Project **Leases**

Topic **Changes in Contingent Rentals**

Purpose of the paper

1. At their December 2009 joint meeting, the boards tentatively decided that:

   (a) The obligation to pay rentals recognised by the lessee, and the receivable recognised by the lessor, would include amounts payable under contingent rental arrangements.

   (b) The carrying amount of the obligation/receivable would be reassessed at each reporting date if any new facts or circumstances indicated that there had been a material change in the obligation/receivable.

2. The boards instructed the staff to provide additional analysis on how to account for changes in the obligation/receivable arising from reassessments of the amounts payable under contingent rental arrangements.

3. The purpose of this paper is to provide the additional analysis requested by the boards.

4. This paper is structured as follows:

   (a) a description of three possible approaches to accounting for changes in the lessee's obligation to pay rentals

   (b) a discussion of the advantages and disadvantages of the three approaches

(c) a discussion of how to account for changes in the lessee's obligation to pay rentals arising from changes in amounts payable under residual value guarantees

(d) a discussion of how to account for changes in the lessor's receivable arising from changes in amounts payable under contingent rental arrangements.

Staff recommendations

5. The staff recommend the following:

For lessees

(a) Changes in amounts payable under contingent rental arrangements arising from current or prior periods should be recognised in profit or loss. All other changes should be recognised as an adjustment to the lessee's right-of-use asset (Approach 1).

(b) Changes in amounts payable under residual value guarantees should be recognised in the same way as changes in amounts payable under contingent rental arrangements.

For lessors

(c) Changes in the lessor's receivable arising from changes in amounts payable under contingent rental arrangements should be treated as adjustments to the original transaction price.

(d) Changes in the lessor's receivable should be allocated to the lessor's performance obligation. If changes are allocated to a satisfied performance obligation, the effect should be recognised in revenue. If changes are allocated to an unsatisfied performance obligation, the lessor should adjust the carrying amount of that performance obligation.

Accounting for changes in the lessee's obligation to pay rentals

6. At their December 2009 joint meeting the staff described three possible ways in which changes in the lessee's obligation to pay contingent rentals could be accounted for:

   (a) Recognise all changes in profit or loss

   (b) Recognise all changes as an adjustment to the right-of-use asset

   (c) Recognise changes in profit or loss or as an adjustment to the right-of-use asset, depending upon the nature of the contingent rental arrangement.

7. The boards indicated to the staff that they viewed all changes in the obligation to pay rentals to be adjustments to the originally assessed cost of the right-of-use asset. However, some of the change in that cost could relate to the current period or to prior periods, and should therefore be recognised in profit or loss. Board members suggested two possible approaches to allocating the change between profit or loss and the right-of-use asset. These approaches are as follows:

   (a) **Approach 1 –** Adjustments to the obligation to pay rentals arising from current or prior periods are recognised in profit or loss. All other changes are recognised as an adjustment to the right-of-use asset. For example, if rentals are contingent on sales, increases in the obligation to pay rentals arising from increased sales in current or prior periods would be recognised in profit or loss. Increases in the obligation to pay rentals arising from increases in forecast future sales would be recognised as an adjustment to the right-of-use asset.

   (b) **Approach 2 –** Adjustments to the obligation to pay rentals are allocated between profit or loss and the right-of-use asset on the same basis as the right-of-use asset is amortised. This would normally be on a time basis. For example, if an adjustment to the obligation to pay rentals arises in year 3 of a 10-year lease, 3/10ths of the adjustment would be recognised in profit or loss in year 3, and 7/10ths of the adjustment would be recognised as an adjustment to the right-of-use asset. However, if amortisation of the right-of-use asset is based on usage, the charge would be allocated on the same basis.

8. For completeness, the staff have considered a third approach.

   (a) **Approach 3 –** All adjustments to the obligation to pay rentals are recognised as adjustments to the right-of-use asset. No attempt is made to allocate any of the change to profit or loss. However, as a result of a change in the carrying amount of the right-of-use asset, the depreciation charge for the current period may change.

9. The Appendix to this paper illustrates these three approaches for three types of contingent rental arrangement.

10. This paper does not discuss recognising all changes in profit or loss, or recognising changes based on the nature of the contingent rental arrangement, because there appeared to be little support for those approaches at the December 2009 joint board meeting.

Advantages and disadvantages of the three approaches

11. The following section discusses the advantages and disadvantages of the three approaches described in paragraphs 7 and 8.

