a)

2- The definition of "period of use of asset "in context of the fact pattern's conditions

In addition, by reference to Par.B14 , the board determined that period to assess the substitution right is "throughout the period of use ", although it is practically understood ,as defined in appendix A

(IFRS 16) " the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time) " , I believe that definition may need more further deliberation because ,

- A- The asset (battery in case pattern) will be likely to be replaced by supplier, accordingly after the first three years, replacing the asset and future conditions may suggest changing the Scope of contract may result in changing of characteristics of identified asset consequently new assessment may be necessary. Furthermore ,in the fact pattern which asset would be relevant depend on different periods with different rights ?
- B- After the first three years of the lease term, the lessor will compensate lessee for lost revenues of substitution so that period of actual use of underlying asset is three years and for such period benefits are derived while lease term is ten years ten years (condition by replacement) which may result in confusion, if we take into account Par .32(IFRS 16) when there is no transfer of ownership (the fact pattern is not clear as to this issue) . in such paragraph The criteria that was applied to measure benefits through depreciation require that the lessee depreciating the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term,

the issue when useful life as defined in IFRS 16 and “period of use” may be different in some instances, accordingly further deliberation is needed in such issue

- C- In accordance to what was aforementioned in (b) above I believe that replacing the definition of period of use by “the period estimated useful life of underlying asset or lease term, whichever is earlier” to cut off differences in terminology and definition and because other substitutions that take place after that period is irrelevant to the right of use of asset and need further deliberations regard the substance of the contract. these types of

substitutions may be indications of rights that need to be reassessed, especially that same criteria and terminologies are used for identifying depreciation period purpose in accordance with IFRS 16 (Par.32).

3- Assessing the substance of lease (control of use of asset) based on substitution right whether substantive or not based on Par.B (14) and BC.112 of the board

Although it was board intention to determine to what extent substitution right can alter substance of lease contract using criteria based on control of use of asset, it was not clear whether board’s intention also is to address other situations in which the case include contract that attached with substitution that may be accounted for under other IFRS’s Scope. particularly, when substitution right is likely to occur after the earlier of both dates (estimated useful life or lease term whichever is earlier? which constitute the time of derived benefits for lessee, and it is gradually occurred .

I encourage more redeliberation of the fact pattern in light of board’s intention in applying substance of agreement BC.112 for substitution rights that may alter contract and degree of control of asset’s use, taking in account the followings conditions

- 1- When substitution is economically feasible or likely to occur after specific point of time, that is after estimated useful life of the underlying asset that attributes to right of use
 - A- The substitution rights which are substantive and compensated by supplier in one point of time, may request more analysis because supplier may has scheduled economic benefit from the substitutions, that based on how likely will the substitutions occur through out lease term, then it is required to assess whether a modification of contract may be seen in light of Par .45 or whether residual value of underlying asset of the right of use will constitute part of such economic benefits of supplier (which is not clear in fact pattern) and for which consideration received by lessee need to be accounted for separately .
 - B- while assessing whether substitution will benefit the supplier or not, this will suggest to take into account both cost and all benefits not only from the substitution but also from the replacing asset (residual value) after estimated life expired. Finally I did not realize whether IFRS 16 address treatment for such compensated lease period not in form of use (during period of substitution) of asset (if material), while in fact it is compensated for by lessor .
 - C- In Par.B(14)b it was stated as a measure to what extent would the supplier benefit economically, that the economic benefits associated with substituting the asset are expected to exceed the costs associated with such substitution, acting as a measure of



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substantive of right of substitution. while I believe that using term commercial substance which was adequately described in IAS 16 will enhance such assessment.

- D- in case of asset's estimated economic useful life that is, much lower than lease term. In other words, when the likelihood of exchange of battery in fact pattern is after three years this may be indication of useful life of underlying asset relate to the right. Additionally, if this period materially less than lease term (10 years) with different rights. For example, different lessee's rights may include both right of substitution and control the use of asset will arise then. When such benefit exist, the question will be demonstrated in mind about what was the consideration given by lessee's to have such right? As a substance, I believe in the fact pattern that the lease in accordance with lessor may be identified as manufacturer or dealer lessor Type (Par.71:74) . As a result, exchanging an asset as apart from product sales cycle may not only be beneficial throughout the estimated usage period (estimated useful life) for each contracting's parties in context of lease but also may have another substance commercially. Consequently, this may need additional guidance from Board to consider for such situations in assessing substance of substitution rights in such case.
- E- If we committee decide to deliberated in further project such fact pattern, we may have as a substance a question of "why we do not have to apply Par.23 IAS 16) for such assets purchased by deferred payments? if in substance no lease contract identified . The Board indicated in such paragraph "The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with IAS 23." (we just have purchase agreement with deferral payments in form of lease contract)
- F- When substitution right is a form (after estimated useful life) it is a matter of purchase of new asset by exchange of other for which exchange of property plant & equipment paragraph Par. 24 of IAS 16 is to be applied .

