



The IFRS Interpretations Committee
The Chairman
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

26 July 2019

Dear Madam,

Re: IFRIC Tentative Agenda Decision “Lease Term and Useful Life of Leasehold Improvements” (June 2019)

We are writing to express our concern with the rationale used to explain the IFRS Interpretations Committee’s (IFRIC) tentative decision not to add the issue of the lease term of a cancellable lease or a renewable lease to its agenda. While we do not disagree with this tentative decision, i.e. that IFRS 16 provides an adequate basis to determine the lease term of cancellable and renewable leases, we are of the view that the rationale is not clearly or fully developed and could be interpreted as a change in the application of the standard which would require standard-setting activity if it were to become recognised as the most appropriate approach.

Furthermore, we are not convinced that the rationale responds to the specific issue raised, which was: Specifically, the request asked whether, when applying paragraph B34 of IFRS 16 and assessing ‘no more than an insignificant penalty’, an entity considers the broader economics of the contract, and not only contractual termination payments. Such considerations might include, for example, the cost of abandoning or dismantling leasehold improvements.

Rather than examining the significance of ‘no more than an insignificant penalty’, the focus of the rationale seems to be placed on the term “enforceable”. The tentative agenda decision states that “In determining the lease term and assessing the length of the non-cancellable period of a lease, paragraph B34 of IFRS 16 requires an entity to determine the period for which the contract is enforceable. Paragraph B34 specifies that ‘a lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.’”

However, in describing the application of the latter requirement, the IFRIC states that “Applying paragraph B34, a lease is no longer enforceable only when both parties have such a right. Consequently, if only one party has the right to terminate the lease without permission from the on the party with no more than an insignificant penalty, the contract is enforceable beyond the date on which it can be terminated by that party.”



Although it is true that the contract is unenforceable when both parties have the right to terminate, it is misleading to infer that if only one party has the right to terminate, the contract is enforceable beyond the termination date. In this, it would be more accurate to state that the contract is enforceable after the specified date only for the party that has the right to terminate or renew, since the other party cannot impose its rights. This is specified in paragraph B35 of the standard.

The IFRIC wording appears to us to introduce confusion to the requirement of paragraph B34 cited by the IFRIC, and to be in contradiction to the explanation provided by paragraph BC127 accompanying IFRS 16 (our emphasis added):

“Cancellable leases

BC127 For the purposes of defining the scope of IFRS 16, the IASB decided that a contract would be considered to exist only when it creates rights and obligations that are enforceable. Any non-cancellable period or notice period in a lease would meet the definition of a contract and, thus, would be included as part of the lease term. To be part of a contract, any options to extend or terminate the lease that are included in the lease term must also be enforceable; for example the lessee must be able to enforce its right to extend the lease beyond the non-cancellable period. If optional periods are not enforceable, for example, if the lessee cannot enforce the extension of the lease without the agreement of the lessor, the lessee does not have the right to use the asset beyond the non-cancellable period. Consequently, by definition, there is no contract beyond the non-cancellable period (plus any notice period) if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term. In assessing the enforceability of a contract, an entity should consider whether the lessor can refuse to agree to a request from the lessee to extend the lease.

We think that the fundamental (and unanswered) question posed is whether the matter of the other than ‘insignificant penalty’ should be taken into consideration when determining the lease term, and if so, how this should be done. The use of the condition of the insignificant penalty in the application section of published IFRS 16 without further explanation may cause confusion about its purpose and may warrant explanation by the IFRIC, but we think that the current text of the tentative agenda decision does not clarify the issue submitted and confuses existing understanding of the standard.

We therefore encourage the IFRIC to reconsider its rationale for this tentative agenda decision and to ensure that there is no risk that it might introduce changes with unintended consequences.

Yours sincerely,

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