
IFRS[®] Interpretations Committee meeting

Date	March 2023
Project	Definition of a Lease—Substitution Rights (IFRS 16)
Topic	Comments on tentative agenda decision
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Introduction

1. At its November 2022 meeting, the IFRS Interpretations Committee (Committee) published a [tentative agenda decision](#) in response to a submission about how to assess whether a contract that includes a particular substitution right contains a lease.
2. This paper:
 - (a) analyses comments on the tentative agenda decision (paragraphs 10–51); and
 - (b) asks the Committee whether it agrees with our recommendation to finalise the agenda decision (paragraph 52).

Structure of the paper

3. This paper includes:
 - (a) Background information (paragraphs 5–9);
 - (b) Comment letter summary (paragraphs 10–15);
 - (c) Staff analysis (paragraphs 16–51); and
 - (d) Staff recommendation and questions for the Committee (paragraph 52).

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4. There are two appendices to this paper:
 - (a) Appendix A—proposed wording of the agenda decision; and
 - (b) Appendix B—analysis of other comments.

Background information

5. In the fact pattern described in the submission:
 - (a) 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).
 - (b) applying the requirements in paragraphs B14–B18 of IFRS 16, 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.
 - (c) 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.
6. The submission asked about:
 - (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 (Question A).

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- (b) how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights—that is, 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 (Question B).
7. For Question A, the Committee concluded that, in the fact pattern described in the submission, applying paragraph B12 of IFRS 16 the customer assesses whether the contract contains a lease—including evaluating whether the supplier’s substitution right is substantive—for each potential separate lease component (that is, for each battery).
8. For Question B, the Committee concluded that:
- (a) each battery is an identified asset. The Committee observed that the condition in paragraph B14(b) of IFRS 16—that the supplier would benefit economically from the exercise of its right to substitute the asset—does not exist throughout the period of use and, consequently, the supplier’s substitution right is not substantive throughout the period of use.
 - (b) 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.
9. Based on its analysis, 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 submission. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan and, instead, published the [tentative agenda decision](#) for comment.

Comment letter summary

10. We received 15 comment letters by the comment letter deadline. All comments received, including any late comment letters, are available on our [website](#)¹. This paper includes analysis of only the comment letters received by the comment letter deadline, which Agenda Paper 2A reproduces.

Question A: level at which to evaluate whether a contract contains a lease

11. Eleven respondents commented. Almost all of these respondents agree with the Committee's analysis and conclusion. Shady Mehelba says more information about the fact pattern would be needed to conclude.

Question B: assessing whether the contract contains a lease

12. Most respondents agree or do not necessarily disagree with the Committee's analysis and conclusion that, in the fact pattern described in the submission, there is an identified asset. However, many of these respondents:
- (a) raise questions about the Committee's technical analysis and conclusion that, in the fact pattern described in the submission, the supplier's substitution rights are not substantive *throughout* the period of use. In particular, these respondents suggest explaining the Committee's judgement in determining that the condition in paragraph B14(b) of IFRS 16 does not exist *throughout* the period of use.
 - (b) request other clarifications to the wording in the agenda decision.
13. Of the remaining respondents:
- (a) ACTEO, SOCPA and David Hardidge disagree with the Committee's analysis and conclusions; and

¹ At the date of posting this paper, there were three late comment letters.

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- (b) Sounder Rajan says more information would be needed to conclude whether, in the fact pattern, there is an identified asset.
14. Mazars suggests considering and concluding on whether the contract is, or contains, a lease. In addition, some respondents suggest considering and concluding on the lease term which they say was a question raised in the submission.
15. Further details about these matters, together with our analysis, are presented below.

Staff analysis

16. This section analyses:
- (a) comments on the Committee’s technical analysis and conclusion that, in the fact pattern described in the submission, the supplier’s substitution rights are not substantive *throughout* the period of use (paragraphs 18–32);
 - (b) requests to extend the scope of the agenda decision (paragraphs 33–38); and
 - (c) requests for standard-setting, including matters to examine in the post-implementation review (PIR) of IFRS 16 (paragraphs 39–51).
17. Appendix B analyses all other comments.