Approach 1 – Adjustments to the obligation to pay rentals arising from current or prior periods are recognised in profit or loss

12. This is the most complex of the three approaches identified. It requires lessees to identify which part of the adjustment to the obligation to pay rentals relates to past or current periods, and which part relates to future periods. It may not always be easy to do this, particularly if an entity has a large number of leases. However, it should be noted that the amount recognised in profit or loss will

usually only relate to the current period, because adjustments in respect of prior periods will normally already have been recognised.

13. This approach best reflects the economics of many of these leases, because it most closely matches the recognition of costs to the periods in which those costs are (or were) incurred. For example, if rentals payable are linked to sales, and the obligation to pay rentals increases because of an increase in expected future sales, the increase in the obligation will be recognised as an adjustment to the right-of-use asset. The increase in the carrying amount of the right-of-use asset will be recognised in profit or loss (through amortisation) in those future periods.

14. In addition, this approach is arguably the most consistent with how changes in accounting estimates are accounted for under IFRS and US GAAP. ASC Topic 250, *Accounting Changes and Error Corrections*, Paragraph 250-10-45-17 states the following:

> A change in accounting estimate shall be accounted for in the period of change if the change affects that period only or in the period of change and future periods if the change affects both. A change in accounting estimate shall not be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

15. Paragraph 36 of IAS 8 *Accounting Policies, Changes in Accounting estimates and errors* includes similar requirements.

Approach 2 - Adjustments to the obligation to pay rentals are allocated between profit or loss and the right-of-use asset on the same basis as the right-of-use asset is amortised

16. This approach is simpler to apply than Approach 1. It assumes that if the cost of the right-of-use asset had been measured accurately at the start of the lease, it would have been amortised. Consequently, a portion of any subsequent adjustment to the cost of the right-of-use asset should be recognised in profit or loss, because it represents previous and current period amortisation. If, therefore, an adjustment is made to the right-of-use asset in year 3 of a 10-year lease, 3/10ths of the adjustment would be recognised in profit or loss of the

current period (representing previous amortisation), and 7/10ths would be recognised as an adjustment to the right-of-use asset. If amortisation of the right-of-use asset is done on a usage basis, the adjustment would be allocated between the right-of-use asset and profit or loss in line with the amortisation pattern of the right-of-use asset (see example 3 in the Appendix). In effect, this approach compensates for under- or over-amortisation in prior periods.

17. Those who support Approach 2 think that adjusting the cost of a right-of-use asset is different from a change in an accounting estimate. Consequently, they do not think that the requirements for changes in accounting estimates are relevant.

18. However, it can be argued that this approach does not reflect the economics of many contingent lease arrangements. For example, if you are 15 years into a 20-year lease that has rentals contingent on sales, 15/20ths of any adjustment to the obligation to pay rentals would be recognised in profit or loss, and 5/20ths would be recognised as an adjustment to the right-of-use asset. However, the whole reason for the change could be due to increased (or decreased) sales in years 16 – 20.

Approach 3 - All adjustments to the obligation to pay rentals are recognised as adjustments to the right-of-use asset

19. This approach is the simplest to apply. It avoids the need to allocate adjustments between profit or loss and the right-of-use asset. The whole of any adjustment is allocated to the right-of-use asset, which is then amortised over the remaining lease term. The following example illustrates the difference between this approach and Approach 1:

> Example
>
> Entity A enters into a three-year lease of a property. Rentals are contingent on sales.
>
> Sales in year 1 are higher than originally estimated. Consequently, rentals for year 1 are CU20 higher than previously estimated. Estimated rentals for years 2 and 3 remain unchanged.

Entity A amortises its right-of-use asset on a straight-line basis. Under Approach 1, the whole of the increase in the liability (CU 20) is recognised in profit or loss. Under approach 3, the whole of the adjustment is added to the carrying amount of the right-of-use asset, and is amortised to profit or loss on a straight-line basis over the remaining lease term.

20. This approach is consistent with the approach to changes in decommissioning liabilities under IFRIC 1 *Changes in Decommissioning, Restoration and Similar Liabilities.* IFRIC 1 requires changes in decommissioning liabilities to be added to or deducted from the carrying amount of the related asset. ASC Topic 410, *Asset Retirement and Environmental Obligations* contains similar requirements to IFRIC 1.

