

Mrs Sue Lloyd

IFRS Interpretations Committee

Columbus Building,
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

Paris, 1 August 2019

Tentative Agenda Decisions – IFRIC Update November 2018

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee Tentative Agenda Decisions published in the June 2019 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to three issues that we think are worth considering:

- The Tentative Agenda Decision on the Lessee’s Incremental Borrowing Rate is not conclusive as to whether IBR should reflect the payment profile of the lease. We believe that sufficient guidance exists in the standard and the basis for conclusions for the Committee to reach the conclusion that IBR should be consistent with the payment profile of the lease.
- The assessment of the lease term is the most important area of judgement in applying IFRS 16, and we observe that significant diversity exists in practice on that matter. This is a strong indicator that the standard needs clarifications, and we believe these clarifications cannot be provided through a simple agenda decision considering the interactions of the different paragraphs of the standard and inconsistencies between the standard itself and the corresponding basis for conclusions. That is why we urge

the Committee and/or the Board to undertake a narrow-scope standard-setting project on the lease term. In the meantime, we believe the Committee should not issue any agenda decision because its conclusions would preempt the outcome of the debate to be held during the standard-setting process.

- By not considering the question of whether the amount of airline compensation for delays or cancellations recognised as a reduction of revenue should be limited to reducing the transaction price to nil, the Committee fails to address an area of significant diversity in practice. A conclusion on that issue would be of great help.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully



Michel Barbet-Massin

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Edouard Fossat

Appendix 1

Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments) — Agenda Paper 4

We agree with the Committee's analysis and with its decision not to add this matter to its standard-setting agenda.

Appendix 2

Compensation for Delays or Cancellations (IFRS 15 Revenue from Contracts with Customers) — Agenda Paper 8

While we agree with the Interpretations Committee that compensation for delays, irrespective of whether stipulated by legislation or the contract, is variable consideration for the transportation service, we have concerns about the fact that the Committee:

- extends that conclusion to cancellations, and
- does not address situations where the compensation exceeds the initial amount of revenue charged to the customer.

Whenever a flight is cancelled (and the passenger is finally not transported by the airline to the promised destination), no service is rendered to the customer. Therefore, no revenue should be recognised, and any reimbursement made to the customer should be accounted for as a settlement of a contract liability. If payment made to the customer exceeds the initial ticket price, we believe it cannot be considered as negative revenue because it is obviously compensation for the damage suffered by the passenger who was unable to reach his destination. As such, any compensation should be recognised as an expense.

If the passenger is moved to another flight operated by the airline, then the situation is similar to that of a delay.

Regarding compensation for delay, it should be seen as a reduction of the selling price, because the airline failed to perform as promised. Nevertheless, we strongly believe that this should not lead to a negative selling price because the airline has, in effect, rendered a service, even if its quality is below expectations. Any compensation beyond the selling price is indemnification for a damage suffered by the passenger.

When writing *“The Committee did not consider the question of whether the amount of compensation recognised as a reduction of revenue is limited to reducing the transaction price to nil.”*, the Committee fails to address situations where diversity in practice exists and maintains uncertainty on how to account for these amounts. We therefore recommend that the Committee also considers the case of compensation that exceeds the initial selling price and includes that analysis in its Agenda Decision.

Appendix 3

Lessee's Incremental Borrowing Rate (IFRS 16 Leases) — Agenda Paper 2

While we agree with the developments made in paragraph 2 and 3 of the tentative agenda decision, and in particular with the quote from BC162 that states that the lessee's incremental borrowing rate is defined *"to take into account the terms and conditions of the lease"*, we disagree with the absence of conclusion reached by the Committee.

When observing that *"in applying judgement in determining its incremental borrowing rate as defined in IFRS 16, a lessee might often refer as a starting point to a readily observable rate for a loan with a similar payment profile to that of the lease."*, the Committee seems to ignore that readily observable interest rates are often available only for loans with final repayment, i.e. with a payment profile that is not similar to that of the lease.

We would have expected the Committee to conclude that, in order *"to take into account the terms and conditions of the lease"* as explained in BC162, a lessee that refers as a starting point to a readily observable rate for a loan with a dissimilar payment profile should then adjust that observable rate for the differences in the payment profiles.

We strongly believe that:

- this matter is an area of diversity in practice,
- the incremental borrowing rate should be consistent with the payment profile of the lease, and
- there is sufficient guidance in the standard and the basis for conclusions for the Committee to reach that conclusion.

Appendix 4

Lease Term and Useful Life of Leasehold Improvements (IFRS 16 Leases and IAS 16 Property, Plant and Equipment) — Agenda Paper 3

Lease term

Assessment of the lease term is the most important area of judgement when applying IFRS 16. We have observed a significant diversity in the assessment of the lease term for the two types of leases described in the submission (cancellable or renewable leases). This is an indicator that the guidance in IFRS 16 and accompanying materials is unclear and insufficient in that respect.

While we understand that issuing an agenda decision would help reducing that diversity, we strongly believe that the clarifications needed cannot be provided through a simple agenda decision. Rather, this issue should be addressed through a standard-setting project in order to bring clarity to the standard and improve consistency between the standard itself and the corresponding basis for conclusions.

