

INTERNATIONAL FINANCIAL REPORTING STANDARD 16 leases

Basis for Conclusions

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Objective

- 1 This Standard sets out the principles for the recognition, measurement, presentation and disclosure of *leases*. The objective is to ensure that *lessees* and *lessors* provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.
- 2 An entity shall consider the terms and conditions of *contracts* and all relevant facts and circumstances when applying this Standard. An entity shall apply this Standard consistently to contracts with similar characteristics and in similar circumstances.

Scope

- 3 An entity shall apply this Standard to all leases, including leases of *right-of-use assets* in a *sublease*, except for:
 - (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
 - (b) leases of biological assets within the scope of IAS 41 *Agriculture* held by a lessee;
 - (c) service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements*;
 - (d) licences of intellectual property granted by a lessor within the scope of IFRS 15 *Revenue from Contracts with Customers*; and
 - (e) rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.
- 4 A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(e).

Recognition exemptions (paragraphs B3–B8)

- 5 A lessee may elect not to apply the requirements in paragraphs 22–49 to:
 - (a) *short-term leases*; and

- (b) leases for which the *underlying asset* is of low value (as described in paragraphs B3–B8).
- 6 If a lessee elects not to apply the requirements in paragraphs 22–49 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognise the *lease payments* associated with those leases as an expense on either a straight-line basis over the *lease term* or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit.
- 7 If a lessee accounts for short-term leases applying paragraph 6, the lessee shall consider the lease to be a new lease for the purposes of this Standard if:
- (a) there is a *lease modification*; or
 - (b) there is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).
- 8 The election for short-term leases shall be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

Identifying a lease (paragraphs B9–B33)

- 9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.
- 10 A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).
- 11 An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.
- Separating components of a contract**
- 12 For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 15. Paragraphs B32–B33 set out guidance on separating components of a contract.
- Lessee**
- 13 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
- 14 The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.
- 15 As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 4.3.3 of IFRS 9 *Financial Instruments*.
- 16 Unless the practical expedient in paragraph 15 is applied, a lessee shall account for non-lease components applying other applicable Standards.
- Lessor**
- 17 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying paragraphs 73–90 of IFRS 15.

Lease term (paragraphs B34–B41)

- 18 An entity shall determine the lease term as the non-cancellable period of a lease, together with both:
- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
 - (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
- 19 In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37–B40.

- 20 A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:
- (a) is within the control of the lessee; and
 - (b) affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph B41).
- 21 An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:
- (a) the lessee exercises an option not previously included in the entity's determination of the lease term;
 - (b) the lessee does not exercise an option previously included in the entity's determination of the lease term;
 - (c) an event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term; or
 - (d) an event occurs that contractually prohibits the lessee from exercising an option previously included in the entity's determination of the lease term.

Lessee

Recognition

- 22 At the commencement date, a lessee shall recognise a right-of-use asset and a lease liability.**

Measurement

Initial measurement

Initial measurement of the right-of-use asset

- 23 At the commencement date, a lessee shall measure the right-of-use asset at cost.**

- 24 The cost of the right-of-use asset shall comprise:

- (a) the amount of the initial measurement of the lease liability, as described in paragraph 26;
- (b) any lease payments made at or before the commencement date, less any *lease incentives* received;
- (c) any *initial direct costs* incurred by the lessee; and
- (d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

- 25 A lessee shall recognise the costs described in paragraph 24(d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies IAS 2 *Inventories* to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this Standard or IAS 2 are recognised and measured applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Initial measurement of the lease liability

- 26 At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the *interest rate implicit in the lease*, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the *lessee's incremental borrowing rate*.**

- 27 At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

- (a) *fixed payments* (including in-substance fixed payments as described in paragraph B42), less any lease incentives receivable;
- (b) *variable lease payments* that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 28);
- (c) amounts expected to be payable by the lessee under *residual value guarantees*;
- (d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs B37–B40); and
- (e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