21. However, it can be argued that this approach does not reflect the economics of leases that include contingent rental arrangements, because costs associated with current or prior periods are recognised in future periods. In addition, this approach is more likely than the other two approaches to lead to an overstatement of the right-of-use asset – resulting in more frequent impairments.

Staff recommendation

22. The staff recommend Approach 1 because:

    (a) It is consistent with the approach to accounting for changes in estimates under both US GAAP and IFRS.

    (b) It is arguably more consistent with the economics of leases that include contingent rental arrangements.

Question 1
The staff recommend approach 1 – changes in amounts payable under contingent rental arrangements arising from current or prior periods should be recognised in profit or loss. All other changes should be recognised as an adjustment to the lessee's right-of-use asset.

Do the boards agree?

Residual value guarantees

23. At their December 2009 joint meeting, the boards tentatively decided that lessees should account for residual value guarantees in the same way as for contingent rental arrangements. This means that:

    (a) The obligation to pay rentals recognised by the lessee would include amounts payable under residual value guarantees.

    (b) The carrying amount of the obligation would be reassessed at each reporting date if any new facts or circumstances indicate that there is a material change in the obligation.

24. The boards did not decide whether changes in the amount payable under residual value guarantees should be allocated to profit or loss or to the right-of-use asset.

25. The boards could decide to treat any changes in amounts payable under residual value guarantees in the same way as changes in amounts payable under contingent rental arrangements. This would mean that changes in the obligation to pay rentals arising from changes in amounts payable under residual value guarantees would be treated as an adjustment to the originally assessed cost of the right-of-use asset. The adjustment to the obligation to pay rentals would be allocated to profit or loss or to the right-of-use asset using the same approach as for contingent rentals (Approach 1, 2 or 3).

26. Treating residual value guarantees in the same way as contingent rental payment would appear reasonable because:

    (a) Residual value guarantees are just a form of contingent rental payment (they are payments that are contingent on the value of the underlying asset). Treating them differently could lead to structuring opportunities.

(b) They are an integral part of the cost of the right-of-use asset to the lessee.

27. However, adding an increase in the amount payable under a residual value guarantee to the carrying amount of the right-of-use asset would appear to be counter-intuitive. An increase in the amount payable under a residual value guarantee arises because of a decrease in the value of the underlying asset. A decrease in the value of the underlying asset may (although not always) indicate a decrease in the value of the right to use that asset. Consequently, adding increases in amounts payable under a residual value guarantee to the carrying amount of the right-of-use asset is likely to result in more frequent impairments of the right-of-use asset (this would be even more of a problem if the boards opt for approach 3 for contingent rentals).

28. Conversely, decreases in amounts payable under residual values guarantees may indicate an increase in the value of the underlying asset. However, this increase in value is reflected as a decrease in the carrying amount of the right-of-use asset.

29. This apparent problem with the treatment of residual value guarantees could be avoided if the boards required all changes in amounts payable under contingent rental arrangements to be reflected in profit or loss.

30. However, the staff note that increases (or decreases) in amounts payable under residual value guarantees sometimes relate to increased (or decreased) usage by the lessee, rather than to changes in the market value of the underlying asset. Consequently, recognising these changes in the same way as changes in usage-based contingent rentals would increase consistency.

Staff recommendation

31. The staff think that changes in amounts payable under residual value guarantees are changes in the originally assessed cost of the right-of-use asset.

Consequently, they should be accounted for in the same way as contingent rental arrangements.

Question 2
The staff recommend that all changes in amounts payable under residual value guarantees should be recognised in the same way as other contingent rental arrangements. Do the boards agree?

Accounting for changes in the lessor's receivable

32. As noted above, the boards tentatively decided at their December 2009 joint meeting that:

    (a) The receivable recognised by the lessor would include amounts payable under contingent rental arrangements.

    (b) The carrying amount of the receivable would be reassessed at each reporting date if any new facts or circumstances indicate that there is a material change in the receivable.

33. Changes in amounts receivable under contingent rental arrangements could:

    (a) all be recognised in profit or loss in the period in which the change occurs

    (b) be treated as an adjustment to the original transaction price and be allocated to the lessor's performance obligation.

34. The staff note that treating changes in the lessor's receivable as adjustments to the original transaction price would:

    (a) be consistent with the lessee treating changes in its obligation to pay rentals as changes in the original cost of the right-of-use asset

    (b) be consistent with the approach taken in the revenue recognition project, where changes in uncertain consideration are treated as changes in the original transaction price.

