

## Definition of a Lease

### Project background

The IASB and the FASB (the Boards) are working together to improve the accounting for leases. The Boards have concluded that a customer (lessee) leasing assets should recognise the assets and liabilities arising from those leases (including leases that are off balance sheet today). An entity will assess whether it needs to apply the requirements in the new *Leases* Standard by identifying whether a contract is, or contains, a lease. The Boards have jointly agreed the definition of a lease.

### What is the purpose of this document?

This document provides an overview of how a lease will be defined in the IASB's new *Leases* Standard, and also includes a working draft of the application guidance and accompanying illustrative examples. It has been provided to help stakeholders prepare for the implementation of the new *Leases* Standard.

This document complements the Project Update *Leases: Definition of a Lease* published in February 2015. That document includes additional information explaining the IASB's decisions regarding the definition of a lease, and how the IASB has responded to feedback received on the 2013 Exposure Draft. That document also explains how and why the IASB views a lease to be different from a service.

### Next steps

The IASB has completed its decision making for the Leases project. The new *Leases* Standard will be effective from 1 January 2019. The IASB plans to issue the new *Leases* Standard before the end of 2015.

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# Overview

The new *Leases* Standard will contain a definition of a lease and application guidance to help an entity assess whether a contract is, or contains, a lease. The definition and application guidance will apply to both parties to a contract, ie the customer (lessee) and the supplier (lessor). The new *Leases* Standard will also contain several examples illustrating how an entity assesses whether a contract is, or contains, a lease.

## What is a lease?

A lease is defined as a contract, or part of a contract, that conveys to the customer the right to use an asset for a period of time in exchange for consideration.

Leases are different from services because, at the start of a lease, the customer obtains control of a resource (the right to use an asset). In contrast, in a service contract, the supplier retains control of the use of any resources needed to deliver the service. Consequently, the definition and

application guidance focus on whether a customer *controls* the use of an asset.

## How to identify a lease?

A lease exists when the customer controls the use of the identified asset throughout the period of use<sup>1</sup>. This is when the customer has the right to:

- obtain substantially all of the economic benefits from use of the identified asset throughout the period of use; and
- direct the use of the identified asset throughout that period.

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<sup>1</sup> The period of use is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time). If a customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

**An entity considers all relevant facts and circumstances in assessing whether a contract is, or contains, a lease<sup>2</sup>.**

In the vast majority of cases, the assessment of whether a contract contains a lease is straightforward. However, in some scenarios—for example, when both the customer and the supplier make decisions about the use of the identified asset—the distinction may require the application of judgement. The guidance and accompanying illustrative examples will be provided in particular to assist those applying the definition to such scenarios.

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<sup>2</sup> An entity makes that assessment for each potential separate lease at inception of the contract. A contract is not reassessed unless the terms and conditions of the contract are changed.

# Is there an identified asset?

*This section contains a working draft of the application guidance on the definition of a lease with respect to whether an identified asset exists. This draft has been prepared by the staff and is subject to refinements in drafting before issuance of the new Leases Standard.*

An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

## **Substantive substitution rights**

Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier (ie the entity that provides goods or services under the contract) has the substantive right to substitute the asset throughout the period of use.

A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- (a) the supplier has the practical ability to substitute alternative assets throughout the period of use (ie the customer cannot prevent the supplier from substituting an asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- (b) the supplier would benefit economically from the exercise of its right to substitute the asset (ie the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur.

Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:

- (a) an agreement by a future customer to pay an above market rate for use of the asset;
- (b) the introduction of new technology that is not substantially developed at inception of the contract;
- (c) a substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and
- (d) a substantial difference between the market price of the asset, and the market price considered likely at inception of the contract.

If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises, and, therefore, are more likely to exceed the benefits associated with substituting the asset.

A supplier might have a right or an obligation to substitute alternative assets if repairs and maintenance are needed, the asset is not operating properly or a technical upgrade becomes available, or only on or after a particular date or the occurrence of a specified event. These rights or obligations do not preclude a customer from having the right to use an identified asset.