Whether supplier has substantive substitution rights throughout period of use

18. Paragraph B14 of IFRS 16 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. A supplier’s right to substitute an asset is substantive only if both of the following conditions exist:

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

19. The tentative agenda decision states:

...

The Committee also observed that determining whether a supplier's right to substitute an asset is substantive *throughout* the period of use requires judgement.

...

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.

Respondents' comments

20. Some respondents (PwC, BDO, Deloitte and ABRASCA) raise concerns about the wording of the Committee's analysis and conclusion on paragraph B14(b). Some of these respondents say the agenda decision does not explain the judgement applied to conclude that the condition in paragraph B14(b) does not exist throughout the period

of use in the fact pattern discussed. Consequently, in their view, the wording could inappropriately imply that the economic benefit to the supplier must exist ‘continuously throughout the period of use’ or ‘at all points in time over the contract term’.

21. Respondents raise concerns about the implications on other fact patterns (for example, situations in which a supplier cannot benefit economically from substitution for one day or one week) and say the agenda decision would result in far fewer, if any, substitution rights being concluded as substantive, which could contradict other requirements of IFRS 16. For example:

(a) Deloitte says:

...in practice there will often be a period at the start of a lease where substitution is not economically beneficial to the supplier...

...the period during which substitution is not economically beneficial may not be significant in the context of the overall contract. In these circumstances, it would appear reasonable to consider [all factors in paragraphs B15–B19 of IFRS 16] as part of the judgement in determining whether a supplier’s right to substitute an asset is substantive throughout the period of use.

(b) PwC says such an implication could be inconsistent with:

(i) paragraph B16 of IFRS 16, which excludes ‘consideration of future events that, at inception of the contract, are not considered likely to occur’.

(ii) Illustrative Example 2 accompanying IFRS 16. In that example, the supplier’s substitution rights are substantive because, among other facts, the supplier would benefit from substitution that allows the supplier ‘to make the most effective use of the space at boarding areas in the airport to meet changing circumstances’.

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22. Respondents suggest explaining the Committee’s judgement and thought process in reaching the conclusion to improve the applicability of the analysis to other fact patterns.
23. The ICAEW says paragraph B14(b) does not explicitly state that the supplier is required to benefit economically ‘throughout the period of use’. They suggest refining the wording in the agenda decision ‘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’. Similarly, ACTEO says ‘[i]t is clear in the standard that the notion of “throughout the period of use” is specified only for the first condition’.
24. ACTEO goes on to say the tentative agenda decision goes beyond a mere illustration of what IFRS 16 requires because ‘[...] none of the following paragraphs cited (B15–B18) explicitly state that the economic benefit must exist at all times’ and adds:
- 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.*
25. David Hardidge says in the fact pattern discussed, a substantive substitution right exists. He also says that although the supplier is not expected to benefit economically from exercising its right to substitute an asset for at least the first three years of the contract, ‘the supplier is not prevented from making a substitution if the information available to it suggests that a substitution should take place’; he says ‘it is the supplier that makes that decision, not the customer during that period’. Therefore, in his view, the supplier has a substantive substitution right throughout the period of use.

Staff analysis

26. The first sentence of paragraph B14 of IFRS 16 states (emphasis added) ‘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*’. The second sentence and the conditions in subparagraphs (a) and (b) include requirements to help assess only whether a substitution right is substantive—if applying the second sentence and the conditions in subparagraphs (a) and (b) an entity concludes that a substitution right is substantive, it is still required to apply the first sentence of paragraph B14 and assess whether that substantive substitution right exists throughout the period of use. Consequently, we continue to agree with the Committee that when assessing whether the customer has the right to use an identified asset, it is necessary to consider whether both conditions in paragraph B14 exist throughout the period of use.
27. We also continue to agree that judgement is required to assess whether a substitution right is substantive throughout the period of use. Paragraph B14(a) of IFRS 16 requires the supplier to have ‘the practical ability to substitute alternative assets *throughout* the period of use’ and states (emphasis added) ‘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*’. The example in paragraph B14(a) illustrates that ‘throughout the period of use’ does not mean at all points throughout that period—a supplier can have the practical ability to substitute alternative assets *throughout* the period of use even if it could source alternative asset only within *a reasonable period of time*.
28. While we think the tentative agenda decision does not suggest that the substitution right must exist at all points throughout the period of use, it could be helpful to amend the tentative agenda decision to:
- (a) refer to the example in paragraph B14(a) to illustrate that ‘throughout the period of use’ does not mean at every point in time during that period; and

