

## NZ IFRIC 4 (PBE)



### **NZ IFRIC Interpretation 4 (PBE)**

#### **Determining whether an Arrangement contains a Lease (NZ IFRIC 4 (PBE))**

**Issued November 2012**

This Interpretation was issued by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 24(1)(a) of the Financial Reporting Act 1993.

This Interpretation is a Regulation for the purposes of the Regulations (Disallowance) Act 1989.

As at 1 December 2012, the requirements in this Interpretation are identical to the requirements in NZ IFRIC 4 *Determining whether an Arrangement contains a Lease* as applied by public benefit entities. Versions of NZ IFRIC 4 applied by public benefit entities prior to adoption of this Interpretation are available in the Archived Standards page of the External Reporting Board (XRB) website at [xrb.govt.nz](http://xrb.govt.nz)

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***A LEASE (NZ IFRIC 4 (PBE))***

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## HISTORY OF AMENDMENTS

### Table of Pronouncements – NZ IFRIC 4 (PBE) *Determining whether an Arrangement contains a Lease*

This table lists the pronouncement establishing NZ IFRIC 4 (PBE).

<b>Pronouncements</b>	<b>Date approved</b>	<b>Early operative date</b>	<b>Effective date (annual reporting periods... on or after ...)</b>
NZ IFRIC 4 (PBE) <i>Determining whether an Arrangement contains a Lease</i>	Nov 2012	Early application permitted	1 Dec 2012

<b>Table of Amended Paragraphs in NZ IFRIC 4 (PBE)</b>		
<b>Paragraph affected</b>	<b>How affected</b>	<b>By ... [date]</b>
Paragraph NZ 3.1	Inserted	NZ IFRIC 4 (PBE) [Nov 2012]
Paragraphs 16–16A	Deleted	NZ IFRIC 4 (PBE) [Nov 2012]
Paragraph NZ 16A.1	Inserted	NZ IFRIC 4 (PBE) [Nov 2012]

The following tables list the pronouncements establishing and substantially amending NZ IFRIC 4 as applied by PBEs prior to the issue of this Interpretation as NZ IFRIC 4 (PBE).

<b>Pronouncements</b>	<b>Date approved</b>	<b>Early operative date</b>	<b>Effective date (annual reporting periods... on or after ...)</b>
NZ IFRIC 4 <i>Determining whether an Arrangement contains a Lease</i>	April 2005	1 Jan 2006	1 Jan 2007
NZ IFRIC 12 <i>Service Concession Arrangements</i>	Mar 2007	Early application encouraged	1 Jan 2008
<i>Omnibus amendments (2007-1)</i>	Nov 2007	Early application permitted	1 Jan 2008

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<b>Table of Amended Paragraphs in NZ IFRIC 4</b>		
<b>Paragraph affected</b>	<b>How affected</b>	<b>By ... [date]</b>
Paragraph 4(b)	Inserted	NZ IFRIC 12 [Mar 2007]
Paragraph 16A	Inserted	<i>Omnibus amendments</i> (2007-1) [Nov 2007]

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NZ IFRIC Interpretation 4 (PBE) *Determining whether an Arrangement contains a Lease* (NZ IFRIC 4 (PBE)) is set out in paragraphs 1–17 and the Appendix.

NZ IFRIC 4 (PBE) is based on IFRIC 4 *Determining whether an Arrangement contains a Lease* (IFRIC 4). NZ IFRIC 4 (PBE) should be read in the context of the IFRIC's Basis for Conclusions on IFRIC 4 and the Illustrative Examples for IFRIC 4.

Any additional material is shown with grey shading. The paragraphs are denoted with "NZ" and identify the types of entities to which the paragraphs apply.

### **Differential Reporting**

Qualifying entities must comply with all the provisions in NZ IFRIC 4 (PBE).

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#### **References**

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- NZ IAS 8 (PBE) *Accounting Policies, Changes in Accounting Estimates and Errors*
- NZ IAS 16 (PBE) *Property, Plant and Equipment*
- NZ IAS 17 (PBE) *Leases*
- NZ IAS 38 (PBE) *Intangible Assets*
- NZ IFRIC 12 (PBE) *Service Concession Arrangements*

NZ IFRIC 4 (PBE) is identical to NZ IFRIC 4 as applied by public benefit entities prior to the issuance of NZ IFRIC 4 (PBE). That is, there are no changes to the recognition, measurement, presentation and disclosure requirements of NZ IFRIC 4 on adoption of this Interpretation.

#### **Background**

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- 1 An entity may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset (eg an item of property, plant or equipment) in return for a payment or series of payments. Examples of arrangements in which one entity (the supplier) may convey such a right to use an asset to another entity (the purchaser), often together with related services, include:
  - outsourcing arrangements (eg the outsourcing of the data processing functions of an entity).
  - arrangements in the telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity.
  - take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (eg a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).
- 2 This Interpretation provides guidance for determining whether such arrangements are, or contain, leases that should be accounted for in accordance with NZ IAS 17 (PBE). It does not provide guidance for determining how such a lease should be classified under that Standard.