35. The staff note that the three approaches to allocating changes in the lessee's obligation to pay rentals between the right-of-use asset and profit or loss described above could also be used to allocate changes in the lessor's receivable between profit or loss and the lessor's performance obligation.

36. However, in the revenue recognition project, the boards have tentatively decided to allocate changes in the transaction price subsequent to the inception of the contract to the reporting entity's performance obligations. If changes are allocated to performance obligations that have been satisfied, the effects of the changes are recognised as revenue. If the effects of the changes relate to obligations that are unperformed, they increase or decrease the measurement of those obligations (refer to March 2009 AP 6B/FASB Memo #115B).

37. The staff think that the approach taken by the lessor should be consistent with the approach adopted in the revenue recognition project.

38. In general, a lessor's performance obligation is satisfied over time (unless payments are based on usage). That is, 3 years into a 10-year lease, the lessor will have satisfied 3/10ths of its performance obligation. Consequently, the lessor will normally allocate 3/10ths of the change in its receivable to profit or loss and 7/10ths to its performance obligation.

39. The staff note that this approach is similar to Approach 2 described above, which is not the approach recommended by the staff for lessees. This asymmetry between the lessee and lessor is due to the fact that the lessee and lessor are recording different things. The lessor is allocating transaction price to unperformed performance obligations. The lessee is recording the cost of its right-of-use asset.

Question 3
The staff recommend that changes in the lessor's receivable be treated as adjustments to the original transaction price and be allocated to the lessor's performance obligation. If changes are allocated to a satisfied performance obligation, the effect should be recognised in revenue. If changes are allocated to an unsatisfied performance obligation, they will adjust the carrying amount that performance obligation.

Do the boards agree?

Appendix - Illustrative examples

A1. The following examples illustrate the three approaches to recognising changes in the lessee's obligation to pay rentals described in this paper.

Example 1 – Payments are contingent on sales

A2. Company A enters into a 3-year lease of a building. Assume the following:

(a) Payments under the lease are contingent on sales.

(b) Cash payments are made at the end of the year.

(c) Payments are based on actual sales in the year.

(d) The lessee's incremental borrowing rate is 10%.

(e) Amortisation of the right-of-use asset is on a straight-line-basis.

A3. Expected payments at the start of the lease are as follows:

	Year 1	Year 2	Year 3
Payment	200	200	200

A4. Consequently, at the start of year 1 the lessee recognises an obligation to pay rentals and a right-of-use asset equal to the present value of the expected lease payments discounted using the lessee's incremental borrowing rate:

Dr	Right-of-use asset	497	
Cr	Liability		497

A5. At the end of year 1 actual and expected payments are revised as follows:

Year	Year 1	Year 2	Year 3
Payment	250	260	270

A6. Journals at the end of year 1 are as follows:

		Approach 1		Approach 2		Approach 3	
Dr	Liability	250		250		250	
Cr	Cash		250		250		250
To recognise payment of rentals							
Dr	Interest cost	50		50		50	
Cr	Liability		50		50		50
To recognise accrual of interest on the liability							

Dr	Right-of-use asset	113		109		163	
Dr	Profit or loss	50		54		0	
Cr	Liability		163		163		163
To recognise change in obligation to pay contingent rentals							
Dr	Amortisation	166		166		166	
Cr	Right-of-use asset		166		166		166
To recognise amortisation of the right-of-use asset							

Under **Approach 1** adjustments relating to current or prior periods are recognised in P&L (50 in this example).
Under **Approach 2** the adjustment is allocated on a time basis; in this case 1/3 of the adjustment is allocated to P&L because we are one year into a 3-year lease.
Under **Approach 3** the full amount of the adjustment is added to the right-of-use asset

A7. Actual and expected usage for years 2 and 3 are in line with expectations.

A8. Journals for year 2 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	260		260		260	
Cr	Cash		260		260		260
To recognise payment of rentals							
Dr	Interest cost	46		46		46	
Cr	Liability		46		46		46
To recognise accrual of interest on the liability							
Dr	Amortisation	222		220		247	
Cr	Right-of-use asset		222		220		247
To recognise amortisation of the right-of-use asset							

Calculations

Expected amortisation of the obligation to pay rentals is as follows:

	Year 1	**Year 2**	**Year 3**
Opening	497	347	182
Interest	50	35	18
Cash	-200	-200	-200
Closing	347	182	0

Revised expected amortisation of the obligation to pay rentals:

	Year 1	**Year 2**	**Year 3**
Opening	497	460	246
Interest	50	46	24
Cash	-250	-260	-270
Adjustment	163	0	0
Closing	460	246	0

Carrying amount of right-of-use asset

	Approach 1	Approach 2	Approach 3
Opening cost	497	497	497
Amortisation	-166	-166	-166
Adjustment	113	109	163
Closing	444	440	494
Amortisation going forward	222	220	247

Example 2 – Payments are contingent on CPI

A9. Company A enters into a 3-year lease of a building. Assume the following:

(a) Payments under the lease are contingent on CPI. The rental in year 1 is CU20,000 and rentals increase by CPI each year.

