

## IFRS Developments

# Subsurface rights (IFRS 16 Leases)

### What you need to know

- In March 2019, the IFRS IC issued a TAD on subsurface rights.
- The IFRS IC observed that the contract described in the submission contains a lease and is accounted for in accordance with IFRS 16.
- The TAD is open for comment until 15 May 2019.
- The IFRS IC's TAD is subject to finalisation at a future meeting.

### Highlights

A topical issue highlighted during the implementation of IFRS 16 Leases is how an entity should account for a contract that contains the right to place an oil pipeline, for example, in a specified underground space (subsurface rights).

In March 2019, the IFRS Interpretations Committee (IFRS IC or the Committee) issued a tentative agenda decision (TAD) that highlighted that the specified underground space is physically distinct and tangible. Therefore, as the contract contains a lease, IFRS 16 applies to that contract.

Entities affected by the TAD need to monitor the development of the issue closely and evaluate how this will impact their assessment of whether specified underground space is an identified asset.

### Background

In certain sectors, including oil and gas, mining, telecommunications and power and utilities, it is common for entities to enter into arrangements to run cables, pipes and networks underground.

For example, a pipeline operator (the customer) may enter into a contract with a farmer to lay an underground pipeline through a field to transport crude oil in exchange for consideration. The contract may specify the path that the pipeline will take, including the width of the pipeline and the depth at which it is situated. No one except the pipeline operator is permitted access to the pipeline, but the farmer (the landowner) can use the land above it for farming or other purposes. The pipeline operator has the right to perform inspections, repairs and maintenance work and replace damaged sections of the pipeline where necessary.

The issue highlighted is whether IFRS 16 or IAS 38 Intangible Assets applies to subsurface rights.

## IFRS IC observations

The IFRS IC observed that the specified underground space in the contract is tangible. Therefore, if the contract contains a lease, IFRS 16 applies and so the entity first considers whether the contract contains a lease as defined in IFRS 16. If the contract does not contain a lease, the entity would consider which other IFRS standard would apply.

In assessing whether the contract contains a lease, the IFRS IC noted that the specified underground space is physically distinct as the path, width and depth are specified in the contract. The space being underground does not affect whether it is an identified asset as the specified underground space is physically distinct in the same way that a specified area of space on the land's surface would be physically distinct. As the landowner does not have the right to substitute the underground space, the Committee concluded that the specified underground space is an identified asset as described in IFRS 16.

The IFRS IC also observed that the customer has the right to obtain substantially all the economic benefits from use of the specified underground space throughout the period of use and the customer has exclusive use of the specified underground space throughout that period of use.

The customer also has the right to direct the use of the specified underground space throughout the period of use. How and for what purpose the specified underground space will be used is predetermined in the contract. The customer has the right to operate the specified underground space by having the right to perform inspections, repairs and maintenance work and the customer makes all the decisions about the use of the specified underground space that can be made during the period of use.

Consequently, the IFRS IC concluded that the contract described in the submission contains a lease as defined in IFRS 16 and is accounted for in accordance with IFRS 16.

## Next steps

The TAD is open for comment until 15 May 2019 and will be subject to finalisation at a future meeting.

Entities affected by this TAD need to monitor the development of the issue closely and evaluate how this will impact their assessment of whether specified underground space is an identified asset.

### How we see it

The Committee's observation that the underground space in the fact pattern described is physically distinct from the remainder of the land and is tangible could be relevant in assessing whether an arrangement is or contains a lease under IFRS 16 in other situations involving rights over specified space.

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