

IFRS AT A GLANCE

IFRIC 4 Determining whether an Arrangement contains a Lease



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Effective Date
Periods beginning on or after 1 January 2006

BACKGROUND AND ISSUE

An entity may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset (e.g. an item of property, plant or equipment) in return for a payment or series of payments. Examples include arrangements in which one entity (the supplier) may convey such a right to use an asset to another entity (the purchaser), often together with related services.

This Interpretation provides guidance for determining whether such arrangements are, or contain, leases that should be accounted for in accordance with IAS 17 *Leases*. It does not provide guidance for determining how such a lease should be classified under that Standard.

In some arrangements, the underlying asset that is the subject of the lease is a portion of a larger asset. This Interpretation does not address how to determine when a portion of a larger asset is itself the underlying asset for the purposes of applying IAS 17. Nevertheless, arrangements in which the underlying asset would represent a unit of account in either IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* are within the scope of this Interpretation.

The issues addressed in this Interpretation are:

- How to determine whether an arrangement is, or contains, a lease as defined in IAS 17
- When the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made
- If an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

ASSESSING OR REASSESSING WHETHER AN ARRANGEMENT IS, OR CONTAINS, A LEASE

- The assessment of whether an arrangement contains a lease is made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement, on the basis of all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement is made only if any one of the following conditions is met:
 - There is a change in the contractual terms, unless the change only renews or extends the arrangement
 - A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with IAS 17. A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement before the end of the term of the original arrangement is evaluated under IFRIC 4 only with respect to the renewal or extension period
 - There is a change in the determination of whether fulfilment is dependent on a specified asset
 - There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.
- A reassessment of an arrangement is based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) do not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting is applied (or ceases to apply).

SCOPE

IFRIC 4 does not apply to arrangements that:

- Are, or contain, leases excluded from the scope of IAS 17
- Are public-to-private service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements*.

DETERMINING WHETHER AN ARRANGEMENT IS, OR CONTAINS, A LEASE

Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- Fulfilment of the arrangement is dependent on the use of a specific asset or assets
- The arrangement conveys a right to use the asset.

FULFILMENT IS DEPENDENT ON THE USE OF A SPECIFIC ASSET

- Although a specific asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of the arrangement is not dependent on the use of the specified asset, e.g., if the supplier is obliged to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other assets not specified in the arrangement, then fulfilment of the arrangement is not dependent on the specified asset and the arrangement does not contain a lease
- A warranty obligation that permits or requires the substitution of the same or similar assets when the specified asset is not operating properly does not preclude lease treatment
- A contractual provision (contingent or otherwise) permitting or requiring the supplier to substitute other assets for any reason on or after a specified date does not preclude lease treatment before the date of substitution.

ARRANGEMENT CONVEYS RIGHT TO USE THE ASSET

An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

- The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset
- The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset
- Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

SEPARATING PAYMENTS FOR THE LEASE FROM OTHER PAYMENTS

- If an arrangement contains a lease, the parties to the arrangement apply the requirements of IAS 17 to the lease element of the arrangement, unless exempted from those requirements in accordance with IAS 17
- Accordingly, if an arrangement contains a lease, that lease is classified as a finance lease or an operating lease in accordance with IAS 17. Other elements of the arrangement not within the scope of IAS 17 are accounted for in accordance with other IFRSs
- Payments and other consideration required by arrangement are separated at inception or upon reassessment into those for the lease and those other elements on the basis of relative fair values, which may require the use of estimation techniques
- Guidance is provided for circumstances in which it is impracticable to separate payments reliably into the various components.

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