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- (b) explain further the Committee’s conclusions about why, in the specific fact pattern discussed in the agenda decision, the supplier’s substitution right is not substantive throughout the period of use.
29. Appendix A to this paper includes our recommended amendments to the tentative agenda decision in this respect.
30. Based on our analysis, we continue to agree with the Committee 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 submission.
31. In response to ACTEO’s comment in paragraph 24, we note that the sentence in the tentative agenda decision ‘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’ simply reflects requirements in paragraph B9 of IFRS 16. Paragraph B9 states:
- To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs B13–B20) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
- (a) the right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs B21–B23); and
- (b) the right to direct the use of the identified asset (as described in paragraphs B24–B30).
32. We disagree with David Hardidge that the supplier’s substantive substitution right exists throughout the period of use because the supplier ‘is not prevented from making a substitution’. Paragraph B14(b) of IFRS 16 requires a supplier to, among other things, benefit economically from the exercise of its right to substitute the asset. If a

substitution right were deemed to be substantive solely on the basis that the supplier is not prevented from making a substitution, then the IASB would not have included the condition in paragraph B14(b). Meeting the condition in paragraph B14(a)—that the supplier has the practical ability to substitute alternative assets throughout the period of use—would have been sufficient to conclude that the supplier is not prevented from making a substitution.

Scope

33. The tentative agenda decision states:

...

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.

...

Respondents' comments

34. Mazars suggests including consideration of the other aspects of the definition of a lease and concluding whether the contract is, or contains, a lease. In addition, some respondents suggest considering and concluding on the lease term, which they say was a question raised in the submission.
35. David Hardidge comments on some of the other aspects of the definition of a lease and provides his views on the application of those requirements to the submitted fact pattern.

Staff analysis

36. As paragraph BC111 of the Basis for Conclusions on IFRS 16 explains, ‘[t]he first requirement for a contract to meet the definition of a lease in IFRS 16 is that a customer should control the use of an identified asset’. The submission acknowledges this (see the original submission reproduced in Appendix B to [Agenda Paper 2](#) of the Committee’s November 2022 meeting) and states ‘[t]his paper solely focuses on substitution rights—that is, it is assumed that *all other criteria of the definition of a lease are met*’.
37. The submission asks about the accounting implications of the substitution right and outlines the possible effects of the different views on the measurement of a right-of-use asset and lease liability (including what the resulting lease term would be). The submission does not however ask questions about those effects. Indeed, in our view the fact pattern described in the submission is not sufficiently detailed to allow the Committee to analyse or conclude on the other aspects of the definition of a lease. Such analysis would have required further details about the fact pattern.
38. Consequently, the Committee has appropriately focussed its analysis and conclusions on the supplier’s substitution rights in the context of the applicable requirements in IFRS 16. Nonetheless, it could be helpful to refer in the agenda decision to the requirements an entity would apply when assessing the lease term, as was done with respect to the other aspects of the definition of a lease. We think it would be helpful to highlight that an entity applies the requirements on the definition of a lease in IFRS 16 only in assessing whether a contract contains a lease; those requirements do not affect an entity’s determination of the lease term. Appendix A to this paper includes our recommended amendments to the tentative agenda decision in this respect.

Requests for standard-setting***Respondents' comments******Annual Improvement***

39. BDO says the phrase ‘throughout the period of use’ in the first sentence of paragraph B14 of IFRS 16 applies to both subparagraphs (a) and (b), so it does not need to be repeated in each subparagraph. However, BDO says the fact that paragraph 14(a) includes that phrase while paragraph 14(b) does not can lead to alternative readings—and consequently inconsistent application—of those requirements. BDO suggests adding the phrase ‘throughout the period of use’ to paragraph 14(b) as an annual improvement.

