



30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

**International
Accounting Standards
Board**

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: July 2008, London

**Project: Recognition of Lease Expense under an Operating Lease
(Agenda Paper 6A)**

1. The IFRIC has received a request to add an item to its agenda to provide guidance on how a lessee should determine an appropriate pattern of recognition of expense for an operating lease with non-level payments.

Submission

2. The leases in question are of properties used in the entity's main operations. They have a 30 year term with no break clauses. The rental payments are determined from a base rental with fixed increases of 2.75% per year.
3. The submission notes that IAS 17 paragraph 33 requires lease payments under an operating lease to be recognised as an expense on a straight line basis over the term of the lease unless another systematic basis is more representative of the time pattern of the user's benefits. Paragraph 34 states that the method of recognition is not dependent on the pattern of lease payments.

4. The submission also states that although this treatment is appropriate for short term leases, for longer term leases recognising the lease expense on a straight-line basis can seriously distort the expense pattern recognised over the term of the lease. It asks the IFRIC to consider whether the expense could be recognised based on the expected usage of the property by customers whose usage will determine the entity's revenue from operations.

Background

5. As the submission notes, the IFRIC has previously considered a question related to the interpretation of the phrase "*another systematic basis... representative of the time pattern of the user's benefit*" included in paragraphs 33 and 34 of IAS 17. The staff has reviewed the original submission that the IFRIC considered in 2005 to assess whether the fact pattern included in the submission differs. The papers related to the original issue are available from the staff on request.
6. In the staff's judgement the fact pattern does not differ. In 2005 the IFRIC specifically considered operating property leases with fixed annual inflationary increases and concluded that "recognising income or expense from annual fixed inflators as they arise would not be consistent with the time pattern of the user's benefit". As the submission point out, however, the IFRIC did not address the question of what an alternative 'time pattern of the user's benefit' might be.

Staff Analysis

7. The staff notes that similar issues (and similar terminology) are present in the depreciation of property, plant and equipment and the amortisation of intangible assets.
 - IAS 16 paragraph 60 says "The depreciation method shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."
 - IAS 38 paragraph 97 says "... The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."

8. The principle in IFRSs thus appears to be clear and any guidance the IFRIC could add would relate to its application or implementation.
9. In practice, 'the pattern in which the asset's future economic benefits are expected to be consumed' is determined by reference to the asset rather than by the revenue which usage of that asset will generate. IAS 16 paragraph 56 requires an entity to take usage into account and states that 'Usage is assessed by reference to the asset's expected capacity or physical output.' In the circumstances described in the submission it seems clear that the asset's expected capacity is not affected by usage. Rather in the early years of the lease usage will not consume all the available capacity.

Staff recommendation

10. The staff recommends that the IFRIC not add this issue to its agenda for the following reasons:
 - The issue does not differ significantly from an issue the IFRIC previously considered and rejected
 - No new facts or arguments have been presented
 - The staff has not identified any divergence in practice, current or emerging
 - The principle in IFRSs is clear and consistent among similar classes of assets. Entities should be expected to use their judgement to apply the principle to their specific circumstances.
11. The staff has set out wording for the tentative agenda decision in Appendix A.

Question for the IFRIC

12. Does the IFRIC agree with the staff recommendation?