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Chair
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20 August 2019

Dear Ms Lloyd

Tentative agenda decision – IFRS 16 – Lease term and useful life of leasehold improvements

We are pleased to comment on the above tentative agenda decision.

We agree with the IFRS Interpretation Committee's decision not to add this issue to its agenda, and with the reasons set out in the tentative agenda decision.

However, in relation to the determination of the lease term, although the requirements of IFRS 16 can be analysed and interpreted to be clear, we believe that there is potential for confusion due to the way in which the words 'enforceable' and 'penalty' are used.

For 'enforceable' this is because a common understanding of 'enforceable' in the context of a contract between two parties is that both of those parties are bound by the terms of that contract. In the context of the requirements in IFRS 16, that is not necessarily the case; in particular, IFRS 16.B34 notes that:

> '…a lease is no longer enforceable only 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.'

Consequently, when only one of the two parties to a lease has that right, the lease is considered to be enforceable. In the context of the requirements of IFRS 16, we agree with the accounting outcome that this leads to. However, we suggest that it would be helpful for some educational material to be developed in order to explain more clearly how and why the term 'enforceable' is used in IFRS 16.

For ‘penalty’ this is because a common understanding of ‘penalty’ is a monetary payment that is imposed. In the context of IFRS 16.B34 that is not necessarily the case. We suggest additional wording be added to item (a) in the tentative agenda decision to clarify the meaning of the use of the word ‘penalty’ as follows:

> ‘…the broader economics of the contract, and not only contractual termination payments. For example, if either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination, <u>which economically compels either party to not terminate the contract</u>, that is more than insignificant, the contract is enforceable beyond the date on which the contract can be terminated; and…’

In our view, this is a good illustration of the point we raised in our recent due process handbook comment letter regarding the nature of explanatory material in agenda decisions and their inclusion in the Bound Volume of the IFRS Standards. In that letter we provided suggested additional language to paragraphs 8.3 and 8.5 that agenda decisions ‘also have authority as implementation guidance because the explanatory material links together the principles and requirements in IFRS standards and sets out the accounting requirements for the fact pattern under consideration’. The additional wording that we have suggested, while providing further explanation of and clarity about what the words in IFRS 16 mean, goes no further than the published requirements in that Standard.

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)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan.

Andrew Buchanan

Global Head of IFRS