Córdoba (SPAIN) February, 3th 2023

Dear members of the International Accounting Standards Board,

We are pleased to respond to your invitation to comment on *Tentative Agenda Decision and comment letters: Definition of a Lease—Substitution Rights (IFRS 16)*. We are faculty members of the Department of Financial Economics and Accounting at Universidad Loyola Andalucía (Spain). We have the following specific comments on the tentative agenda decision:

The consultation contains two issues:

- Is there a substantive substitution right when the supplier has it only for part of the contract term?
- How should the unit of account be defined when the contract contains multiple assets with similar characteristics to determine the existence of a substantive substitution right?

1. Substitution right for part of the contract term

IFRS 16.B14 sets out the criteria for assessing whether there is a substantive substitution right that should extend throughout the period of use. These are as follows:

- The first is the practical ability to substitute the asset over the contract period: "*the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time)*" (IFRS16.B14a).
- The second is that the supplier would benefit from such substitution: "*the supplier would benefit economically from the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).*" (IFRS16.B14.b).

In addition, IFRS 16.B15 clarifies that the substantive substitution right must be present throughout the period of use: "*If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.*"

The facts raise the question of whether the benefit of substitution should be apparent over the entire period of use, given that it is not explicitly mentioned in paragraph IFRS16.B14.b. In our view, the two conditions (practical ability and benefit from substitution) form the substantive substitution right. If one of them were not present, the substitution right would not exist. As stated in paragraphs B14 and B15, the substantive substitution right must be present throughout the period of use, then if it is not, as is the case here, the leased asset can be considered to be identified because the lessee cannot substantively substitute it. Here the standard seems clear.

A different issue is to evaluate, in view of the PIR of IFRS 16, whether these cases in which the substantive substitution right is given during part of the period of the right-of-use should affect the term of the lease. During part of the contract, they would be leases (in this case, 3 years), and thereafter, they would be a service provided by the supplier who has alternatives to use the leased asset and may find it economically beneficial to substitute. The current wording could lead to the absurdity of a lessee recognizing control over an asset that could be substantially substituted by the supplier and that this substitution period could be very relevant, for example, for 9.5 years in the contract under consultation. Is the lessee really controlling the asset? Our view is that the determination of the term should contain an analysis of the period in which the asset is identified.

A literal reading of IFRS16. B14.b9, according to which, if the economic benefit is present in part of the period of use, it would imply that there is a substitution right during the entire lease would be erroneous. However, we question whether this requirement (the substitution right must be present during the entire period of use) is conceptually reasonable. This discussion is beyond the scope of the TAD, but it might be an input for the future Post-Implementation Review of IFRS 16. In our view, if the practical ability or economic benefit is present for part of the contract term, it would not qualify as a lease for that period. It should be recalled that the right-of-use is understood as a bundle of services: one part may qualify as a lease (since the lessee can identify the asset) and the other as a service contract (when the lessor can substitute the underlying asset, and the latter is not identified).

A second issue is leases in which the supplier must replace the asset to fulfill the contractual obligation. In the fact pattern of this case submitted by the consultant, it was stated that, although the contract was for 10 years, it was expected to be used with the required performance (more than 70% of capacity) for 8 years without having to be replaced by the supplier. Moreover, they will most likely be used for 3 years because the supplier has an economic interest in the replacement at that time. Our understanding is that this substitution is a new lease because the supplier (lessor) fulfills its contractual obligation when it makes the replacement asset available to the customer (lessee). The conceptual basis of the right-of-use model is that the lease contract is not executory because the supplier (lessor) has complied with the delivery of the leased asset: *"the lessee controls the right to use the underlying asset throughout the lease term. Once the asset is made available for use by the lessee, the lessor is unable to retrieve or otherwise use the underlying asset for its own purposes during the lease term, despite being the legal owner of the underlying asset."* (IFRS 16.FC25.a).