(b) Cash payments are made at the end of the year.

(c) The lessee's incremental borrowing rate is 10%.

(d) Amortisation of the right-of-use asset is on a straight-line basis.

(e) At the start of the lease CPI is expected to be 3% in years 2 and 3.

A10. Expected payments at the start of the lease are as follows:

	Year 1	**Year 2**	**Year 3**
Payment	20,000	20,600	21,218

A11. Consequently, at the start of year 1 the lessee recognises an obligation to pay rentals and a right-of-use asset equal to the present value of the expected lease payments discounted using the lessee's incremental borrowing rate:

Dr	Right-of-use asset	51,148	
Cr	Liability		51,148

A12. Actual CPI for year 2 was 4%. CPI in year 3 is expected to be 5%. Consequently, at the end of year 2 actual and expected payments are revised as follows:

	Year 1	**Year 2**	**Year 3**
Payment	20,000	20,800	21,840

A13. Journals at the end of year 1 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	20,000		20,000		20,000	
Cr	Cash		20,000		20,000		20,000
To recognise payment of rentals							
Dr	Interest cost	5,115		5,115		5,115	
Cr	Liability		5,115		5,115		5,115
To recognise accrual of interest on the liability							

Dr	Amortisation	17,049		17,049		17,049	
Cr	Right-of-use asset		17,049		17,049		17,049
To recognise amortisation of the right-of-use asset							

A14. Journals at the end of year 2 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	20,800		20,800		20,800	
Cr	Cash		20,800		20,800		20,800
To recognise payment of rentals							
Dr	Interest cost	3,626		3,626		3,626	
Cr	Liability		3,626		3,626		3,626
To recognise accrual of interest on the liability							
Dr	Amortisation	17,049		17,049		17,049	
Cr	Right-of-use asset		17,049		17,049		17,049
To recognise amortisation of the right-of-use asset							
Dr	Right-of-use asset	565		510		765	
Dr	Profit or loss	200		255		0	
Cr	Liability		765		765		765
To recognise change in the obligation to pay rentals							

Under **Approach 1** adjustments relating to current or prior periods are recognised in P&L (20,800-20,600 in this example).
Under **Approach 2** the adjustment is allocated on a time basis; in this case 2/3 of the adjustment is allocated to P&L because we are two years into a 3-year lease.
Under **Approach 3** the full amount of the adjustment is added to the right-of-use asset.

A15. Actual CPI at the end of year 3 was in line with expectations (5%).

A16. Journals at the end of year 3 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	21,840		21,840		21,840	
Cr	Cash		21,840		21,840		21,840
To recognise payment of rentals							
Dr	Interest cost	1,985		1,985		1,985	
Cr	Liability		1,985		1,985		1,985
To recognise accrual of interest on the liability							
Dr	Amortisation	17,614		17,559		17,814	
Cr	Right-of-use asset		17,614		17,559		17,814
To recognise amortisation of the right-of-use asset							

Calculations

Expected amortisation of the obligation to pay rentals at the start of the lease is as follows:

	Year 1	**Year 2**	**Year 3**
Opening	51,148	36,263	19,289
Interest	5,115	3,626	1,929
Cash	-20,000	-20,600	-21,218
Closing	36,263	19,289	0

Revised expected amortisation of the obligation to pay rentals at the end of year 2:

	Year 1	**Year 2**	**Year 3**
Opening	51,148	36,263	19,855
Interest	5,115	3,626	1,985
Cash	-20,000	-20,800	-21,840
Adjustment	0	765	0
Closing	36,263	19,855	0

Carrying amount of right-of-use asset

	Approach 1	**Approach 2**	**Approach 3**
Opening	51,148	51,148	51,148
Amortisation year 1	-17,049	-17,049	-17,049
End of year 1	34,099	34,099	34,099
Amortisation year 2	-17,049	-17,049	-17,049
Adjustment	565	510	765
End of year 2	17,614	17,559	17,814
Amortisation year 3	-17,614	-17,559	-17,814
End of year 3	0	0	0

Example 3 – Payments are contingent on usage

A17. Company A enters into a 3 year lease of a car. Assume the following:

(a) Payments are contingent on miles driven.