We list below some of our concerns:

– *Interactions between paragraphs B34 and B37:*

Some stakeholders understand that paragraph B34 is about the contractual provisions of the lease while paragraph B37 introduces economic incentives or economic compulsion in the analysis. If, as explained in the tentative agenda decision, economic compulsion to renew a lease or not to terminate it created by leasehold improvements is taken into account to determine the non-cancellable period from the lessee's point of view (i.e. application of paragraph B34), then we fail to understand why it is mentioned in paragraph B37(b) for the assessment of whether the exercise of a renewal option (or non-exercise of a termination option) is reasonably certain. Either non-removable leasehold improvements create a non-cancellable period for the lessee, or they are considered in the analysis of renewal options, but it cannot be both.

– *Inconsistency between paragraph B34 and its rationale stated in paragraph BC127 regarding the penalty:*

Paragraph B34 states that termination rights (of both lessee and lessor) are disregarded if termination implies more than an insignificant penalty for the deciding party. Beyond the non-cancellable period from the lessee's perspective, the question is to assess whether the lessee can enforce its renewal right, as explained in paragraph BC127 ("*...*) 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.”).

We believe there is an inconsistency between the last sentence in paragraph BC127 *“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.”* and the *“no more than an insignificant penalty”* in paragraph B34. More than an insignificant penalty is a very low threshold to disregard termination options, and we strongly believe that a lessor whose agreement is requested in view of the renewal of a lease can refuse to renew it despite a more than insignificant penalty, provided that this penalty is still affordable.

– *Inconsistency between BC156 and how the lease term is determined in paragraphs B34-B40:*

In its tentative agenda decision, the Committee bases its conclusion on the sole quote of BC156 *“the lease term should reflect an entity’s reasonable expectation of the period during which the underlying asset will be used because that approach provides the most useful information”*. We believe the Committee cannot interpret IFRS 16 provisions regarding the assessment of the lease term on that sole basis because the Board, when finalising IFRS 16, has waived this goal of reflecting the entity’s reasonable expectation of the period during which it will use the underlying asset. As explained in BC156, the *“longest possible term that is more likely than not to occur”*, which corresponds to the entity’s reasonable expectation, has been abandoned and replaced by the longest possible term that is both reasonably certain and enforceable from the lessee’s perspective. This makes a big difference, and this implies that the initial view of the Board in BC156 cannot be the basis for the Committee’s agenda decision regarding the lease term.

– *Interpretation of the term “enforceable”:*

We have concerns regarding the interpretation given by the Committee to the *enforceable* period of the lease. In other IFRSs, the term *“enforceable”* relates to contractual or legal provisions that one party has the ability to enforce in court (see in particular IFRS 15 and the enforceable right to payment). We believe it important to keep that meaning throughout IFRSs.

In addition, we note that in its tentative agenda decision, the Committee failed to establish a clear demonstration that IFRS 16 provisions, and the accompanying literature, would obviously lead to the Committee’s conclusion. That conclusion is only based on a quote of BC156, that can be challenged (see above), and an *“observation”* of the Committee of how to apply paragraph B34, i.e. a simple statement without existing written support from the standard or the accompanying materials. This lack of relevant quotes in the tentative agenda

decision is in itself a demonstration that the tentative agenda decision goes beyond the requirements of the standard, and that standard-setting is needed to solve this issue.

Useful life of non-removable leasehold improvements

We disagree with the Committee's observation that "*applying paragraphs 56-57 of IAS 16, an entity might often reach this conclusion [that the useful life of the non-removable leasehold improvements is the same as the lease term] for leasehold improvements that the entity will use and benefit from only for as long as it uses the underlying asset in the lease*".

As explained above, the lease term in IFRS 16 corresponds to the longest possible term that is both reasonably certain and enforceable from the lessee's perspective. An entity might expect to renew a lease without being reasonably certain to do so or might expect that the lessor will accept to renew a lease without having an enforceable right to force the renewal. In these situations, the lease term will be shorter than the expected period during which the entity will use the leased asset and the non-removable leasehold improvements. We do not consider these situations to be rare, and this assessment is strongly related to the conclusion that will be reached on the lease term.

Interaction between the determination of the useful life of non-removable leasehold improvements and the enforceable period of the lease and lease term

The Committee's developments in that section of the tentative agenda decision are consistent with the conclusion reached in the *Lease term* section. Therefore, all our comments above are applicable to that part of the tentative agenda decision as well, and we believe that the principles and requirements in IFRS 16 do not provide a sufficient basis for the Committee to reach that conclusion.

Appendix 5

Presentation of Liabilities or Assets Related to Uncertain Tax Treatments (IAS 1 Presentation of Financial Statements) — Agenda Paper 7

We agree with the Committee's analysis that liabilities and assets arising from the application of IFRIC 23 are tax liabilities and tax assets, whether current or deferred, as defined by IAS 12.

We also agree that presenting them within a line item such as provisions will be inconsistent with the requirements of IAS 1 paragraph 54.

We therefore encourage the Committee to finalise the Agenda Decision as tentatively drafted.

Appendix 6

Disclosure of Changes in Liabilities Arising from Financing Activities (IAS 7 Statement of Cash Flows) — Agenda Paper 5–5A

We agree with the Interpretations Committee’s decision not to add this matter to its standard-setting agenda, and we agree with the explanations provided in the Agenda Decision to help preparers in meeting the disclosures objectives of paragraph 44A of IAS 7.

Appendix 7

Subsequent Expenditure on Biological Assets (IAS 41 Agriculture) — Agenda Paper 9

We agree with the Committee that the only issue around whether to capitalise subsequent expenditure relating to biological assets measured at fair value is a presentation impact on the P&L.

We also agree that IAS 41 does not prescribe the accounting treatment for those subsequent expenditures, and that this is an area for an accounting policy choice that should be dealt with through relevant disclosures.