2. Unit of account when analyzing the substitution right

The Tentative Decision provides a good analysis of why each battery is a distinct asset, and its identification should be evaluated on an individual basis. As indicated by some participants and reflected in paragraph 19.a) of the Staff Paper of the November IFRS Interpretation Committee's meeting, the portfolio accounting (IFRS 16.B1) is a practical expedient. It requires that its results do not differ significantly from those that would be obtained with an individualized approach.

PhD Horacio Molina-Sánchez PhD Marta de Vicente-Lama PhD M^a del Mar Ortiz-Gómez

PhD Antonio Barral-Rivada PhD Enrique Mesa Pérez

Universidad Loyola Andalucía

6 February 2023

Mr. Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Mr. Mackenzie,

IFRS Interpretations Committee Tentative Agenda Decision

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comment on the Tentative Agenda Decision: Definition of a Lease—Substitution Rights (IFRS 16 *Leases*).

We agree with the IFRS Interpretations Committee's reasons for not adding a standard-setting project to its work plan based on the specific fact pattern described in the Tentative Agenda Decision.

If you need further clarification or have any queries regarding this letter, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,



TAN BEE LENG
Executive Director



IKATAN AKUNTAN INDONESIA
(INSTITUTE OF INDONESIA CHARTERED ACCOUNTANTS)

Ref. : 374/DSAK/IAI/II/2023

Jakarta, 6 February 2023

IFRS Interpretations Committee
Columbus Building, 7 Westferry
Circus Canary Wharf, London

Comment on Tentative Agenda Decision (TAD): *Definition of a lease—Substitution rights* (IFRS 16)

Dear IFRS Interpretations Committee (Committees),

Dewan Standar Akuntansi Keuangan (DSAK) - The Indonesian Financial Accounting Standards Board, as part of Ikatan Akuntan Indonesia (IAI) - the Institute of Indonesia Chartered Accountants, is the national accounting standard-setter in Indonesia. On behalf of DSAK IAI, I am writing to respond regarding on the TAD: *Definition of a lease—Substitution rights* (IFRS 16).

We are writing to you herewith to confirm that we agree with IFRS Interpretation Committee's analysis of the application of the requirements in IFRS 16 on fact pattern described in the TAD, and that we agree with IFRS Interpretation Committee's conclusion not to add or change requirements in IFRS Accounting Standards but to publish an agenda decision to outline the applicable requirements for the fact pattern described.

We hope that our responses could contribute to the Interpretation Committee's future deliberations. Should you have further concerns regarding our responses, please do not hesitate to contact us at dsak@iaiglobal.or.id.

Yours sincerely.



Indra Wijaya

Chairman

The Indonesian Financial Accounting Standards Board
Institute of Indonesia Chartered Accountants



TENTATIVE AGENDA DECISION: DEFINITION OF A LEASE - SUBSTITUTION RIGHTS (IFRS 16)

Issued 6 February 2023

ICAEW welcomes the opportunity to comment on the Tentative Agenda Decision: Definition of a Lease - Substitution Rights (IFRS 16) published by IASB on 29 November 2022, a copy of which is available from this [link](#).

For questions on this response please contact the Financial Reporting Faculty at frf@icaew.com quoting REP 10/23.

This response of 6 February 2023 has been prepared by the ICAEW Financial Reporting Faculty. Recognised internationally as a leading authority on corporate reporting, the faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial and non-financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common corporate reporting problems.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of building the economies of tomorrow, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 165,000 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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ICAEW

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The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