- 28 Variable lease payments that depend on an index or a rate described in paragraph 27(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.
- Subsequent measurement**
- Subsequent measurement of the right-of-use asset*
- 29 **After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 34 and 35.**
- Cost model**
- 30 To apply a cost model, a lessee shall measure the right-of-use asset at cost:
- (a) less any accumulated depreciation and any accumulated impairment losses; and
 - (b) adjusted for any remeasurement of the lease liability specified in paragraph 36(c).
- 31 A lessee shall apply the depreciation requirements in IAS 16 *Property, Plant and Equipment* in depreciating the right-of-use asset, subject to the requirements in paragraph 32.
- 32 If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the *useful life* of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the *useful life* of the right-of-use asset or the end of the lease term.
- 33 A lessee shall apply IAS 36 *Impairment of Assets* to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.
- Other measurement models**
- 34 If a lessee applies the fair value model in IAS 40 *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IAS 40.
- 35 If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.
- Subsequent measurement of the lease liability*
- 36 **After the commencement date, a lessee shall measure the lease liability by:**
- (a) increasing the carrying amount to reflect interest on the lease liability;
 - (b) reducing the carrying amount to reflect the lease payments made; and
 - (c) remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 39–46, or to reflect revised in-substance fixed lease payments (see paragraph B42).
- 37 Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 26, or if applicable the revised discount rate described in paragraph 41, paragraph 43 or paragraph 45(c).
- 38 After the commencement date, a lessee shall recognise in profit or loss, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:
- (a) interest on the lease liability; and
 - (b) variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.
- Reassessment of the lease liability**
- 39 After the commencement date, a lessee shall apply paragraphs 40–43 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognise any remaining amount of the remeasurement in profit or loss.
- 40 A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, if either:
- (a) there is a change in the lease term, as described in paragraphs 20–21. A lessee shall determine the revised lease payments on the basis of the revised lease term; or
 - (b) there is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 20–21 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

- 41 In applying paragraph 40, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.
- 42 A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:
- (a) there is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.
 - (b) there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (ie when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.
- 43 In applying paragraph 42, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.
- Lease modifications*
- 44 A lessee shall account for a lease modification as a separate lease if both:
- (a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
- 45 For a lease modification that is not accounted for as a separate lease, at the *effective date of the lease modification* a lessee shall:
- (a) allocate the consideration in the modified contract applying paragraphs 13–16;
 - (b) determine the lease term of the modified lease applying paragraphs 18–19; and
 - (c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
- 46 For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
- (a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognise in profit or loss any gain or loss relating to the partial or full termination of the lease.
 - (b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.
- 46A As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 46B is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.
- 46B The practical expedient in paragraph 46A applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of the following conditions are met:
- (a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
 - (b) any reduction in lease payments affects only payments originally due on or before 30 June 2022 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2022 and increased lease payments that extend beyond 30 June 2022); and
 - (c) there is no substantive change to other terms and conditions of the lease.
- Presentation**
- 47 A lessee shall either present in the statement of financial position, or disclose in the notes:
- (a) right-of-use assets separately from other assets. If a lessee does not present right-of-use assets separately in the statement of financial position, the lessee shall:

- (i) include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
 - (ii) disclose which line items in the statement of financial position include those right-of-use assets.
- (b) lease liabilities separately from other liabilities. If the lessee does not present lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those liabilities.
- 48 The requirement in paragraph 47(a) does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the statement of financial position as investment property.
- 49 In the statement of profit or loss and other comprehensive income, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, which paragraph 82(b) of IAS 1 *Presentation of Financial Statements* requires to be presented separately in the statement of profit or loss and other comprehensive income.
- 50 In the statement of cash flows, a lessee shall classify:
- (a) cash payments for the principal portion of the lease liability within financing activities;
 - (b) cash payments for the interest portion of the lease liability applying the requirements in IAS 7 *Statement of Cash Flows* for interest paid; and
 - (c) short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Disclosure

- 51 **The objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the statement of financial position, statement of profit or loss and statement of cash flows, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. Paragraphs 52–60 specify requirements on how to meet this objective.**
- 52 A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements. However, a lessee need not duplicate information that is already presented elsewhere in the financial statements, provided that the information is incorporated by cross-reference in the single note or separate section about leases.
- 53 A lessee shall disclose the following amounts for the reporting period:
- (a) depreciation charge for right-of-use assets by class of underlying asset;
 - (b) interest expense on lease liabilities;
 - (c) the expense relating to short-term leases accounted for applying paragraph 6. This expense need not include the expense relating to leases with a lease term of one month or less;
 - (d) the expense relating to leases of low-value assets accounted for applying paragraph 6. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 53(c);
 - (e) the expense relating to variable lease payments not included in the measurement of lease liabilities;
 - (f) income from subleasing right-of-use assets;
 - (g) total cash outflow for leases;
 - (h) additions to right-of-use assets;
 - (i) gains or losses arising from sale and leaseback transactions; and
 - (j) the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.
- 54 A lessee shall provide the disclosures specified in paragraph 53 in a tabular format, unless another format is more appropriate. The amounts disclosed shall include costs that a lessee has included in the carrying amount of another asset during the reporting period.
- 55 A lessee shall disclose the amount of its lease commitments for short-term leases accounted for applying paragraph 6 if the portfolio of short-term leases to which it is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense disclosed applying paragraph 53(c) relates.

