

06 August 2019

Ms. Sue Lloyd
Chair of the IFRS Interpretations Committee
International Accounting Standards Board
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**Comments on the Tentative Agenda Decision Relating to
IFRS 16 *Leases* and IAS 16 *Property, Plant and Equipment*—
Lease Term and Useful Life of Leasehold Improvements**

1. The Accounting Standards Board of Japan (the “ASBJ” or “we”) welcome the opportunity to comment on the IFRS Interpretation Committee (the “Committee”)’s tentative agenda decision relating to IFRS 16 *Leases* and IAS 16 *Property, Plant and Equipment* — Lease Term and Useful Life of Leasehold Improvements, proposed in the June 2019 IFRIC Update.
2. The tentative agenda decision proposes that an entity consider the economics of the contract in determining the period for which the contract is enforceable. Our understanding is that this decision is consistent with the treatment in Accounting Standards Update No. 2016-02, *Leases (Topic 842)*.
3. However, we are of a view that it is difficult for the agenda decision to conclude that it is clear that the economic losses, which only one of the parties incurs without a legal or contractual obligation to pay to the other party, are included in the term ‘penalty’ described in paragraph B34 of IFRS 16 for the following reasons:
 - (a) The definition of contract in paragraph B34 of IFRS 16 is the same as that in IFRS 15 *Revenue from Contracts with Customers*. Paragraph 10 of IFRS 15 states that ‘a contract is an agreement between two or more parties that creates

enforceable rights and obligations’ and that ‘enforceability of the rights and obligations in a contract is a matter of law.’

- (b) According to the IASB staff’s analysis, paragraphs BC127 to BC129 and paragraphs BC155 to BC157 of IFRS 16 suggest that the economics of a contract are relevant to the determination of a lease term. However, paragraphs BC127 to BC129 of IFRS 16 merely discuss the enforceability of a contract, that is, whether each party to a lease contract has enforceable rights and obligations, and do not discuss economic losses which only one of the parties incurs.

In addition, paragraphs BC155 to BC157 of IFRS 16 merely state that an entity should consider the economics of a contract in assessing whether a lessee is reasonably certain to exercise (or not to exercise) an option in determining the period covered by the option, and do not directly relate to the assessment of the enforceability of a contract.

4. Consequently, we are of a view that the IASB should reconsider its objective of prescribing paragraph B34 separately from paragraph B37 in IFRS 16, because the difference between the assessment of the enforceable period in paragraph B34 and the assessment of whether a lessee is reasonable certain to exercise (or not to exercise) an option in paragraph B37 becomes unclear, if an entity were required to consider the economics of the contract in determining the enforceable period.
5. In addition, if the useful life of the leasehold improvement (which is estimated based on ‘available for use’ (paragraph 8 of IAS 16 *Property, Plant and Equipment*)), were to be linked to the lease term (which is determined based on whether the lessee is reasonably certain to exercise (or not to exercise) the option), we are of a view that, whether an entity should consider the economics of a contract in the determination of the enforceable period may have an effect on the determination of the lease term, and consequently may also have an impact on the useful life of the leasehold improvement.
6. From the discussions above, we are of a view that it would be appropriate for the IASB to amend IFRS 16 to clarify the objective of prescribing paragraph B34 through standard-setting activities, perhaps as an annual improvement, instead of the Committee issuing the agenda decision. We think it is necessary to define ‘penalty’ and to clarify whether the meaning of ‘enforceable’ is limited to the enforceability in

law or contract or if it also includes economic losses which only one of the parties incurs considering the economics of the contract.

7. We hope that our comments are helpful for the Committee's and the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. Kogasaka', written in a cursive style.

Atsushi Kogasaka

Chair

Accounting Standards Board of Japan