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- 3 In some arrangements, the underlying asset that is the subject of the lease is a portion of a larger asset. This Interpretation does not address how to determine when a portion of a larger asset is itself the underlying asset for the purposes of applying NZ IAS 17 (PBE). Nevertheless, arrangements in which the underlying asset would represent a unit of account in either NZ IAS 16 (PBE) or NZ IAS 38 (PBE) are within the scope of this Interpretation.

### Scope

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NZ 3.1 This Interpretation applies only to public benefit entities.

- 4 This Interpretation does not apply to arrangements that:
- (a) are, or contain, leases excluded from the scope of NZ IAS 17 (PBE); or
  - (b) are public-to-private service concession arrangements within the scope of NZ IFRIC 12 (PBE).

### Issues

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- 5 The issues addressed in this Interpretation are:
- (a) how to determine whether an arrangement is, or contains, a lease as defined in NZ IAS 17 (PBE);
  - (b) when the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made; and
  - (c) if an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

### Consensus

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#### **Determining whether an arrangement is, or contains, a lease**

- 6 Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:
- (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
  - (b) the arrangement conveys a right to use the asset.



## **Fulfilment of the arrangement is dependent on the use of a specific asset**

- 7 Although a specific asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of the arrangement is not dependent on the use of the specified asset. For example, if the supplier is obliged to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other assets not specified in the arrangement, then fulfilment of the arrangement is not dependent on the specified asset and the arrangement does not contain a lease. A warranty obligation that permits or requires the substitution of the same or similar assets when the specified asset is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the supplier to substitute other assets for any reason on or after a specified date does not preclude lease treatment before the date of substitution.
- 8 An asset has been implicitly specified if, for example, the supplier owns or leases only one asset with which to fulfil the obligation and it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets.

## **Arrangement conveys a right to use the asset**

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

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### **Assessing or reassessing whether an arrangement is, or contains, a lease**

- 10 The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement, on the basis of all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:
- (a) There is a change in the contractual terms, unless the change only renews or extends the arrangement.
  - (b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with paragraph 4 of NZ IAS 17 (PBE). A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement before the end of the term of the original arrangement shall be evaluated under paragraphs 6–9 only with respect to the renewal or extension period.
  - (c) There is a change in the determination of whether fulfilment is dependent on a specified asset.
  - (d) There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.
- 11 A reassessment of an arrangement shall be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting shall be applied (or cease to apply) from:
- (a) in the case of (a), (c) or (d) in paragraph 10, when the change in circumstances giving rise to the reassessment occurs;
  - (b) in the case of (b) in paragraph 10, the inception of the renewal or extension period.

### **Separating payments for the lease from other payments**

- 12 If an arrangement contains a lease, the parties to the arrangement shall apply the requirements of NZ IAS 17 (PBE) to the lease element of the arrangement, unless exempted from those requirements in accordance with paragraph 2 of NZ IAS 17 (PBE). Accordingly, if an arrangement contains a lease, that lease shall be classified as a finance lease or an operating lease in accordance with

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paragraphs 7–19 of NZ IAS 17 (PBE). Other elements of the arrangement not within the scope of NZ IAS 17 (PBE) shall be accounted for in accordance with other Standards.

- 13 For the purpose of applying the requirements of NZ IAS 17 (PBE), payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. The minimum lease payments as defined in paragraph 4 of NZ IAS 17 (PBE) include only payments for the lease (ie the right to use the asset) and exclude payments for other elements in the arrangement (eg for services and the cost of inputs).
- 14 In some cases, separating the payments for the lease from payments for other elements in the arrangement will require the purchaser to use an estimation technique. For example, a purchaser may estimate the lease payments by reference to a lease agreement for a comparable asset that contains no other elements, or by estimating the payments for the other elements in the arrangement by reference to comparable agreements and then deducting these payments from the total payments under the arrangement.
- 15 If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:
- (a) in the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value of the underlying asset that was identified in paragraphs 7 and 8 as the subject of the lease. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest.\*
  - (b) in the case of an operating lease, treat all payments under the arrangement as lease payments for the purposes of complying with the disclosure requirements of NZ IAS 17 (PBE), but
    - (i) disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and
    - (ii) state that the disclosed payments also include payments for non-lease elements in the arrangement.

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\* ie the lessee's incremental borrowing rate of interest as defined in paragraph 4 of NZ IAS 17 (PBE).

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### **Effective date**

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16–16A [Deleted]

NZ 16.1 A public benefit entity shall apply this Interpretation for annual periods beginning on or after 1 December 2012. Early application is permitted. This Interpretation replaces NZ IFRIC 4 as applied by public benefit entities prior to the issuance of this Interpretation. There are no changes to the requirements of NZ IFRIC 4 as applied by public benefit entities.
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### **Transition**

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17 [Deleted]

### **IFRIC Illustrative Examples**

*[These illustrative examples do not form part of NZ IFRIC 4 (PBE).]*

### **IFRIC Basis for Conclusions**

BC1–BC50 [Paragraphs BC1–BC50 do not form part of NZ IFRIC 4 (PBE).]