KEY POINTS

1. ICAEW welcomes the opportunity to comment on the IFRS Interpretations Committee's tentative agenda decision (TAD) regarding the definition of a lease and substitution rights (IFRS 16).
2. In the fact pattern described in the request, the IFRS Interpretations Committee (the Committee) concluded that the supplier does not have the substantive right to substitute the assets. Although we do not necessarily disagree with this conclusion, we believe there is ambiguity as to whether the condition in paragraph B14(b) has been met. This ambiguity does not appear to have been fully considered by the Committee.
3. In the TAD, the Committee observed that "the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier's substitution right is not substantive throughout the period of use." This wording could be read to suggest that the supplier's substitution rights would be substantive only if the supplier could benefit economically at all points in time over the contract term. We are concerned that such an interpretation would inappropriately introduce a "bright line" to the application of this paragraph.
4. Paragraph B14(a) states that there has to be a practical ability to substitute throughout the period of use. Paragraph B14(b) states that the supplier would need to benefit economically from exercising its right to substitute the asset. We note, however, that paragraph B14(b) does not explicitly state that the supplier would have to benefit economically throughout the period of use. We therefore suggest that the wording of the agenda decision is refined so as not to imply that substitution has to be economically beneficial at all points in time over the contract term in order for a substantive substitution right to exist.
5. We would not expect, for example, that where the condition in paragraph B14(b) exists for all but the first week of a three-year contract, the supplier's substitution right should automatically be determined as not substantive. As noted by the Committee, this determination is a matter of judgement and we suggest that this is further emphasised in the agenda decision.
6. We also do not expect there are many contracts in existence that incentivise a supplier to substitute the asset on a regular (or even daily) basis throughout the entire period of use. In most cases substitution will be economically beneficial only in particular future circumstances that are to some extent uncertain – for example future customer activity that determines demand for the asset in question. Therefore, we think the assessment should focus more on whether those circumstances could arise throughout the period of use and are expected to actually arise at one or more points during that period.
7. To confirm, we do not necessarily disagree with the Committee's overall conclusion in relation to the fact pattern considered but we are concerned about the way paragraph B14(b) appears to have been interpreted to reach this conclusion. We would support further consideration by the Committee as to how this paragraph should be interpreted, including the reasons for including the reference to "throughout the period of use" in paragraph B14(a) but not B14(b). Should the Committee conclude that this phrase nonetheless applies to B14(b), we suggest that the Committee explores further what "throughout the period of use" means in practical terms and emphasises the judgements required.

PO Box 1411
Beenleigh QLD 4207
6 February 2023

Mr Bruce Mackenzie
Chair IFRS Interpretations Committee
International Accounting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Online submission: <https://www.ifrs.org/projects/work-plan/definition-of-a-lease-substitution-rights-ifrs-16/>

Dear Bruce

Tentative agenda decision - Definition of a Lease - Substitution Rights (IFRS 16)

I am pleased to make this submission on the above Tentative Agenda Decision (TAD) relating to Definition of a Lease - Substitution Rights (IFRS 16).

I have extensive experience in accounting advice on International Financial Reporting Standards across a wide range of clients, industries and issues in the for-profit, not-for-profit, private and public sectors.

My clients have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, federal, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises). I also have some commercial, standard setting and academic experience.

Overall

I agree with the TAD that the level at which to evaluate whether a contract contains a lease is the individual battery. I also believe that the portfolio approach (while not specifically mentioned in the TAD) only applies once you have worked out what the individual leases are.

I do not agree with the analysis or conclusions in relation to the substantive substitution right. I believe that in the fact pattern a substantive substitution right exists, that the customer does not control the right to use the asset throughout the period of use, and consequently leases do not exist for the individual batteries.

I cover the following issues:

1. Reasons for substitution rights
2. Examples of substitution rights
3. Definition of a lease
4. Definition of control
5. Definition of substantive
6. Application to facts
7. Definition of lease term

Substantial substitution right

1. Reasons for substitution rights

Substitution rights should be understood with the legal and economic environment of the arrangements. It should be remembered that the underlying asset for rental arrangements (assuming not a finance lease and irrespective of whether the definition of operating lease is met) is that the asset is controlled by the supplier and is recognised on the supplier's balance sheet as property, plant and equipment.

Suppliers / lessors will almost always have a significant and often substantial (not to be confused with substantive) interest in what happens to the asset at the end of the arrangement (the residual value). For example, the asset being rented out again, or repurposed.

In the fact pattern in the original submission, the customer contract for the batteries was for 10 years, with a second life application for a total useful life of 15 years. Therefore, the supplier has an economic imperative in protecting the value of the battery for its second life application. Not protecting the usable life of the battery for its second life application could considerably affect the overall profitability and return on the asset.

One way to protect the usable life of the battery (i.e. its ability to store the electricity charge) is by ensuring the battery is not overused during the 10 year contract. It appears that this economic imperative has been included in the rental arrangements by permitting the supplier to exchange (overused) batteries with those less used, and at the same time ensuring that the customer is not too inconvenienced.

2. Examples of substitution rights

The staff paper included the following examples where substitution rights are more common:

- aviation
- transportation
- logistics
- IT infrastructure services,
- mining, and
- industries for which a secondary market exists for used assets, such as:
 - engines
 - medical equipment
 - oilfield equipment.

