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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.

Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: May 2006, London
Project: Recognition of Contingent rentals (Agenda Paper 2)

Introduction

1. The IFRIC Agenda Committee has been considering requests for clarification of IAS 17's requirements on contingent rentals [*Deleted*]
2. The Agenda Committee recommendation is that no interpretation of or amendment to IAS 17 should be made at the present time due to there being no significant diversity in practice.

Background

3. The issue arises from the interpretation of the following paragraphs of IAS 17:
 - paragraph 33 of IAS 17, which deals with lessee accounting for operating leases, states "*Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.*"

- paragraph 50 of IAS 17, which deals with lessor accounting for operating leases, states “*Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.*”
- paragraph 4 of IAS 17 defines contingent rent as “... *that portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, future market rates of interest).*”

4. There are two views on how these paragraphs should be interpreted:

View 1

5. Paragraph 4 of IAS 17 states that contingent rents are a portion of the lease payments. As paragraphs 33 and 50 of IAS 17 require lease payments/lease income to be recognised on a straight-line basis, entities should estimate the amount of any contingent rent and include it in the total lease payments/ lease income to be recognised on a straight-line basis.

View 2

6. Paragraph 25 of IAS 17, which deals with the subsequent measurement of finance leases in the financial statements of lessees, states that contingent rents shall be charged as expenses in the periods in which they are incurred. There is no similar statement with regard to operating leases. However, it can be argued that a consistent approach should be taken for operating leases. That is, lease payments in terms of paragraphs 33 and 50 of IAS 17 should be interpreted as meaning lease payments excluding contingent rentals and contingent rentals should be recognised as income/expense in the periods in which they are earned/incurred.

Suggested resolution

7. *[Deleted]*
8. The theoretical argument for including estimates of contingent rentals in the measurement of finance leases is probably stronger than the argument for including estimated contingent rentals in the income/expense recognised in respect of operating leases. Finance leases give rise to financial assets/liabilities that normally, on initial recognition, are recorded at fair value. However, IAS 17 explicitly excludes contingent rentals from the measurement of finance lease assets and liabilities. It would therefore be strange to require estimates of contingent rentals to be included the income/expense recognised in respect of operating leases when this approach is not adopted for finance leases.
9. It can also be argued that the uncertainty surrounding the estimation of future contingent rentals would result in a rental income/expense that is less reliable than if contingent rentals are recognised as they are earned/incurred.
10. The Agenda Committee believes that view 2 is the approach intended by IAS 17. Whilst the current wording of IAS 17 does not unambiguously support this interpretation, there is little evidence that there is significant diversity in practice – that is, most reporting entities adopt the approach outlined in view 2. Therefore, the Agenda Committee does not recommend that an interpretation of or amendment to IAS 17 be made at the present time.
11. *[Deleted]*

Clarification of the definition of contingent rentals

12. The Agenda Committee was also asked to consider whether additional guidance is required on what constitutes contingent rentals. For example, how should a lease that provides for a rental increase of, say, CPI + 2% be treated? However, the Agenda Committee recommend that no guidance is issued as this does not appear to be a significant or widespread issue.