

## STAFF PAPER

January 2020

## IFRS® Interpretations Committee meeting

Project	Definition of a Lease—Shipping Contract (IFRS 16)		
Paper topic	Agenda decision to finalise		
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## Introduction

1. In September 2019, the IFRS Interpretations Committee (Committee) published a [tentative agenda decision](#) in response to a submission asking whether, applying IFRS 16 *Leases*, the customer has the right to direct the use of a ship throughout the five-year term of a particular contract.
2. In the fact pattern described in the submission:
  - (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.
  - (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 the remaining relevant decisions about how and for what purpose the ship is used throughout the period of use. Those decision-making rights are relevant because they affect the economic benefits to be derived from use of the ship.
  - (d) the supplier operates and maintains the ship throughout the period of use.

3. In considering the question, the Committee observed that in the fact pattern described in the submission:
  - (a) because not all relevant decisions about how and for what purpose the ship is used are predetermined, the customer considers paragraph B24(a) of IFRS 16 in assessing whether it has the right to direct the use of the ship;
  - (b) within the scope of its right of use defined in the contract, the customer can change how and for what purpose the ship is used. The predetermination in the contract of many of the relevant 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; and
  - (c) 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.
4. Accordingly, the Committee concluded that, in the fact pattern described in the submission, the customer has the right to direct the use of the ship throughout the five-year period of use and, consequently, the contract contains a lease.
5. The objective of this paper is to:
  - (a) analyse the comments on the tentative agenda decision; and
  - (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision.
6. There are three appendices to this paper:
  - (a) Appendix A—Proposed wording of the agenda decision;
  - (b) Appendix B—Comment letters; and
  - (c) Appendix C—Other comments.

## Comment Letter Summary

7. We received 13 comment letters by the comment letter deadline. All comments received, including any late comment letters, are available on our [website](#)<sup>1</sup>. This agenda paper includes analysis of only the comment letters received by the comment letter deadline. These are reproduced in Appendix B to this paper.
8. Nine respondents (Accounting Standards Committee of Germany (ASCG), Malaysian Accounting Standards Board (MASB), Institute of Indonesia Chartered Accountants (IAI), Accounting Standards Board of India (ICAI), David Hardidge, the Institute of Chartered Accountants of Nigeria (ICAN), Deloitte, National Board of Accountants and Auditors (NBAA) [Tanzania] and Mazars) agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons set out in the tentative agenda decision. Five of these respondents (ASCG, ICAI, David Hardidge, Deloitte and Mazars) suggest improvements to the wording of the agenda decision.
9. Of the four remaining respondents:
  - (a) Petróleo Brasileiro (Petrobras) disagrees with the Committee's technical conclusion;
  - (b) the Accounting Standards Board of Japan (ASBJ) requests clarity about an important aspect of the fact pattern;
  - (c) Shady Mehelba disagrees with the Committee's decision not to add the matter to its standard-setting agenda; and
  - (d) Md Mazedul Islam disagrees with parts of the fact pattern in the tentative agenda decision.
10. Further details about respondents' comments, together with our analysis, are presented below.

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<sup>1</sup> At the date of posting this agenda paper, there were no late comment letters.

## Staff analysis

### ***Structure of our analysis***

11. This paper analyses separately comments that relate to:
  - (a) the Committee’s technical conclusion. Respondents’ comments on the Committee’s technical analysis and conclusion relate to determining whether particular decision-making rights are relevant to changing how and for what purpose the asset is used. Respondents raised the following:
    - (i) does the customer need to assess which decision-making rights are relevant (paragraphs 13–18)?
    - (ii) how does the customer determine which decision-making rights are relevant (paragraphs 19–26)?
    - (iii) is the information in the fact pattern sufficient to reach a conclusion (paragraphs 27–31)?
  - (b) requests for standard-setting—decisions determined before the period of use (paragraphs 32–35).
12. Appendix C to this paper analyses all other comments.

### ***Does the customer need to assess which decision-making rights are relevant?***

#### *Respondents’ comments*

13. The ASBJ says the tentative agenda decision is unclear about whether:
  - (a) decision-making rights retained by the customer throughout the period of use would always be considered relevant, leading to the conclusion that the contract would always include a lease. If this is the intent of the agenda decision, the ASBJ disagrees with the Committee’s conclusion; or
  - (b) the customer first assesses, based on the facts and circumstances, whether those decision-making rights are relevant. The contract includes a lease only if the customer’s decision-making rights are relevant. If this is the intent of the agenda decision, the ASBJ agrees with the technical

conclusion but suggests that the final agenda decision clarify that the customer is required to determine whether its decision-making rights are relevant.