- 56 If right-of-use assets meet the definition of investment property, a lessee shall apply the disclosure requirements in IAS 40. In that case, a lessee is not required to provide the disclosures in paragraph 53(a), (f), (h) or (j) for those right-of-use assets.
- 57 If a lessee measures right-of-use assets at revalued amounts applying IAS 16, the lessee shall disclose the information required by paragraph 77 of IAS 16 for those right-of-use assets.
- 58 A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 39 and B11 of IFRS 7 *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.
- 59 In addition to the disclosures required in paragraphs 53–58, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 51 (as described in paragraph B48). This additional information may include, but is not limited to, information that helps users of financial statements to assess:
- (a) the nature of the lessee's leasing activities;
 - (b) future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from:
 - (i) variable lease payments (as described in paragraph B49);
 - (ii) extension options and termination options (as described in paragraph B50);
 - (iii) residual value guarantees (as described in paragraph B51); and
 - (iv) leases not yet commenced to which the lessee is committed.
 - (c) restrictions or covenants imposed by leases; and
 - (d) sale and leaseback transactions (as described in paragraph B52).
- 60 A lessee that accounts for short-term leases or leases of low-value assets applying paragraph 6 shall disclose that fact.
- 60A If a lessee applies the practical expedient in paragraph 46A, the lessee shall disclose:
- (a) that it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 46B or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see paragraph 2); and
 - (b) the amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 46A.

Lessor

Classification of leases (paragraphs B53–B58)

- 61 A lessor shall classify each of its leases as either an *operating lease* or a *finance lease*.
- 62 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.
- 63 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- (a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
 - (b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the *fair value* at the date the option becomes exercisable for it to be reasonably certain, at the *inception date*, that the option will be exercised;
 - (c) the lease term is for the major part of the *economic life* of the underlying asset even if title is not transferred;
 - (d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
 - (e) the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.
- 64 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

- (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
- (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
- 65 The examples and indicators in paragraphs 63–64 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.
- 66 Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.
- Finance leases**
- Recognition and measurement**
- 67 At the commencement date, a lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the *net investment in the lease*.
- Initial measurement*
- 68 The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease.
- 69 Initial direct costs, other than those incurred by manufacturer or dealer lessors, are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.
- Initial measurement of the lease payments included in the net investment in the lease**
- 70 At the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:
- fixed payments (including in-substance fixed payments as described in paragraph B42), less any lease incentives payable;
 - variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
 - any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
 - the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraph B37); and
 - payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
- Manufacturer or dealer lessors**
- 71 At the commencement date, a manufacturer or dealer lessor shall recognise the following for each of its finance leases:
- revenue being the fair value of the underlying asset, or, if lower, the present value of the lease payments accruing to the lessor, discounted using a market rate of interest;
 - the cost of sale being the cost, or carrying amount if different, of the underlying asset less the present value of the *unguaranteed residual value*; and
 - selling profit or loss (being the difference between revenue and the cost of sale) in accordance with its policy for outright sales to which IFRS 15 applies. A manufacturer or dealer lessor shall recognise selling profit or loss on a finance lease at the commencement date, regardless of whether the lessor transfers the underlying asset as described in IFRS 15.
- 72 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to profit or loss equivalent to the profit or loss resulting from an outright sale of the underlying asset, at normal selling prices, reflecting any applicable volume or trade discounts.

- 73 Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in a lessor recognising an excessive portion of the total income from the transaction at the commencement date. If artificially low rates of interest are quoted, a manufacturer or dealer lessor shall restrict selling profit to that which would apply if a market rate of interest were charged.
- 74 A manufacturer or dealer lessor shall recognise as an expense costs incurred in connection with obtaining a finance lease at the commencement date because they are mainly related to earning the manufacturer or dealer's selling profit. Costs incurred by manufacturer or dealer lessors in connection with obtaining a finance lease are excluded from the definition of initial direct costs and, thus, are excluded from the net investment in the lease.

Subsequent measurement

- 75 **A lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.**
- 76 A lessor aims to allocate finance income over the lease term on a systematic and rational basis. A lessor shall apply the lease payments relating to the period against the *gross investment in the lease* to reduce both the principal and the *unearned finance income*.
- 77 A lessor shall apply the derecognition and impairment requirements in IFRS 9 to the net investment in the lease. A lessor shall review regularly estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.
- 78 A lessor that classifies an asset under a finance lease as held for sale (or includes it in a disposal group that is classified as held for sale) applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* shall account for the asset in accordance with that Standard.