If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

### **Portions of assets**

A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre-optic cable) is not an identified asset, unless it represents substantially all of the capacity of the entire asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the entire asset.

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# Does the customer have the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use?

*This section contains a working draft of the application guidance on the definition of a lease with respect to whether a customer has the right to obtain substantially all of the economic benefits from use of an asset. This draft has been prepared by the staff and is subject to refinements in drafting before issuance of the new Leases Standard.*

To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these

items), and other economic benefits from using the asset that could be realised from a commercial transaction with a third party.

When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset. For example, if a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle within that territory, and not beyond.

If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if the customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. This is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the supplier as consideration for the right to use that space.

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# Does the customer have the right to direct the use of the identified asset throughout the period of use?

*This section contains a working draft of the application guidance on the definition of a lease with respect to a customer's right to direct the use of an identified asset. This draft has been prepared by the staff and is subject to refinements in drafting before issuance of the new Leases Standard.*

A customer has the right to direct the use of an identified asset throughout the period of use only if either:

- (a) the customer has the right to direct how and for what purpose the asset is used by having the right to make the relevant decisions about how and for what purpose the asset is used throughout the period of use (**'Situation A'**); or

- (b) the relevant decisions about how and for what purpose the asset is used are predetermined and:
  - (i) the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions (**'Situation B1'**); or
  - (ii) the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use (**'Situation B2'**).

## **How and for what purpose the asset is used**

A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:

- (a) rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from retail space);
- (b) rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);
- (c) rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used);
- (d) rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (as described in Situation B1).

#### **Decisions determined during and before the period of use**

The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

In assessing whether a customer has the right to direct the use of an asset, an entity shall consider

only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset as described in Situation B2. Consequently, unless the conditions in Situation B2 exist, an entity shall not consider decisions that are predetermined before the period of use.

For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

## **Protective rights**

A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. These protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset within that scope.

# Illustrative examples

*This section includes a working draft of the illustrative examples accompanying the application guidance on the definition of a lease. This draft has been prepared by the staff and is subject to refinements in drafting before issuance of the new Leases Standard.*

## Example 1A—Rail cars

### Facts

*A contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period. The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (ie if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).*

### Example 1A—Rail cars

Analysis

#### Is there an identified asset?

There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired. The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

#### Does the customer control the use of the identified asset throughout the period of use?

Customer has the right to control the use of the 10 rail cars throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.
- (b) Customer has the right to direct the use of the cars (because the conditions in Situation A exist). The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

**The contract contains leases of rail cars. Customer has the right to use 10 rail cars for five years.**

### Example 1B—Rail cars

Facts

*The contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified is equivalent to Customer having the use of 10 rail cars for five years. Supplier provides the rail cars, driver and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfil the requirements of the contract. Similarly, Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.*

Analysis

#### **Is there an identified asset?**

The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

- (a) Supplier has the practical ability to substitute the cars and engine throughout the period of use; alternative cars and engines are readily available to Supplier and Supplier can substitute the cars and engine without Customer's approval.
- (b) Supplier would benefit economically from substituting the cars and engine. There would be minimal, if any, cost associated with substituting the cars or engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting the cars or the engine in contracts of this nature because substitution allows Supplier to, for example, (i) use cars or an engine to fulfil a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (ii) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

#### **Does the customer control the use of the identified asset throughout the period of use?**

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits from use, of identified cars or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

**The contract does not contain a lease of rail cars or of an engine.**

## Example 2— Concession space

Facts

*A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the contract term. There are minimal costs to Supplier associated with changing the space for the Customer; Customer uses a kiosk (that Customer owns) to sell its goods that can be moved easily. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.*

Analysis

### Is there an identified asset?

Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However, the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

- (a) Supplier has the practical ability to change the space used by Customer throughout the period of use. There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer’s approval.
- (b) Supplier would benefit economically from substituting the space. There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

### Does the customer control the use of the identified asset throughout the period of use?

In this example, this assessment is not needed to conclude upon whether the contract is, or contains, a lease.