Also, movable assets such as

- photocopiers
- multifunctional office devices
- heavy equipment
- batteries for electric vehicles
- IT hardware
- forklift trucks
- ships and

- heavy mobile equipment used in the mining industry (such as earthmovers, haulers and power generators)

In my experience, I have also seen substantive substitution rights for intragroup fleet operations for motor vehicles, and for office suite space.

In the examples I have seen, where there are substantial substitution rights, the customer does not care which particular asset is being used, as long as the asset works, and they are not inconvenienced if there is a substitution.

This is important to note, as the customer is interested in the services the assets provide, and not the individual asset.

3. Definition of a lease

IFRS 16 paragraph 9 states that 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.

As noted in the TAD, paragraph B14 states “even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use”.

Also, paragraph B21 states “to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period).”

Paragraph B21 is not met when there is a substantive substitution right, because the customer cannot control the use of an identified asset, because it is the supplier that controls whether the customer has use of that identified asset or another identified asset.

4. Definition of control

The TAD’s conclusion on the first 3 years is not consistent the application of control in other standards. In other standards, control is based on the power to exercise decision making and is not defined as only existing if there is some probability weighted reason for exercising control.

5. Definition of substantive

Similarly, the definition of substantive in other standards is applied similar to genuine, and not considered to exist only in some probability weighted circumstances.

The substitution rights in the TAD fact pattern appear to have been included for genuine reasons, consistent with the economic imperative of the supplier to manage the residual value of the battery.

6. Application to facts

Given the economic imperative for the supplier to ensure that the battery has a sufficient useable life for the second life application, it would be reasonable to assume that the supplier has sufficient information available to it (e.g. internal monitoring within the battery, or information to be provided by the customer) to assess when it is economically beneficial to make a substitution.

While the TAD states that the “supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract”, the supplier is not prevented from making a substitution, for example if the information available (e.g. from monitoring usage) suggests that a substitution should take place. The point is that it is the supplier that makes that decision, not the customer during that period. So, even if circumstances for a substitution are not expected to be the norm, if the circumstances arise as envisaged in the contract, the supplier still has control over the decision making on the substitution, and the customer does not control the asset in the first 3 years. Therefore, the supplier has a substantive substitution right throughout the period of use.

Also, the customer does not control the asset during the period of use under paragraph B21 because it is the supplier that controls whether the customer has use of that identified asset or another identified asset, both during the first 3 years, and the period thereafter.

7. Definition of lease term

I am disappointed the Committee decided not to explore what the lease term would have been under the TAD reasoning. Based on the definition of lease term, and assuming that the arrangement is a lease – which I disagree with, it appears that the lease term is 10 years. I do not see how a lease term (of say) 3 years is met (being the view under the TAD that the substitution right does not exist).

The original submission (included in the staff paper) states “The term of the contract is 10 years. At inception of the contract, the customer expects the asset to operate above the minimum capacity specified in the contract (without replacement) for 8 years.” It appears that replacement is therefore expected after 8 years – to be determined by the supplier considering both the minimum service level, and the supplier’s management of the residual value of the battery.

Based on an assumed lease term of 10 years, this would have resulted in the ridiculous outcome of the TAD saying no substantive substitution right exists, but the asset is expected to be substituted before the end of the 10 years.

Further exploration of the issue would highlight that the 3 years is not a fixed period. As noted above, the supplier is not prevented from making a substitution if the information available (e.g. from monitoring usage) suggests that a substitution should take place. Also, it appears that the 3 years is some sort of probability weighted average. How would this fit into the definition of lease term under IFRS 16?

If, somehow, the lease term is interpreted to be the first 3 years based on some probability weighted average, then presumably the lease term would need to be updated for changed facts and circumstances (for example, when it is considered likely a substitution will not

occur). There is no clear mechanism in IFRS 16 to change lease term based on the provisions of the contract and probability weighted averages of expected exercise of substitution rights, as the lease term reassessment and lease remeasurement under IFRS 16 (paragraphs 20 and 21) are linked to changes in the assessment of options.

Any changes would have to be applied to the individual contract, that is, for each individual battery. While this assessment, assuming the information is available to the customer, might not be impractical if all the batteries were all the same type and installed at the same time, the complexity of calculations and assessment increases dramatically if there is a rolling installation as the technology and utilisation of batteries changes.

Conclusion

Trying to work out probability weighted expected periods for the non-exercise of a substitution right for individual batteries, and then some sort of remeasurement to account for these changes, starts seeming absurd.

