

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 network<sup>1</sup>, 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](mailto: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.