Concerns about the outcome

40. ACTEO and SOCPA raise concerns about the outcome of the agenda decision and suggest undertaking standard-setting:
- (a) ACTEO says the tentative agenda decision would inappropriately change the distinction between a service contract and a lease contract and would ‘seriously undermine the possibility of demonstrating any substitution rights’.
 - (b) SOCPA says the Committee’s conclusion ‘is a word for word interpretation of the current IFRS 16’. However, the resulting outcome does not, in their view, reflect economic reality and suggest reviewing paragraph B14 of IFRS 16. SOCPA also suggests considering further the assumption in IFRS 16 that a customer has access to information relating to a supplier’s ability to economically benefit from the exercise of its right to substitute the asset.
41. ACTEO says the agenda decision could be disruptive and may require entities to change their accounting practices retrospectively, which could be very onerous.

Other matters

42. ACTEO says there is a ‘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.’
43. Shady Mehelba suggests:
- (a) adding more examples to paragraph B14(a) of IFRS 16 to illustrate when a supplier has the practical ability to substitute assets; and
 - (b) clarifying the definition of ‘period of use’.
44. While agreeing with the Committee’s technical analysis and conclusions, Universidad Loyola Andalucía identify two related matters that they suggest considering in a PIR of IFRS 16.

Staff analysis***Annual Improvement***

45. We agree that the phrase ‘throughout the period of use’ in the first sentence of paragraph B14 of IFRS 16 (see paragraph 18 of this paper) applies to both subparagraphs (a) and (b). However, we think the requirements in paragraphs B13–B19 provide an adequate basis for an entity to assess whether substitution rights are substantive and therefore it is unnecessary to amend paragraph B14(b) as suggested by BDO. In our view, it would be difficult to propose amending only one aspect of the requirements on the definition of a lease in isolation. Further, we note that if the Committee decides to finalise the agenda decision, then the explanatory material in that agenda decision—which in our view does not add or change requirements in IFRS Accounting Standards—would be helpful in explaining how to apply the requirements in paragraphs B13–B19 to a fact pattern in which the supplier cannot

benefit economically from substitution throughout the period of use. The agenda decision would therefore improve the consistency of application of IFRS Accounting Standards (paragraph 8.3 of the [Due Process Handbook](#)).

Concerns about the outcome

46. Paragraphs BC112–BC115 of the Basis for Conclusions on IFRS 16 explain the IASB’s rationale in developing the requirements related to substitution rights. As the tentative agenda decision notes, ‘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 IASB also specifically considered situations in which a customer might have no access to information relating to a supplier’s ability to benefit economically from the exercise of its substitution right (paragraph BC115). As a consequence, the IASB developed the requirements in paragraph B19².
47. We think some of the concerns about the outcomes may have assumed that the agenda decision would be read to say that ‘throughout the period of use’ means at every point in time throughout that period. The additional wording suggested in Appendix A to this paper regarding ‘throughout the period of use’ may help alleviate those concerns.
48. When developing new requirements, the IASB considers the usefulness of the information provided by those new requirements. The Committee has responded to the questions asked in the submission. In such situations, we think the Committee’s role is to respond by explaining how to apply the requirements in the context of the particular facts submitted and not to reconsider the usefulness of the information provided by the requirements.

Other matters

49. We disagree with ACTEO that this and other recent agenda decisions are ‘gradually amending [IFRS 16] and fundamental principles on which it was based’. Agenda

² Paragraph B19 states: ‘If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.’

decisions cannot add or change requirements in IFRS Accounting Standards. Before publishing an agenda decision, the Committee assesses this requirement (including considering related comments on a tentative agenda decision). In addition—as required by paragraph 8.7 of the [Due Process Handbook](#)—before an agenda decision is published the IASB is asked whether it objects to the agenda decision. Specifically, IASB members are asked whether they object to the Committee’s conclusion that the agenda decision does not add or change requirements in IFRS Accounting Standards.

50. The suggestions in paragraph 43 go beyond the question asked in the submission and are, in our view, unnecessary.
51. The IASB will undertake a PIR of IFRS 16³. As part of Phase I of the [PIR process](#), the IASB identifies matters to be examined, drawing on discussions with the Committee, the IASB’s advisory groups and other interested parties. The IASB consults publicly on the matters identified. Interested stakeholders will have the opportunity to comment at that stage.