(b) Payments equal CU1 per mile.

(c) Cash payments are made at the end of the year.

(d) Cash payments in the year are based on the actual mileage in the year.

(e) Lessee's incremental borrowing rate is 10%.

(f) Amortisation of the right-of-use asset is based on expected usage.

A18. Expected mileage and payments at the start of the lease are as follows:

	Year 1	**Year 2**	**Year 3**
Payment	2,000	2,000	2,000

A19. Consequently, at the start of year 1 the lessee recognises an obligation to pay rentals and a right-of-use asset equal to the present value of the expected lease payments discounted using the lessee's incremental borrowing rate:

Dr	Right-of-use asset	4,974	
Cr	Liability		4,974

A20. At the end of year 1 actual and revised expected mileage is as follows:

	Year 1	**Year 2**	**Year 3**
Payment	2,500	2,500	3,000

A21. Journals at the end of year 1 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	2,500		2,500		2,500	
Cr	Cash		2,500		2,500		2,500
To recognise payment of rentals							
Dr	Interest cost	497		497		497	
Cr	Liability		497		497		497
To recognise accrual of interest on the liability							
Dr	Amortisation	1,554		1,554		1,554	
Cr	Right-of-use asset		1,554		1,554		1,554
To recognise amortisation of the right-of-use asset							

Dr	Right-of-use asset	1,281		1,224		1,781	
Dr	Profit or loss	500		557		0	
Cr	Liability		1,781		1,781		1,781
To recognise change in the obligation to pay rentals							

Under **Approach 1** adjustments relating to the current or prior periods are recognised in profit or loss (2,500-2000).
Under **Approach 2** 2,500/8,000ths of the adjustment is recognised in profit or loss.
Under **Approach 3** the whole of the adjustment is added to the right-of-use asset.

A22. Actual and expected usage in years 2 and 3 is in line with expectations.

A23. Journals at the end of year 2 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	2,500		2,500		2,500	
Cr	Cash		2,500		2,500		2,500
To recognise payment of rentals							
Dr	Interest cost	475		475		475	
Cr	Liability		475		475		475
To recognise accrual of interest on the liability							
Dr	Amortisation	2,137		2,111		2,364	
Cr	Right-of-use asset		2,137		2,111		2,364
To recognise amortisation of the right-of-use asset							

A24. Journals at the end of year 3 are as follows:

		Approach 1		**Approach 2**		**Approach 3**	
Dr	Liability	3,000		3,000		3,000	
Cr	Cash		3,000		3,000		3,000
To recognise payment of rentals							
Dr	Interest cost	273		273		273	
Cr	Liability		273		273		273
To recognise accrual of interest on the liability							
Dr	Amortisation	2,564		2,533		2,837	
Cr	Right-of-use asset		2,564		2,533		2,837
To recognise amortisation of the right-of-use asset							

Calculations

Expected amortisation of the obligation to pay rentals at the start of the lease is as follows:

	Year 1	Year 2	Year 3
Opening	4,974	3,471	1,818
Interest	497	347	182
Cash	-2,000	-2,000	-2,000
Closing	3,471	1,818	0

Revised expected amortisation of the obligation to pay rentals at the end of year 1 is as follows:

	Year 1	Year 2	Year 3
Opening	4,974	4,752	2,727
Interest	497	475	273
Cash	-2,500	-2,500	-3,000
Adjustment	1,781	0	0
Closing	4,752	2,727	0

Amortisation of the right-of-use asset

	Approach 1	Approach 2	Approach 3
Opening	4,974	4,974	4,974
Amortisation year 1	-1,554[1]	-1,554	-1,554
Adjustment	1,281	1,224	1,781
Closing year 1	4,701	4,644	5,201
Amortisation year 2	-2,137[2]	-2,111	-2,364
Closing year2	2,564	2,533	2,837
Amortisation year 3	-2,564	-2,533	-2,837
	0	0	0

[1] Equals 4,974 x (2,500/(2,500 + 2,500 + 3,000))
[2] Equals 4,701 x (2,500/(2,500 + 3,000))