Lease modifications

- 79 A lessor shall account for a modification to a finance lease as a separate lease if both:
- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
- 80 For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:
- if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
 - account for the lease modification as a new lease from the effective date of the modification; and
 - measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
 - otherwise, the lessor shall apply the requirements of IFRS 9.

Operating leases

Recognition and measurement

- 81 **A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.**
- 82 A lessor shall recognise costs, including depreciation, incurred in earning the lease income as an expense.
- 83 A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.
- 84 The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with IAS 16 and IAS 38.
- 85 A lessor shall apply IAS 36 to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.
- 86 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.
- Lease modifications*
- 87 A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Presentation

88 A lessor shall present underlying assets subject to operating leases in its statement of financial position according to the nature of the underlying asset.

Disclosure

89 **The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the statement of financial position, statement of profit or loss and statement of cash flows, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. Paragraphs 90–97 specify requirements on how to meet this objective.**

90 A lessor shall disclose the following amounts for the reporting period:

- (a) for finance leases:
 - (i) selling profit or loss;
 - (ii) finance income on the net investment in the lease; and
 - (iii) income relating to variable lease payments not included in the measurement of the net investment in the lease.
- (b) for operating leases, lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

91 A lessor shall provide the disclosures specified in paragraph 90 in a tabular format, unless another format is more appropriate.

92 A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 89. This additional information includes, but is not limited to, information that helps users of financial statements to assess:

- (a) the nature of the lessor's leasing activities; and
- (b) how the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor shall disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits.

Finance leases

93 A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.

94 A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation shall identify the unearned finance income relating to the lease payments receivable and any discounted unguaranteed residual value.

Operating leases

95 For items of property, plant and equipment subject to an operating lease, a lessor shall apply the disclosure requirements of IAS 16. In applying the disclosure requirements in IAS 16, a lessor shall disaggregate each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor shall provide the disclosures required by IAS 16 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor.

96 A lessor shall apply the disclosure requirements in IAS 36, IAS 38, IAS 40 and IAS 41 for assets subject to operating leases.

97 A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

Sale and leaseback transactions

98 If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 99–103.

Assessing whether the transfer of the asset is a sale

99 An entity shall apply the requirements for determining when a performance obligation is satisfied in IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the asset is a sale

100 If the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset:

- (a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.
 - (b) the buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.
- 101 If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:
- (a) any below-market terms shall be accounted for as a prepayment of lease payments; and
 - (b) any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.
- 102 The entity shall measure any potential adjustment required by paragraph 101 on the basis of the more readily determinable of:
- (a) the difference between the fair value of the consideration for the sale and the fair value of the asset; and
 - (b) the difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.
- 102A After the commencement date, the seller-lessee shall apply paragraphs 29-35 to the right-of-use asset arising from the leaseback and paragraphs 36-46 to the lease liability arising from the leaseback. In applying paragraphs 36-46, the seller-lessee shall determine 'lease payments' or 'revised lease payments' in a way that the seller-lessee would not recognise any amount of the gain or loss that relates to the right of use retained by the seller-lessee. Applying the requirements in this paragraph does not prevent the seller-lessee from recognising in profit or loss any gain or loss relating to the partial or full termination of a lease as required by paragraph 46(a).
- Transfer of the asset is not a sale**
- 103 If the transfer of an asset by the seller-lessee does not satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset:
- (a) the seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IFRS 9.
 - (b) the buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IFRS 9.

Temporary exception arising from interest rate benchmark reform

- 104 A lessee shall apply paragraphs 105-106 to all lease modifications that change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 5.4.6 and 5.4.8 of IFRS 9). These paragraphs apply only to such lease modifications. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9.
- 105 As a practical expedient, a lessee shall apply paragraph 42 to account for a lease modification required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if, and only if, both of these conditions are met:
- (a) the modification is necessary as a direct consequence of interest rate benchmark reform; and
 - (b) the new basis for determining the lease payments is economically equivalent to the previous basis (ie the basis immediately preceding the modification).
- 106 However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

Appendix A

Defined terms

This appendix is an integral part of the Standard.