14. To clarify this point, both the ASBJ and Deloitte suggest changing the wording of bullet (c) of the fact pattern in the agenda decision. In effect, both respondents suggest clarifying that the customer has determined that its decision-making rights during the period of use are relevant because they affect the economic benefits to be derived from use of the ship.

*Staff analysis*

15. The tentative agenda decision notes that paragraph B24(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)’.

16. Paragraph B25 states (emphasis added):

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. Therefore, we agree with the ASBJ that the customer is required to determine whether its decision-making rights are those that are most relevant to changing how and for what purpose the asset is used throughout the period of use. In the fact pattern described in the agenda decision, the customer has already made this determination, concluding that its rights to make the remaining decisions about how and for what

purpose the ship is used throughout the period of use are relevant because they affect the economic benefits to be derived from use of the ship.

18. We also agree with the ASBJ and Deloitte that this point could be clarified in the agenda decision. Consequently, we recommend the following amendment to bullet (c) of the fact pattern (new text underlined, and deleted text struck through):

(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 the remaining ~~relevant~~ decisions about how and for what purpose the ship is used throughout the period of use. ~~Those~~ The customer has determined that those remaining decision-making rights are relevant because they affect the economic benefits to be derived from use of the ship.

***How does the customer determine which decision-making rights are relevant?***

*Respondents' comments*

19. Five respondents (Deloitte, Mazars, the ASCG, the ASBJ and Petrobras) raise comments or questions about how the customer determines which decision-making rights are relevant.
20. Two of those respondents (Deloitte and Mazars) say it would be helpful for the agenda decision to include analysis of how the customer determines the decision-making rights that are relevant to changing how and for what purpose the asset is used. For example, Deloitte suggests adding the following concluding paragraph to the agenda decision:

In particular, the contract specifies the customer's right to use an identified ship for a five-year period to transport a specific load of a specific type of commodity from three separate points of origin to a common destination point – thus making these aspects of the contract pre-determined. However, the customer has the right to determine the order of voyages throughout the period of use (i.e. to determine from where the ship sails for

each voyage), which in the circumstances, significantly impacts the economic benefits expected from use of the ship.

21. The ASCG also suggests additional clarity about the relevance of the customer’s decision-making rights:

As the main conclusion...appears to be that the “customer’s right of use” (i.e. the right to direct how and for what purposes an asset is used) mainly depends on whether or not “the customer has the right to make all *relevant* decisions” – which the customer seems to have in this fact pattern –, it should be underlined in this context that “*relevant*” connotes to “*affect[ing] the economic benefits to be derived from the use*”.

22. In contrast, the ASBJ and Petrobras suggest that the tentative agenda decision is overly specific. Petrobras says ‘this tentative agenda decision would restrict an entity’s ability to make judgments when applying IFRS 16.’ The ASBJ says ‘in other cases, the customer’s remaining decision-making rights may not be relevant because they do not affect the economic benefits to be derived from use of the ship.’ Therefore, the ASBJ suggests adding the following to the Committee’s conclusion:

The conclusions are reached based on the customer’s determination that the remaining decision rights are relevant. It should be noted that there may be cases where the customer’s remaining decision-making rights are not relevant and, therefore, the contract does not include a lease.

*Staff analysis*

23. The question submitted asked whether, applying IFRS 16, the customer has the right to direct the use of a ship throughout the five-year term of a particular contract. The contract was one for which the customer could make one important decision about how and for what purpose the ship is used throughout the period of use, with all other decisions about how and for what purpose the ship is used being predetermined in the contract. The tentative agenda decision explained how an entity applies the requirements in IFRS 16 in that situation; it did not address the very specific decision-making rights described in the submission.

24. We continue to support this approach. In our view, such an approach is more helpful to stakeholders in understanding how to apply the requirements in IFRS 16 than changing the analysis to focus on the very specific decision-making rights described in the submission. This is because the agenda decision would explain how to apply IFRS 16 not only to the particular contract in the submission but also in other situations in which some—but not all—decisions about how and for what purpose an asset is used are predetermined, and the customer has the right to make relevant how and for what purpose decisions that are not predetermined. Focussing on the very specific decision-making rights in the submission could limit the usefulness of the agenda decision.
25. We disagree with the ASBJ’s suggestion to include a statement in the conclusion about other contracts that might not contain a lease—in our view, the agenda decision should conclude only on the fact pattern it describes; a conclusion about other contracts (for which the customer’s decision-making rights are not relevant) would complicate the agenda decision and, thus, potentially be confusing.
26. However, we agree that it would be helpful to highlight in the agenda decision the requirements in paragraph B25 of IFRS 16 that specify when decisions-making rights are relevant. We therefore recommend adding the following sentence to the Committee’s analysis of ‘the right to direct how and for what purpose an asset is used’:

The customer has the right to make decisions about the use of the ship that affect the economic benefits to be derived from that use.

