



## 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](mailto:frf@icaew.com) quoting REP 10/23.

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## 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.