

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS**

Q&A No. 2019-13

Determining the lease term of leases that are renewable subject to mutual agreement of the lessor and the lessee

This Q&A is a supplement to PIC Q&A 2019-12, providing guidance on determining the lease term under PFRS 16. This focuses on lease contracts that are renewable subject to mutual agreement of the parties.

Issue 1:

What is the non-cancellable lease term?

Fact Pattern 1:

A lessee enters into a lease contract with a lessor for the lease of land over a one-year period, renewable for another year subject to agreement of both parties. The lessee constructed leasehold improvement on the leased land.

Consensus:

The non-cancellable period is just one year because there is no enforceable contract after the one-year period. Under PFRS 16, a renewal option is only considered in determining the lease term if it is enforceable. The renewal option in this case is not enforceable as both parties still need to agree to renew, including the terms of the renewal. A renewal that is still subject to mutual agreement of the parties is legally unenforceable under Philippine laws until both parties come to an agreement on the terms.

Fact Pattern 2:

Same as in Fact Pattern 1, except that historically, the parties have always come to a mutual agreement to renew the contract.

Consensus:

The non-cancellable period is still just the one-year contractual period. Despite the history of renewal, the lessee's right to use the underlying asset does not go beyond the one-year period covered by the current contract as any renewal still has to be agreed on by both parties. A renewal is treated as a new contract.

Other reminders:

- Note that the above fact patterns are different from Example 4 (Lease continues to be renewed until either party terminates or an "evergreen lease") of PIC Q&A No. 2019-12. In

that fact pattern, while the initial term is only for 12 months, the contract specifically indicated that the lease will automatically renew for an indefinite period until either party cancels the contract. Thus, in that fact pattern, the lessee has an enforceable right to continue using the underlying asset beyond the initial 12 month-period until either the lessor cancels the contract or the lessee decides to stop leasing the asset.

- Note also that an evergreen lease is still enforceable even if the future lease rates are still to be mutually agreed by the parties because it provides the lessee with a right to use the asset beyond the initial one-year period.

Issue 2:

Under both Fact Patterns 1 and 2 above, what is the depreciable life of the related leasehold improvement?

Consensus:

The assessment on whether a renewal option is enforceable or not would impact the determination of the amortization period of any related leasehold improvements as PAS 16 requires consideration of any legal limits imposed on the use of the asset. In the fact patterns above, the amortization period cannot go beyond the one-year contractual period.

Effective date

The effective date of the consensus in this Q&A follow that of Appendix C of PFRS 16, upon approval by the FRSC.

Date approved by PIC: December 17, 2019

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Date approved by FRSC: December 23, 2019