***Is the information in the fact pattern sufficient to reach a conclusion?***

27. Petrobras disagrees with the Committee’s technical conclusion because, in its view:
- (a) assessing whether the customer’s decision-making rights are relevant is a matter of judgement and does not require a conclusion from the Committee; and



- (b) the information in the fact pattern is insufficient to conclude that the customer has the right to direct the use of the asset (and thus that the contract contains a lease). Petrobras says, based on the fact pattern, ‘one could assert that all relevant decisions are predetermined’.

*Staff analysis*

28. We agree that, depending on the facts and circumstances, judgement may be involved in determining whether particular decision-making rights are relevant. However, an entity must make that determination applying the requirements in IFRS 16. As highlighted in the tentative agenda decision, an entity applies:
  - (a) paragraph B25 which states ‘[a]n 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’; and
  - (b) paragraph B26 that includes examples of relevant decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used.
29. We note that, for decision-making rights to be relevant, IFRS 16 requires only that those decision-making rights *affect* the economic benefits to be derived from use; IFRS 16 does not state ‘significantly affect’ or otherwise imply any threshold in making that determination. For this reason, we would expect relatively little judgement to be required to make that determination.
30. We disagree with Petrobras’s view that the information in the fact pattern is insufficient to conclude that the contract contains a lease on the grounds that one could assert that all relevant decisions are predetermined. This is because the fact pattern described in the agenda decision states that the customer (a) has decision-making rights during the period of use; and (b) has determined that those decision-making rights affect the economic benefits to be derived from use of the ship. Consequently, applying paragraph B25, the customer’s decision-making rights are relevant and, in the fact pattern described, give the customer the right to direct the use

of the ship because the supplier has no such how and for what purpose decision-making rights.

31. Furthermore, as noted in the tentative agenda decision and described in paragraph BC121 of IFRS 16, the Board ‘would expect decisions about how and for what purpose an asset is used to be predetermined in relatively few cases.’ Given that the customer has relevant decision-making rights during the period of use, in our view there is little doubt that, in this fact pattern, all relevant decisions are *not* predetermined.

***Request for standard-setting—decisions determined before the period of use***

*Respondent’s comments*

32. Shady Fouad Mehelba recommends the following amendment to B29 of IFRS 16 (suggested new text underlined):

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). In conjunction with those decisions prior to, or during period, of use of asset, entity should consider substance of predetermined decisions that affect entity’s ability to direct the use of asset. Consequently, unless the conditions in paragraph B24(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use...

*Staff analysis*

33. Applying paragraph B29, decisions that are predetermined and cannot be changed during the period of use do not affect the assessment of whether the customer has the right to direct the use of an asset (unless those decisions relate to the design of the asset).

34. Paragraph B29 explains that if, for example, 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 considers those rights when assessing whether it has the right to direct the use of the asset.
35. In our view, paragraph B29 is clear in this respect and, therefore, we recommend no amendment to that paragraph.

### Staff recommendation

36. On the basis of our analysis, we recommend finalising the agenda decision as published in [IFRIC Update](#) in September 2019, with the changes recommended in paragraphs 18 and 26 of the paper. Appendix A sets out the proposed wording of the final agenda decision.

**Question for the Committee**

Does the Committee agree with our recommendations in paragraph 36 of this paper?

## Appendix A—Proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined, and deleted text is struck through).

### Definition of a Lease—Predetermined decision-making rights ~~Shipping Contract~~ (IFRS 16)

The Committee received a request about whether the customer has the right to direct the use of a ship throughout the five-year term of a particular 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.
- 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 the remaining ~~relevant~~ decisions about how and for what purpose the ship is used throughout the period of use. ~~Those~~ The customer has determined that those remaining decision-making rights are relevant because they affect the economic benefits to be derived from use of the ship.
- d. the supplier operates and maintains the ship throughout the period of use.

### The right to direct the use of an identified asset

Paragraph B24 of IFRS 16 specifies when a customer has the right to direct the use of an identified asset throughout the period of use. Paragraph B24(b) applies only when the relevant decisions about how and for what purpose the asset is used are predetermined. The Board noted in paragraph BC121 of IFRS 16 that ‘it would expect decisions about how and for what purpose an asset is used to be predetermined in relatively few cases’.