I understand why some people want to recognise “something” on-balance sheet for the customer. However, based on the given facts and circumstances, the customer does not control the use of the individual batteries throughout the contract term. Consequently, the definition of a lease is not met, and the customer should not be recognising a right-of-use asset for individual batteries and a corresponding liability for payments related to those individual batteries.

Yours sincerely,

David Hardidge

<https://www.linkedin.com/in/davidhardidge/>



Association pour la participation des
entreprises françaises à l'harmonisation
comptable internationale

The IFRS Interpretations Committee,
7 Westferry Circus,
Canary Wharf,
London E14 4HD,
United Kingdom

Paris, 4 February 2023

Dear M Mackenzie,

Tentative Agenda Decision: Definition of a Lease—Substitution Rights (IFRS 16)

We are writing in response to the above-mentioned Tentative Agenda Decision (TAD) since we believe that:

- **The TAD goes beyond a mere illustration of what the current standard requires**

As the TAD points out, the existence of a right of substitution must be assessed on the basis of paragraph B14 and the two conditions that must exist: a practical ability to substitute alternative assets and an economic benefit from this substitution. It is clear in the standard that the notion of "throughout the period of use" is specified only for the first condition; this temporal condition is not included in the second condition and we do not believe that this was an omission made while drafting the standard.

Furthermore, none of the following paragraphs cited (B15-B18) explicitly state that the economic benefit must exist at all times.

Therefore, when the Committee concludes that *"To assess whether the contract contains a lease, the customer would then apply the requirements in paragraphs B21–B30 of IFRS 16 to determine whether, throughout the period of use, it has the right to obtain substantially all the economic benefits from use, and direct the use, of each battery"*, we believe that this is an interpretation of the standard and not merely a reminder of its contents.

- **The conclusion seriously undermines any possibility of demonstrating any substitution rights**

Although the Committee reminds us that judgment should be used to assess the existence of a substitution right, we believe that its conclusion on this fact pattern will call into question many existing (and in our view justified) substitution rights. It is indeed unlikely that a lessor can have an

equivalent economic advantage throughout the contract, and quite rarely from day one. This, however, does not mean that this right is not genuine.

The Committee also insists on the so-called rarity of these rights by recalling § BC113 and the high hurdle set for a customer to conclude that there is no identified asset; the general reading of this TAD therefore seems to us to lead to a very strong limitation of substitution rights. However, the standard was initially drafted in full recognition of their existence, in particular to allow the distinction between service contracts and lease contracts. If the Board now considers that this distinction is no longer relevant and that the substitution rights must be reviewed, then this must be done by means of a revision of the standard, during the post-application review, for example.

This matter causes us to bring to the Board's attention the succession of various recent conclusions arrived at by the Committee which are, in our view, gradually amending the standard and the fundamental principles on which it was based (we will cite here, for example, the treatment of variable rents in the case of sale and lease back). We believe that all these revisions deserve a clear and structured debate which cannot be performed by means of TADs or even targeted amendments

- **If this conclusion were to be confirmed then the TAD is incomplete and should also address the initial term of the lease**

We note that in the original submission the issue of the initial lease term was also raised. We believe that this is a valid question which also deserves to be dealt with once the Committee concludes that there is a lease contract and an identified asset.

- **Transitional provisions**

We believe that the conclusion could be disruptive and may require entities to change their current accounting practices. Since it is an agenda decision, it should be applied retroactively, thus requiring the reintegration into accounting systems of contracts that had been excluded from them, and consequently a return to the inception date to determine a discount rate, a lease term and more. This could therefore be very onerous.

If you require any further information on this subject, please do not hesitate to contact us.

Yours sincerely,

ACTEO

Lise CHORQUES



Mr Bruce Mackenzie

IFRS Interpretations Committee

*Columbus Building,
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom*

La Défense, 6 February 2023

**Tentative Agenda Decision – IFRIC Update November 2022 – Definition of a Lease—
Substitution Rights (IFRS 16)**

Dear Bruce,

MAZARS is pleased to comment on the above IFRS Interpretations Committee Tentative Agenda Decision, published in the November 2023 IFRIC Update.

We welcome the tentative agenda decision as it provides, in its first part, useful guidance on how to assess whether a contract relies on an identified asset, and whether a substitution right is substantive. We consider this agenda decision to be valuable educational material.