**The contract does not contain a lease.**

### Example 3A—Fibre-optic cable

Facts

*Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (ie Customer ‘lights’ the fibres and decides what data, and how much data, those fibres will transport). If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer’s fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).*

Analysis

**Is there an identified asset?**

There are three identified fibres. The fibres are explicitly specified in the contract and are physically distinct from other fibres within the cable. Supplier cannot substitute the fibres other than for reasons of repairs, maintenance or malfunction.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the fibres throughout the 15-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the fibres over the 15-year period of use. Customer has exclusive use of the fibres throughout the period of use.
- (b) Customer has the right to direct the use of the fibres (because the conditions in Situation A exist). Customer makes the relevant decisions about how and for what purpose the fibres are used by deciding (i) when and whether to light the fibres and (ii) when and how much output the fibres will produce (ie what data, and how much data, those fibres will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier’s decisions about repairing and maintaining the fibres are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibres are used. Consequently, Supplier does not control the use of the fibres during the period of use.

**The contract contains a lease of dark fibres. Customer has the right to use the three dark fibres for 15 years.**

### Example 3B—Fibre-optic cable

Facts

*Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities). Supplier makes decisions about the transmission of data (ie Supplier lights the fibres, and makes decisions about which fibres are used to transmit Customer's traffic and the electronic equipment connected to the fibres).*

Analysis

#### **Is there an identified asset?**

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable. Consequently, Customer does not have the right to use an identified asset.

#### **Does the customer control the use of the identified asset throughout the period of use?**

In this example, this assessment is not needed to conclude upon whether the contract is, or contains, a lease.

**The contract does not contain a lease.**

#### Example 4—Retail unit

#### Facts

*Customer enters into a contract with property owner (Supplier) to use Retail Unit A for a five-year period. Retail Unit A is part of a larger retail space with many retail units. Customer is granted the right to use Retail Unit A. Supplier can require Customer to move to another retail unit only under specified circumstances (for example, to accommodate a major new tenant that would occupy a number of units in the retail space). If those circumstances arise, Supplier is required to provide Customer with a retail unit of a similar quality to Retail Unit A and to pay for Customer's relocation costs. Although it is possible that those circumstances will arise, at inception of the contract, they are not considered likely to arise. For example, it is unlikely that a potential new tenant will lease a large amount of retail space at a rate that would be sufficiently favourable to cover the costs of relocating Customer and other tenants in the retail space. The contract requires Customer to use Retail Unit A to operate its well-known store brand to sell its goods during the hours that the larger retail space is open. Customer makes all of the decisions about the use of the retail unit during the period of use. For example, Customer decides on the mix of goods sold from the unit, the pricing of the goods sold and the quantities of inventory held. Customer also controls physical access to the unit throughout the five-year period of use. The contract requires Customer to make fixed payments to Supplier, as well as variable payments that are a percentage of sales from Retail Unit A. Supplier provides cleaning and security services, as well as advertising services, as part of the contract.*

## Example 4—Retail unit

Analysis

### Is there an identified asset?

Retail Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the right to substitute the retail unit if specified circumstances arise and could benefit from substitution in those circumstances. However, Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not likely to arise.

### Does the customer control the use of the identified asset throughout the period of use?

Customer has the right to control the use of Retail Unit A throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of Retail Unit A over the five-year period of use. Customer has exclusive use of Retail Unit A throughout the period of use. Although a portion of the cash flows derived from sales from Retail Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the retail unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits from the use of Retail Unit A.
- (b) Customer has the right to direct the use of Retail Unit A (because the conditions in Situation A exist). The contractual restrictions on the goods that can be sold from Retail Unit A, and when Retail Unit A is open, define the scope of Customer's right to use Retail Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Retail Unit A is used by being able to decide, for example, the mix of products that will be sold in the retail unit and the sale price for those products. Customer has the right to change these decisions during the five-year period of use.