The Committee observed that, in the fact pattern described in the request, because not all relevant decisions about how and for what purpose the ship is used are predetermined, the customer considers paragraph B24(a) of IFRS 16 in assessing whether it has the right to direct the use of the ship.

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

Paragraph B24(a) 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. 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 can change how and for what purpose the ship is used. The customer has the right to make decisions about the use of the ship that affect the economic benefits to be derived from that use. The predetermination in the contract of many of the relevant 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.

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.

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 and, consequently, the contract contains a lease.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine ~~its accounting for whether~~ the contract described in the request contains a lease. Consequently, the Committee ~~{decided}~~ not to add the matter to its standard-setting agenda.

## **Appendix B—Comment letters**

## Appendix C—Other comments

C1. The following table summarises respondents’ comments together with our analysis and conclusions.

<b>Respondents’ comments</b>	<b>Staff analysis and conclusions</b>
<p><i>1. Non-lease components of the contract</i></p> <p>The ICAI suggests that it may be helpful to clarify whether the contract has a non-lease service component, noting that the lessor maintains and operates the ship.</p>	<p><i>We recommend no change to the agenda decision in response to this comment.</i></p> <p>The question submitted asks whether the customer has the right to direct the use of the ship and, thus, whether the contract contains a lease. Addressing non-lease components of the contract goes beyond the question asked.</p>
<p><i>2. Reference to paragraph B24(b) in the agenda decision</i></p> <p>David Hardidge suggests that the first reference to paragraph B24(b) should clarify that the Committee’s view is that ‘relevant decisions’ in paragraph B24(b) means all relevant decisions. The tentative agenda decision currently states ‘Paragraph B24(b) applies only when the relevant decisions about how and for what purpose the asset is used are predetermined.’</p>	<p><i>We recommend no change to the agenda decision in response to this comment.</i></p> <p>The wording in the tentative agenda decision reflects the wording of paragraph B24(b). The Committee included an important observation in the tentative agenda decision based on its analysis of the requirements: ‘The Committee observed that, in the fact pattern described in the request, because not all relevant decisions about how and for what purpose the ship is used are predetermined, the customer considers paragraph B24(a) of IFRS 16 in assessing whether it has the right to direct the use of the ship.’</p> <p>The Committee’s observation aligns with the flowchart in paragraph B31, and therefore reflects the requirements in IFRS 16.</p>



<b>Respondents' comments</b>	<b>Staff analysis and conclusions</b>
<p>3. <i>Observations about the fact pattern</i></p> <p>(a) Md Mazedul Islam disagrees that, in the fact pattern, the customer has the right to obtain substantially all the economic benefits from use of the ship. This is because the customer pays a portion of the economic benefits generated from use of the ship to the lessor in the form of lease payments.</p> <p>(b) Md Mazedul Islam describes situations (different from those in the fact pattern) in which he thinks a customer may have the right to make relevant decisions about how and for what purpose the ship is used throughout the period of use.</p> <p>(c) David Hardidge disagrees with the reference to 'many' in bullet (c) of the fact pattern, which states 'many, but not all, of the relevant decisions...are predetermined in the contract'. He suggests referring to 'some', instead of 'many', given the Committee's discussion.</p>	<p><i>We recommend no change to the agenda decision in response to these comments.</i></p> <p>Observation (a) is not relevant to the question asked, which addresses whether the customer has the right to direct the use of the ship. Nonetheless, we note that requirements in paragraph B23 of IFRS 16 state the opposite to the view set out in the comment letter.</p> <p>Observation (b)—discussing other situations—goes beyond the question asked.</p> <p>Regarding observation (c), in our view 'many' better reflects the fact pattern submitted and is helpful to retain in the final agenda decision. In this particular fact pattern, all but one of the how and for what purpose decisions (ie the starting point for each voyage) is predetermined.</p>

<b>Respondents' comments</b>	<b>Staff analysis and conclusions</b>
<p><i>4. Other fact patterns</i></p> <p>The MASB agrees with the Committee's technical conclusion, but notes that the conclusion might be different if the contract were to relate to a fleet of ships and the supplier could decide which ship to provide to the customer.</p>	<p><i>We recommend no change to the agenda decision in response to this comment.</i></p> <p>The Committee has discussed the fact pattern submitted; discussing a different fact pattern goes beyond the question asked.</p>