**commencement date of the lease
(commencement date)** The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**.

economic life Either the period over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more users.

effective date of the modification	The date when both parties agree to a lease modification .
fair value	For the purpose of applying the lessor accounting requirements in this Standard, the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
finance lease	A lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset .
fixed payments	Payments made by a lessee to a lessor for the right to use an underlying asset during the lease term , excluding variable lease payments .
gross investment in the lease	The sum of:
	(a) the lease payments receivable by a lessor under a finance lease ; and (b) any unguaranteed residual value accruing to the lessor.
inception date of the lease (inception date)	The earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.
initial direct costs	Incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease .
interest rate implicit in the lease	The rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.
lease	A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
lease incentives	Payments made by a lessor to a lessee associated with a lease , or the reimbursement or assumption by a lessor of costs of a lessee.
lease modification	A change in the scope of a lease , or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets , or extending or shortening the contractual lease term).
lease payments	Payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term , comprising the following:
	(a) fixed payments (including in-substance fixed payments), less any lease incentives ; (b) variable lease payments that depend on an index or a rate; (c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and (d) payments of penalties for terminating the lease , if the lease term reflects the lessee exercising an option to terminate the lease.
	For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees . Lease payments do not include payments allocated to

	<p>non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.</p> <p>For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. Lease payments do not include payments allocated to non-lease components.</p>
lease term	<p>The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:</p> <ul style="list-style-type: none"> (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
lessee	An entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.
lessee's incremental borrowing rate	The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.
lessor	An entity that provides the right to use an underlying asset for a period of time in exchange for consideration.
net investment in the lease	The gross investment in the lease discounted at the interest rate implicit in the lease .
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset .
optional lease payments	Payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term .
period of use	The total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time).
residual value guarantee	A guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.
right-of-use asset	An asset that represents a lessee's right to use an underlying asset for the lease term .
short-term lease	A lease that, at the commencement date , has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.
sublease	A transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.
underlying asset	An asset that is the subject of a lease , for which the right to use that asset has been provided by a lessor to a lessee .

unearned finance income	The difference between: (a) the gross investment in the lease ; and (b) the net investment in the lease .
unguaranteed residual value	That portion of the residual value of the underlying asset , the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.
variable lease payments	The portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date , other than the passage of time.

Terms defined in other Standards and used in this Standard with the same meaning

contract	An agreement between two or more parties that creates enforceable rights and obligations.
useful life	The period over which an asset is expected to be available for use by an entity; or the number of production or similar units expected to be obtained from an asset by an entity.

Appendix B **Application guidance**

This appendix is an integral part of the Standard. It describes the application of paragraphs 1–103 and has the same authority as the other parts of the Standard.

Portfolio application

- B1 This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

Combination of contracts

- B2 In applying this Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:
- (a) the contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together;
 - (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
 - (c) the rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in paragraph B32.

Recognition exemption: leases for which the underlying asset is of low value (paragraphs 5–8)

- B3 Except as specified in paragraph B7, this Standard permits a lessee to apply paragraph 6 to account for leases for which the underlying asset is of low value. A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased.
- B4 The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in paragraph 6 regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value.
- B5 An underlying asset can be of low value only if:
- (a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
 - (b) the underlying asset is not highly dependent on, or highly interrelated with, other assets.

B6 A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

B7 If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

B8 Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Identifying a lease (paragraphs 9–11)

B9 To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs B13–B20) for a period of time, an entity shall assess whether, throughout the *period of use*, the customer has both of the following:

- (a) the right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs B21–B23); and
- (b) the right to direct the use of the identified asset (as described in paragraphs B24–B30).

B10 If the 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.

B11 A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in IFRS 11 *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.

B12 An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph B32 for guidance on separate lease components.

Identified asset

B13 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

B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier 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 (for example, the customer cannot prevent the supplier from substituting the 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).

B15 If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

B16 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 of the contract, 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 during the period of use, and the market price considered likely at inception of the contract.

B17 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.

B18 The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

B19 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

B20 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 asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Right to obtain economic benefits from use

B21 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.

B22 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 (see paragraph B30). For example:

- (a) 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.
- (b) if a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle for the permitted mileage, and not beyond.

B23 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.

Right to direct the use

B24 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 throughout the period of use (as described in paragraphs B25–B30); 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; 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.

How and for what purpose the asset is used

B25 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.

B26 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); and
- (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).