Although cleaning, security, and advertising services are essential to the efficient use of Retail Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Retail Unit A is used. Consequently, Supplier does not control the use of Retail Unit A during the period of use and Supplier's decisions do not affect Customer's control of the use of Retail Unit A.

**The contract contains a lease of retail space. Customer has the right to use Retail Unit A for five years.**

### Example 5—Truck rental

Facts

Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer has no right to continue using the truck after the specified trip is complete. The cargo to be transported, and the timing and location of pick-up in New York and delivery in San Francisco, are specified in the contract. Customer is responsible for driving the truck from New York to San Francisco.

Analysis

**Is there an identified asset?**

There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the truck throughout the period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.
- (b) Customer has the right to direct the use of the truck (because the conditions in Situation B1 exist). How and for what purpose the truck is used (ie the transportation of specified cargo from New York to San Francisco within a specified timeframe) is predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

*Because the duration of the contract is one week, this lease meets the definition of a short-term lease.*

**The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.**

### Example 6A—Ship

Facts

*Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery. Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship during the term of the contract or operating the ship itself.*

Analysis

**Is there an identified asset?**

There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits from use of the ship.

However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (ie the transportation of specified cargo from Rotterdam to Sydney within a specified timeframe) is predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were only one of many customers transporting cargo on the ship.

**The contract does not contain a lease.**

### Example 6B—Ship

Facts

*Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract and Supplier does not have substitution rights. Customer decides whether and what cargo will be transported, and when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo. Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship during the term of the contract or operating the ship itself.*

Analysis

#### **Is there an identified asset?**

There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

#### **Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the ship throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
- (b) Customer has the right to direct the use of the ship (because the conditions in Situation A exist). The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer’s right to use the ship. They are protective rights that protect Supplier’s investment in the ship and Supplier’s personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where, and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

Although the operation and maintenance of the ship is essential to its efficient use, Supplier’s decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier’s decisions are dependent upon Customer’s decisions about how and for what purpose the ship is used.

**The contract contains a lease. Customer has the right to use the ship for five years.**

### Example 7—Aircraft

Facts

*Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft. There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly, and which passengers and cargo will be transported on the aircraft. Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft during the term of the contract. Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier’s fleet to meet Customer’s specifications.*

Analysis

**Is there an identified asset?**

There is an identified asset. The aircraft is explicitly specified in the contract and, although Supplier can substitute the aircraft, its substitution right is not substantive. Supplier’s substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the aircraft throughout the two-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.
- (b) Customer has the right to direct the use of the aircraft (because the conditions in Situation A exist). The restrictions on where the aircraft can fly define the scope of Customer’s right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where, and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

Although the operation of the aircraft is essential to its efficient use, Supplier’s decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use and Supplier’s decisions do not affect Customer’s control of the use of the aircraft.

**The contract contains a lease. Customer has the right to use the aircraft for two years.**

### Example 8—Contract for shirts

Facts

*Customer enters into a contract with a manufacturer (Supplier) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of the shirts are specified in the contract. Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third party supplier. The capacity of the factory exceeds the output for which Customer has contracted (ie Customer has not contracted for substantially all of the capacity of the factory). The factory is used to fulfil contracts with a number of Supplier’s customers. Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfil with the output of the factory that is not used to fulfil Customer’s contract.*

Analysis

**Is there an identified asset?**

The factory is an identified asset. The factory is implicitly specified because Supplier can fulfil the contract only through the use of this asset.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits from use of the factory. This is because Supplier could decide to use the factory to fulfil other customer contracts during the contract term.

Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year contract term. Customer’s rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (ie Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfil with the output produced).

