

Jan 30, 2023

IFRS Foundation  
7 Westferry Circus,  
Canary Wharf  
London E14 4HD,  
United Kingdom

### **SOCPA Comments on *Tentative Agenda Decision, Definition of a Lease—Substitution Rights (IFRS 16)***

**Dear Colleagues,**

The Saudi Organization for Chartered and Professional Accountants (SOCPA) appreciates the efforts of the IFRS Interpretations Committee (Committee) and welcomes the opportunity to comment on the *Tentative Agenda Decision, Definition of a Lease—Substitution Rights (IFRS 16)*.

Our comments on the 2 questions raised in the request received by the IFRS Interpretation committee are given below.

- 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.***

SOCPA agrees with the conclusion in the tentative agenda decision and believes the principles in paragraph B12 and B32 of IFRS 16 address this. As detailed in paragraph B32, the assessment whether a contract contains a lease should be made for each asset, if the customer (lessee) can benefit from the use of the asset on its own or together with other resources readily available to the customer (lessee) and the underlying asset is neither highly dependent on, nor highly interrelated with, other assets in the contract.

- b. How to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights – i.e. 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***

Based on the fact pattern in the request received by the IFRS Interpretation committee, it would be clear that the supplier has the practical ability to substitute alternative assets throughout the period of use. However, the question is whether the supplier would benefit economically from the exercise of its right to substitute the asset throughout the period of use.

Paragraph B14 of IFRS 16 states:

“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) .....
- (b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).”

In the tentative agenda “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.”

While the committee’s conclusion in the tentative agenda is a word for word interpretation of the current IFRS 16, SOCPA sees an anomaly in this conclusion. In the fact pattern, the total term of the contract is 10 years, and 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. The concern here is whether the committee’s conclusion is supported by paragraph B14(b), i.e., is it sufficient to comply with paragraph B14(b) when the absence of lessor’s economic benefit is only for a part of the lease term. What about the length of such absence? For example, what if the scenario stated that the supplier is not expected to benefit economically from exercising its right to substitute a battery for one month? Would it still be interpreted to conclude that the supplier’s substitution right is not substantive throughout the period of use?

SOCPA believes this area requires further study. If there were 2 similar transactions, in one of which the supplier is expected to benefit economically from exercising its right to substitute an asset anytime during the contract term, and in the other the supplier is not expected to benefit economically from exercising its right to substitute an asset for only a part of the contract term - should the two transactions be accounted for by the customer (lessee) differently? i.e. In one instance the contract does not contain a lease and in the other the contract contains a lease.

SOCPA understands IFRS 16 was introduced to increase visibility of companies’ lease commitments and better reflect economic reality. It seems that the tentative agenda conclusion and the current IFRS 16 when applied to the fact pattern in the request and the scenarios detailed above do not reflect the economic reality of the transactions.

SOCPA agrees that the requirements in paragraphs B13–B19 of IFRS 16 set a high threshold for a customer (lessee) to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The inclusion of paragraph B14(b) perhaps strengthens this, but in reality, the assumption implied in the standard that a customer (lessee) have access to information relating to a supplier’s (lessor’s) ability to economically benefit from the exercise of its right to substitute the asset needs further consideration.

Even if the assumption about the customer’s access to the lessor information is held, there is still a case for the contract to be split into 2 different periods that should be accounted for separately; i.e. a period in which paragraph B14 is fulfilled and a period in which paragraph B14 is not met.

Based on our observations, we believe the IASB should review paragraph B14 and determine if it assists to increase visibility of companies’ lease commitments and better reflect economic

reality of transactions or if there is an alternative approach that needs to be considered. Therefore, we believe that the current principles and requirements in IFRS 16 **do not** provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease in the fact pattern described in the request. Consequently, the Committee **should decide the addition of** a standard-setting project to the work plan.

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,



**Dr. Ahmad Almeghames**  
Chief Executive Officer