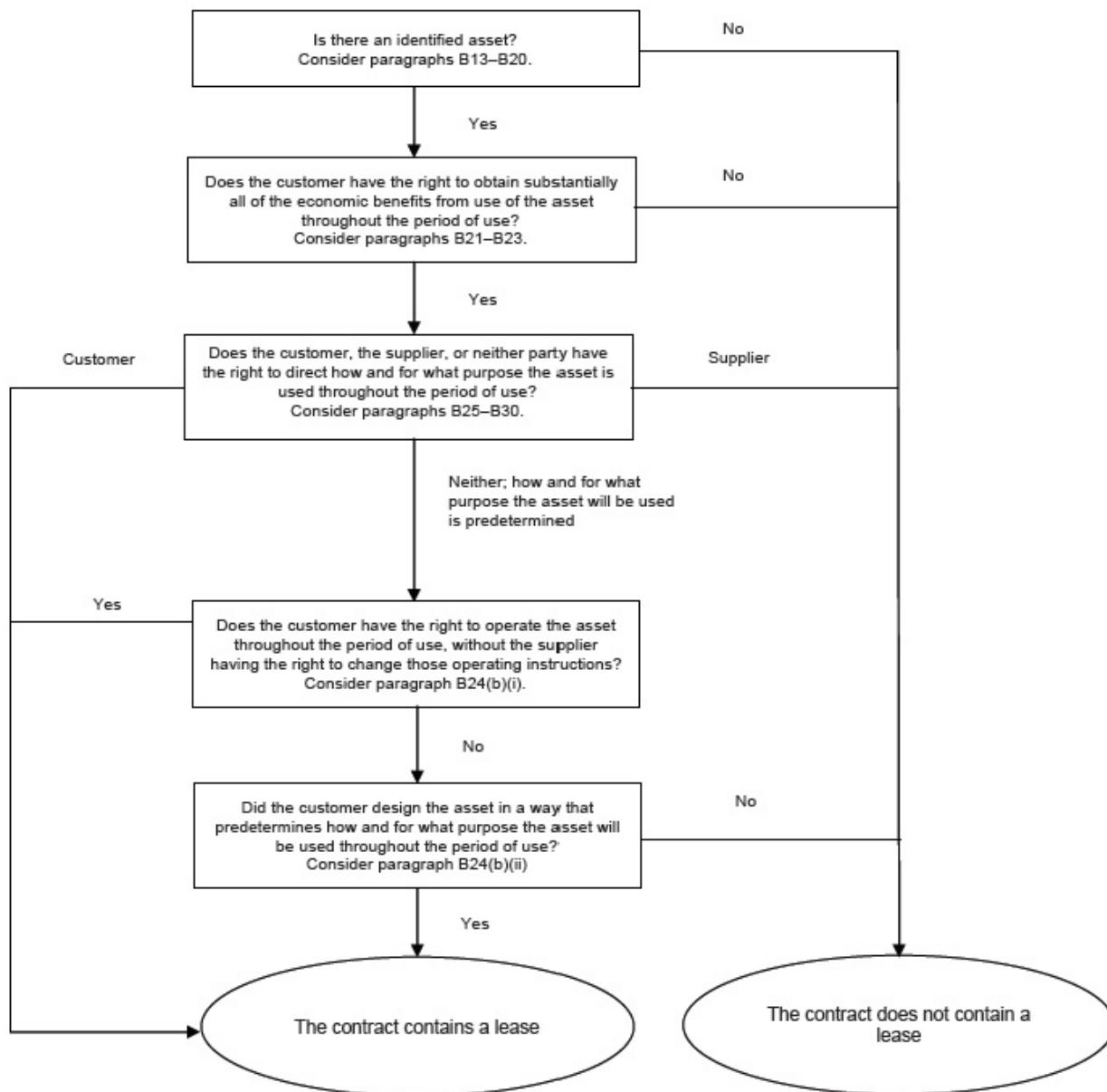
B27 Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain 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 (see paragraph B24(b)(i)).

Decisions determined during and before the period of use

- B28 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.
- B29 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 (or specific aspects of the asset) as described in paragraph B24(b)(ii). Consequently, unless the conditions in paragraph B24(b)(ii) 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

- B30 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. 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.
- B31 The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.



Separating components of a contract (paragraphs 12–17)

- B32 The right to use an underlying asset is a separate lease component if both:
- (a) the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
 - (b) the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

- B33 A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Lease term (paragraphs 18–21)

- B34 In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.
- B35 If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.
- B36 The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.
- B37 At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. Examples of factors to consider include, but are not limited to:
- (a) contractual terms and conditions for the optional periods compared with market rates, such as:
 - (i) the amount of payments for the lease in any optional period;
 - (ii) the amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
 - (iii) the terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
 - (b) significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
 - (c) costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
 - (d) the importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialised asset, the location of the underlying asset and the availability of suitable alternatives; and
 - (e) conditionality associated with exercising the option (ie when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.
- B38 An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph B42, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.

- B39 The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.
- B40 A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.
- B41 Paragraph 20 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:
- (a) significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
 - (b) a significant modification to, or customisation of, the underlying asset that was not anticipated at the commencement date;
 - (c) the inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and
 - (d) a business decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of a business unit within which the right-of-use asset is employed).