Either the fact that Customer does not have the right to obtain substantially all of the economic benefits from use of the factory, or that Customer does not have the right to direct the use of the factory, would be sufficient in isolation to conclude that Customer does not control the use of the factory.

**The contract does not contain a lease.**

**Example 9A—Contract for energy/power**

Facts

*A utility company (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract and Supplier has no substitution rights. The solar farm is owned by Supplier and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer’s specifications, and then operating and maintaining it. There are no decisions to be made about whether, when, or how much electricity will be produced because the design of the asset has predetermined those decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.*

Analysis

**Is there an identified asset?**

There is an identified asset because the solar farm is explicitly specified in the contract and Supplier does not have the right to substitute the specified solar farm.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 20-year period of use. Customer has exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will receive economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.
- (b) Customer has the right to direct the use of the solar farm (because the conditions in Situation B2 exist). Neither Customer, nor Supplier, decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (ie the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer’s design of the solar farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer’s control over that design is substantively no different from Customer controlling those decisions.

**The contract contains a lease. Customer has the right to use the solar farm for 20 years.**

### Example 9B—Contract for energy/power

Facts

*Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by Supplier. Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer—Customer had no involvement in that design.*

Analysis

**Is there an identified asset?**

There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to obtain substantially all of the economic benefits from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year period of use.

However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (ie whether, when and how much power the plant will produce) is predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use. Customer has no other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

**The contract does not contain a lease.**

**Example 9C—Contract for energy/power**

**Facts**

*Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract with Supplier states that Customer has rights to all of the power produced by the plant (ie Supplier cannot use the plant to fulfil other contracts). Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate. Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.*

**Analysis**

**Is there an identified asset?**

There is an identified asset. The power plant is explicitly specified in the contract and Supplier does not have the right to substitute the specified plant.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the power plant throughout the 10-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.
- (b) Customer has the right to direct the use of the power plant (because the conditions in Situation A exist). Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when and how much power the plant will produce throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer’s decision-making about the timing and quantity of power produced, in effect, determines when, and whether, the plant produces output.

Although the operation and maintenance of the power plant are essential to its efficient use, Supplier’s decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier’s decisions are dependent upon Customer’s decisions about how and for what purpose the power plant is used.

**The contract contains a lease. Customer has the right to use the power plant for 10 years.**

**Example 10A—Contract for network services**

**Facts**

*Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer’s premises—Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.*

**Analysis**

**Is there an identified asset?**

There is no need to assess whether the servers installed at Customer’s premises are identified assets. This assessment would not change the analysis of whether the contract contains a lease because Customer does not have the right to control the use of the servers.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer does not control the use of the servers because Customer’s only decision-making rights relate to deciding upon the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used.

Supplier is the only party that can make relevant decisions about the use of the servers during the period of use. Supplier has the right to decide how data is transported using the servers, whether to reconfigure the servers and whether to use the servers for another purpose. Accordingly, Supplier controls their use in providing network services to Customer.

**The contract does not contain a lease.**

**Example 10B—Contract for network services**

Facts

*Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer’s premises in accordance with Customer’s instructions and provides repair and maintenance services for the server, as needed, throughout the contract term. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations; Customer can change its decisions in this regard throughout the period of use.*

Analysis

**Is there an identified asset?**

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning.

**Does the customer control the use of the identified asset throughout the period of use?**

Customer has the right to control the use of the server throughout the three-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.
- (b) Customer has the right to direct the use of the server (because the conditions in Situation A exist). Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

**The contract contains a lease. Customer has the right to use the server for three years.**

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## Further information

The IASB is close to finalising a new *Leases* Standard. It plans to issue this new Standard before the end of 2015.

The Boards' redeliberations of the proposals in the 2013 Exposure Draft have taken place in public meetings.

Information about these meetings is available on the IASB's website.

Exposure documents and the comment letters are also available on the IASB's website.

To stay up to date with the latest developments of this project and to sign up for email alerts, please visit the project homepage on <http://go.ifrs.org/Leases>.

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