Staff recommendation and questions for the Committee

52. Based on our analysis in paragraphs 16-51 and Appendix B to this paper, we recommend finalising the agenda decision, as published in the [IFRIC Update](#) in November 2022, with changes to the tentative agenda decision as suggested in Appendix A to this paper. If the Committee agrees with our recommendation, we will ask the IASB whether it objects to the agenda decision at the first IASB meeting at which it is practicable to present the agenda decision.

Questions for the Committee

1. Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 52 of this paper?

³ At its meeting in September 2022, the IASB decided to consider in the second half of 2023 when to begin the PIR of IFRS 16.

Questions for the Committee

2. Do Committee members have any comments on the wording of the agenda decision in Appendix A?

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—Substitution Rights (IFRS 16)

The Committee received a request about how to assess whether a contract contains a lease.

The request asked about:

- 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.
- 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.

The definition of a lease

Paragraph 9 of IFRS 16 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’. Applying paragraph B9 of IFRS 16, to meet the definition of a lease the customer must have both:

- a. the right to obtain substantially all the economic benefits from use of an identified asset throughout the period of use; and
- b. the right to direct the use of the identified asset throughout the period of use.

The period of use is ‘the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)’. (Appendix A to IFRS 16)

Paragraph B12 of IFRS 16 states that ‘an entity shall assess whether a contract contains a lease for each potential separate lease component’ and directs an entity to paragraph B32 of

IFRS 16 for application guidance on separate lease components. Paragraph B32 specifies that the right to use an underlying asset is a separate lease component if both:

- a. the lessee can benefit from use of the underlying asset either on its own or together with other resources readily available to it; and
- b. the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

Identified asset

The first requirement for a contract to meet the definition of a lease is that a customer controls the use of an identified asset. Paragraphs B13–B20 of IFRS 16 provide application guidance on an identified asset.

Paragraph B13 states that ‘an asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer’.

But ‘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’ (paragraph B14). In that case, the supplier—rather than the customer—controls the use of the asset. As a consequence, there is no identified asset; the contract does not contain a lease.

For a substitution right to be *substantive*, paragraph B14 states that both of the following conditions must exist:

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

Paragraph B16 states that ‘an entity’s evaluation of whether a supplier’s substitution right is substantive excludes consideration of future events that, at inception of the contract, are not considered likely to occur.’

Paragraphs B15–B18 specify requirements that mean, in each of the following situations, a supplier’s substitution right is *not* substantive (or the customer is not precluded from having the right to use an identified asset):

- a. the supplier has the right or obligation to substitute the asset only on or after a particular date or the occurrence of a specified event;
- b. the supplier would benefit economically from the exercise of its right only on the occurrence of a future event that, at inception of the contract, is not considered likely to occur; or
- c. the supplier has the right or obligation to substitute the asset only for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available.

Paragraph B17 notes that the costs of substitution are more likely to exceed the associated benefits when the asset is located at the customer’s premises or elsewhere. ~~Paragraph B19 requires the customer to presume that a supplier’s substitution right is *not* substantive if the customer cannot readily determine whether the supplier has a substantive substitution right.~~

Paragraph BC113 of the Basis for Conclusions on IFRS 16 explains the IASB’s rationale in developing the requirements on substitution rights and states that ‘the IASB’s intention in including [these requirements] is to differentiate between:

- a. substitution rights that result in there being no identified asset because the supplier, rather than the customer, controls the use of an asset; and
- b. substitution rights that do not change the substance or character of the contract because it is not likely, or practically or economically feasible, for the supplier to exercise those rights’.

Paragraph BC113 goes on to explain that, at the time of developing IFRS 16, the IASB was of the view ‘that, in many cases, it will be clear that the supplier would not benefit from the exercise of a substitution right because of the costs associated with substituting an asset’.

Paragraph B19 requires the customer to presume that a supplier’s substitution right is not substantive if the customer cannot readily determine whether the supplier has a substantive substitution right. Paragraph BC115 explains ‘[i]t is intended that a customer should assess whether substitution rights are substantive if it is reasonably able to do so—
If substitution rights are substantive, then the IASB thinks that this would be relatively clear from the facts and circumstances’ (paragraph BC115).