In-substance fixed lease payments (paragraphs 27(a), 36(c) and 70(a))

- B42 Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. In-substance fixed lease payments exist, for example, if:
- (a) payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. Examples of those types of payments include:
 - (i) payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or
 - (ii) payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved.
 - (b) there is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be lease payments.
 - (c) there is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

Lessee involvement with the underlying asset before the commencement date

Costs of the lessee relating to the construction or design of the underlying asset

- B43 An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.
- B44 If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee shall account for those costs applying other applicable Standards, such as IAS 16. Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

Legal title to the underlying asset

- B45 A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction.

- B46 If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for applying paragraphs 98–103.
- B47 However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. For example, this may be the case if a manufacturer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the manufacturer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease.
- Lessee disclosures (paragraph 59)**
- B48 In determining whether additional information about leasing activities is necessary to meet the disclosure objective in paragraph 51, a lessee shall consider:
- (a) whether that information is relevant to users of financial statements. A lessee shall provide additional information specified in paragraph 59 only if that information is expected to be relevant to users of financial statements. In this context, this is likely to be the case if it helps those users to understand:
 - (i) the flexibility provided by leases. Leases may provide flexibility if, for example, a lessee can reduce its exposure by exercising termination options or renewing leases with favourable terms and conditions.
 - (ii) restrictions imposed by leases. Leases may impose restrictions, for example, by requiring the lessee to maintain particular financial ratios.
 - (iii) sensitivity of reported information to key variables. Reported information may be sensitive to, for example, future variable lease payments.
 - (iv) exposure to other risks arising from leases.
 - (v) deviations from industry practice. Such deviations may include, for example, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.
 - (b) whether that information is apparent from information either presented in the primary financial statements or disclosed in the notes. A lessee need not duplicate information that is already presented elsewhere in the financial statements.
- B49 Additional information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 51 could include information that helps users of financial statements to assess, for example:
- (a) the lessee's reasons for using variable lease payments and the prevalence of those payments;
 - (b) the relative magnitude of variable lease payments to fixed payments;
 - (c) key variables upon which variable lease payments depend and how payments are expected to vary in response to changes in those key variables; and
 - (d) other operational and financial effects of variable lease payments.
- B50 Additional information relating to extension options or termination options that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 51 could include information that helps users of financial statements to assess, for example:
- (a) the lessee's reasons for using extension options or termination options and the prevalence of those options;
 - (b) the relative magnitude of *optional lease payments* to lease payments;
 - (c) the prevalence of the exercise of options that were not included in the measurement of lease liabilities; and
 - (d) other operational and financial effects of those options.
- B51 Additional information relating to residual value guarantees that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 51 could include information that helps users of financial statements to assess, for example:
- (a) the lessee's reasons for providing residual value guarantees and the prevalence of those guarantees;
 - (b) the magnitude of a lessee's exposure to residual value risk;
 - (c) the nature of underlying assets for which those guarantees are provided; and
 - (d) other operational and financial effects of those guarantees.
- B52 Additional information relating to sale and leaseback transactions that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 51 could include information that helps users of financial statements to assess, for example:
- (a) the lessee's reasons for sale and leaseback transactions and the prevalence of those transactions;

- (b) key terms and conditions of individual sale and leaseback transactions;
- (c) payments not included in the measurement of lease liabilities; and
- (d) the cash flow effect of sale and leaseback transactions in the reporting period.

Lessor lease classification (paragraphs 61–66)

- B53 The classification of leases for lessors in this Standard is based on the extent to which the lease transfers the risks and rewards incidental to ownership of an underlying asset. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the underlying asset's economic life and of gain from appreciation in value or realisation of a residual value.
- B54 A lease contract may include terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (such as a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease). In that case, for the purposes of classifying the lease, the effect of any such changes shall be deemed to have taken place at the inception date.
- B55 When a lease includes both land and buildings elements, a lessor shall assess the classification of each element as a finance lease or an operating lease separately applying paragraphs 62–66 and B53–B54. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.
- B56 Whenever necessary in order to classify and account for a lease of land and buildings, a lessor shall allocate lease payments (including any lump-sum upfront payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.
- B57 For a lease of land and buildings in which the amount for the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease applying paragraphs 62–66 and B53–B54. In such a case, a lessor shall regard the economic life of the buildings as the economic life of the entire underlying asset.

Sublease classification

- B58 In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:
- (a) if the head lease is a short-term lease that the entity, as a lessee, has accounted for applying paragraph 6, the sublease shall be classified as an operating lease.
 - (b) otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).