We agree with the Interpretations Committee tentative decision that in the fact pattern described in the submission, the level at which to evaluate whether a contract contains a lease is that of a single battery, rather than all batteries considered together.

Applying the guidance in the tentative agenda decision to the fact pattern described in the submission, we also agree with the Interpretations Committee's tentative decision that the supplier's substitution right is not substantive throughout the period of use and therefore the contract relies on identified assets.

We nevertheless regret that in the tentative agenda decision, the Interpretations Committee does not pursue the analysis to the end.

We believe that information in the fact pattern described in the submission is sufficient for the Interpretations Committee to conclude whether the contract is a lease of the identified assets, instead of just ending the analysis by concluding that the contract involves identified assets.

In addition, concluding that the contract is a lease would have allowed the Interpretations Committee to answer the question in the submission regarding the lease term. Indeed, once it is concluded that the contract is a lease, it is still unclear whether it has a lease term of 3 years (expected duration before the supplier exercises its substitution right), 8 years (expected maximum period before replacement of a battery – after 8 years a battery will not meet the performance requirements in the contract anymore), or 10 years (duration of the contract). It would be useful if the Committee answered that question, which was also specifically raised by the submitter.

Should you have any questions regarding our comments on the tentative agenda decision, please do not hesitate to contact me (+33 6 62 99 57 81).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Edouard Fossat', written over a horizontal line.

Edouard Fossat

Financial Reporting Technical Support

Bruce Mackenzie
Chair, IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

6 February 2023

Dear Bruce

Tentative Agenda Decision: Definition of a Lease - Substitution Rights (IFRS 16)

We are pleased to comment on the above Tentative Agenda Decision (the TAD). Following consultation with the BDO network¹, this letter summarises views of member firms that provided comments on the TAD.

We agree with the Committee's analysis and conclusion in the TAD in response to question (a) of the request. However, we have some concerns about some of the wording and analysis in the TAD in response to question (b) of the request.

As explained in the attached Appendix, we believe further clarification should be made to the TAD. In particular, it would be helpful to provide further guidance about what is meant by 'throughout the period of use' in this fact pattern, and to include considerations that are relevant in determining the lease term.

Our comments on the TAD are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at abuchanan@bdoifra.com.

Yours faithfully



Andrew Buchanan

Global Head of IFRS and Corporate Reporting

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Appendix

Question (a)

The level at which to evaluate whether a contract contains a lease - by considering each asset separately or all assets together - when the contract is for the use of more than one similar asset.

We agree that, in the fact pattern described in the request, when applying the requirements of IFRS 16.B12 the customer would consider each battery as a separate lease component.

Question (b)

How to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights—ie the supplier:

- i. has the practical ability to substitute alternative assets throughout the period of use; but*
- ii. would not benefit economically from the exercise of its right to substitute the asset throughout the period of use.*

In determining whether there is an identified asset, IFRS 16.B13-B19 set out various requirements that are to be applied. However, and as noted by members of the Committee at its meeting in November 2022, those requirements need to be considered as a whole as well as being applied individually. We suggest that this is included in the first paragraph of the ‘Identified asset’ section of the TAD:

‘...identified asset. Paragraph B13-B20 of IFRS 16 provided application guidance, which should be applied individually and as a whole when determining whether there is an identified asset.’

The first sentence of IFRS 16.B14 states that ‘Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use.’ (*emphasis added*) In our view, the inclusion of ‘throughout the period of use’ in that introductory sentence means that it does not then need to be repeated in each subparagraph of IFRS 16.B14 because it applies to both IFRS 16.B14 subparagraph (a) and subparagraph (b). However, the fact that the wording ‘throughout the period of use’ is included in (a) and omitted from (b) could lead a reader of the standard to a different conclusion. We suggest that the wording ‘throughout the period of use’ be added to subparagraph (b) as part of annual improvements to remove the need for interpretation.

The analysis included in the TAD which concludes that the condition IFRS 16.B14(b) does not exist throughout the period of use is not clear. We suggest adding further clarification to walk the reader through the Committee’s thought process, expanding on what is meant by ‘throughout the period of use’ in this fact pattern. For example, although it would be rare for a supplier to benefit economically from substituting the asset immediately after the

commencement date of the lease, we would not view this as preventing a lessor from benefitting economically from substitution ‘throughout the period of use’.