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. The example in paragraph B14(a)—specifying that the supplier has the practical ability to substitute alternative assets throughout the period of use even if it does not already have alternative assets but could source those assets within a reasonable period of time—illustrates that ‘throughout the period of use’ does not mean every minute of every day within that period.

Application of the requirements in IFRS 16 to the fact pattern described in the request

In the fact pattern described in the request:

- a. *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).*
- b. *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.*

- c. *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.*

The level at which to evaluate whether a contract contains a lease

In the fact pattern described in the request, the customer is able to benefit from use of each asset (a battery) together with other resources (a bus) available to it and each battery is neither highly dependent on, nor highly interrelated with, the other batteries in the contract.

Therefore, the Committee concluded that, in the fact pattern described in the request, applying paragraph B12, the customer assesses whether the contract contains a lease—including evaluating whether the supplier’s substitution right is substantive—for each potential separate lease component, ie for each battery.

Identified asset

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. While determining whether a supplier's substitution right is substantive throughout the period of use can require judgement, the Committee observed that the facts and circumstances in this fact pattern are such that it is clear that the supplier's right is not substantive throughout that period. 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 assess ~~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. If the customer concludes that the contract contains a lease, it would apply the requirements in paragraphs 18–21 of IFRS 16 to determine the lease term.

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.

Appendix B—analysis of other comments

B1. The following table summarises respondents’ comments together with our analysis and conclusions.

Respondents’ comments and suggestions	Staff analysis and conclusions
<p><i>1. Paragraph B19 of IFRS 16</i></p> <p>Paragraph B19 of IFRS 16 states ‘If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive’.</p> <p>PwC suggests reinforcing the importance of this paragraph given the high hurdle that is required in assessing if substitution right is ‘readily determinable’.</p>	<p><i>We recommend adding a sentence to the agenda decision.</i></p> <p>Paragraph BC115 of IFRS 16 explains the IASB’s rationale for including paragraph B19 and explains ‘it is intended that a customer should assess whether substitution rights are substantive if it is reasonably able to do so.’</p> <p>The agenda decision already reproduces the requirements in paragraph B19. We think it would be helpful to add wording from paragraph BC115 to the agenda decision.</p> <p>Appendix A includes the recommended addition (new text is underlined).</p>
<p><i>2. Application of the requirements on asset substitution</i></p> <p>BDO suggests clarifying that the requirements on asset substitution in paragraphs B13–B19 of IFRS 16 need to be considered individually and as a whole.</p>	<p><i>We recommend no change.</i></p> <p>The agenda decision reproduces the relevant requirements in paragraphs B13–B19 and we think it is unnecessary to make the suggested clarification.</p>
<p><i>3. Lessee / lessor perspective</i></p> <p>PwC suggests clarifying which parts of the analysis are applicable for both the lessee</p>	<p><i>We recommend no change.</i></p> <p>The submission asks about how a customer assesses whether a contract contains a lease.</p>

Respondents' comments and suggestions	Staff analysis and conclusions
<p>and the lessor compared to the parts that are applicable for the lessee only.</p>	<p>Accordingly, the Committee's technical analysis and conclusions focus on the customer. While we agree that many of the requirements discussed in the agenda decision also apply to the supplier, we think considering the supplier's perspective and highlighting which requirements apply to the supplier would go beyond the questions asked.</p>
<p><i>4. Additional facts and clarifications</i></p> <p>Two respondents (Sounder Rajan and Shady Mehelba) said additional facts and clarifications would be needed to answer the submitter's questions.</p>	<p><i>We recommend no change.</i></p> <p>We think it is unnecessary to obtain additional facts and clarifications. The facts noted in the agenda decision (and provided in the submission) are sufficient to answer the questions asked.</p>
<p><i>5. Consider other circumstances</i></p> <p>Shady Mehebla encourages the Committee to consider other situations involving substitution rights to assess whether further clarification or guidance to paragraph B14(a) is needed.</p>	<p><i>We recommend no change.</i></p> <p>Considering other situations would go beyond the questions asked.</p>