Other comments

It would be helpful for the analysis to give an indication of items to consider and the technical requirements to be applied when determining the lease term, such as the following:

- Is the economic life of the battery the ceiling to be applied in this fact pattern?
- The interaction with IFRS 16.B35 because the lessor could be viewed as having an implicit option to cancel the lease by substituting the battery. Because it is a lessor option, then the lessee would be required to disregard the option in accordance with the requirements of IFRS 16.B35.

6 February 2023

Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Mr Mackenzie

Tentative agenda decision – Definition of a Lease – Substitution Rights (IFRS 16)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November 2022 IFRIC Update of the tentative agenda decision (TAD) not to take onto the Committee's agenda the request about how to assess whether a contract contains a lease.

With regards to the first issue addressed within the TAD, the level at which to evaluate whether a contract contains a lease, we agree with the decision not to add this item on to the Committee's agenda and the conclusions as presented in the TAD.

On the second issue of how to assess whether a contract contains a lease when the supplier has particular substitution rights, we acknowledge that it may be reasonable to conclude that in the fact pattern presented in the TAD the supplier's substitution right is not substantive. However, we are concerned that the conclusion seems to be based on the fact that the supplier does not benefit economically from substitution *throughout* the period of use. This conclusion implies that a substitution right is only substantive if it is economically beneficial to the supplier at all times during the lease term.

We note that IFRS 16:B16 states:

'An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur.'

This paragraph can reasonably be read to indicate that future events that are likely to occur should be considered in the assessment of whether a substitution right is substantive. We note that in practice there will often be a period at the start of a lease where substitution is not economically beneficial to the supplier. We expect that a supplier would apply judgement and consider all factors in IFRS 16:B15-B19 to determine whether the substitution right is substantive.

Whilst in the fact pattern in the TAD there is a clearly defined period where the supplier is not expected to benefit economically from exercising its right to substitute a battery, in other fact patterns there may be some uncertainty over the date when substitution becomes economically beneficial and the period during which substitution is not economically beneficial may not be significant in the context of the overall

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contract. In these circumstances it would appear reasonable to consider these factors as part of the judgement in determining whether a supplier's right to substitute an asset is substantive throughout the period of use.

We would therefore suggest that to improve the applicability of the analysis to other fact patterns, the TAD should explain the judgement applied in reaching the conclusion that the condition in IFRS 16:14(b) is not met in the fact pattern presented in the TAD.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'V Poole', with a stylized flourish at the end.

Veronica Poole
Global IFRS and Corporate Reporting Leader

PRE-003/23

February, 06 th, 2022

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Reference: Tentative Agenda Decision (TAD): Definition of a Lease—Substitution Rights (IFRS 16)

Dear IFRS Interpretations Committee members,

The Brazilian Association of Public Companies (ABRASCA, as abbreviated in Portuguese) welcomes the opportunity to submit comments on the Tentative Agenda Decision (TAD) Lessor Definition of a Lease—Substitution Rights (IFRS 16). Our comments reflect the views of our 474 members, which include companies of different sizes and different segments in Brazil.

ABRASCA supports the IFRS Interpretations Committee (Committee) initiative to discuss a request received to provide guidance on the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the TAD.

Before applying the requirements in IFRS 16 to the fact pattern, we noted that the Committed reproduced in a section of the TAD extracts from the relevant literature and included the following observation:

Consequently, the Committee observed that the requirements in paragraphs B13–B19 set a high hurdle for a customer to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The Committee also observed that determining whether a supplier's right to substitute an asset is substantive *throughout* the period of use requires judgement. (Emphasis added)

In another section of the TAD, the Committed applied the requirements in IFRS 16 to the fact pattern. Despite having previously mentioning that determining whether a supplier's right to substitute an asset is substantive *throughout* the period of use requires judgement, the conclusion regarding the existence of an identified asset in the fact pattern does not refers to judgement whatsoever. More specifically, the Committee concluded the following:

(...) The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is

not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier's substitution right is not substantive throughout the period of use.

A literal application of the preceding paragraph could mean that if there is expectation – at the inception of the contract - that a supplier would not benefit economically from the substitution of an asset for one single day or week, the supplier's substitution right would not be substantive throughout the period of use. A day or a week is part of the period of use. If such literal interpretation of the TAD is not the intention of the Committee, we ask for clarification.

If you have any questions regarding our comments, please contact us at abrasca@abrasca.org.br.

Best regards,

A handwritten signature in black ink, appearing to be 'Pablo Cesário', written in a cursive style.

Pablo Cesário
CEO
ABRASCA Brazilian Association of Public Companies