Appendix C

Effective date and transition

This appendix is an integral part of the Standard and has the same authority as the other parts of the Standard.

Effective date

-
- C1 An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 *Revenue from Contracts with Customers* at or before the date of initial application of this Standard. If an entity applies this Standard earlier, it shall disclose that fact.
- C1A *Covid-19-Related Rent Concessions*, issued in May 2020, added paragraphs 46A, 46B, 60A, C20A and C20B. A lessee shall apply that amendment for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not authorised for issue at 28 May 2020.
- C1B *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in August 2020, added paragraphs 104–106 and C20C–C20D. An entity shall apply these amendments for annual reporting periods beginning on or after 1 January 2021. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.
- C1C *Covid-19-Related Rent Concessions beyond 30 June 2021*, issued in March 2021, amended paragraph 46B and added paragraphs C20BA–C20BC. A lessee shall apply that amendment for annual reporting periods beginning on or after 1 April 2021. Earlier application is permitted, including in financial statements not authorised for issue at 31 March 2021.

C1D *Lease Liability in a Sale and Leaseback*, issued in September 2022, amended paragraph C2 and added paragraphs 102A and C20E. A seller-lessee shall apply these amendments for annual reporting periods beginning on or after 1 January 2024. Earlier application is permitted. If a seller-lessee applies these amendments for an earlier period, it shall disclose that fact.

Transition

C2 For the purposes of the requirements in paragraphs C1–C20E, the date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard.

Definition of a lease

C3 As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

- (a) to apply this Standard to contracts that were previously identified as leases applying IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease*. The entity shall apply the transition requirements in paragraphs C5–C18 to those leases.
- (b) not to apply this Standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

C4 If an entity chooses the practical expedient in paragraph C3, it shall disclose that fact and apply the practical expedient to all of its contracts. As a result, the entity shall apply the requirements in paragraphs 9–11 only to contracts entered into (or changed) on or after the date of initial application.

Lessees

C5 A lessee shall apply this Standard to its leases either:

- (a) retrospectively to each prior reporting period presented applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
- (b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs C7–C13.

C6 A lessee shall apply the election described in paragraph C5 consistently to all of its leases in which it is a lessee.

C7 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Leases previously classified as operating leases

C8 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall:

- (a) recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying IAS 17. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
- (b) recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IAS 17. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:
 - (i) its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or
 - (ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.
- (c) apply IAS 36 *Impairment of Assets* to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph C10(b).

C9 Notwithstanding the requirements in paragraph C8, for leases previously classified as operating leases applying IAS 17, a lessee:

- (a) is not required to make any adjustments on transition for leases for which the underlying asset is of low value (as described in paragraphs B3–B8) that will be accounted for applying paragraph 6. The lessee shall account for those leases applying this Standard from the date of initial application.
- (b) is not required to make any adjustments on transition for leases previously accounted for as investment property using the fair value model in IAS 40 *Investment Property*. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IAS 40 and this Standard from the date of initial application.
- (c) shall measure the right-of-use asset at fair value at the date of initial application for leases previously accounted for as operating leases applying IAS 17 and that will be accounted for as investment property using the fair value model in IAS 40 from the date of initial application. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IAS 40 and this Standard from the date of initial application.

C10 A lessee may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph C5(b) to leases previously classified as operating leases applying IAS 17. A lessee is permitted to apply these practical expedients on a lease-by-lease basis:

- (a) a lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
- (b) a lessee may rely on its assessment of whether leases are onerous applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* immediately before the date of initial application as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.
- (c) a lessee may elect not to apply the requirements in paragraph C8 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessee shall:
 - (i) account for those leases in the same way as short-term leases as described in paragraph 6; and
 - (ii) include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application.
- (d) a lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- (e) a lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Leases previously classified as finance leases

C11 If a lessee elects to apply this Standard in accordance with paragraph C5(b), for leases that were classified as finance leases applying IAS 17, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IAS 17. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application.

Disclosure

C12 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall disclose information about initial application required by paragraph 28 of IAS 8, except for the information specified in paragraph 28(f) of IAS 8. Instead of the information specified in paragraph 28(f) of IAS 8, the lessee shall disclose:

- (a) the weighted average lessee's incremental borrowing rate applied to lease liabilities recognised in the statement of financial position at the date of initial application; and
- (b) an explanation of any difference between:
 - (i) operating lease commitments disclosed applying IAS 17 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application as described in paragraph C8(a); and
 - (ii) lease liabilities recognised in the statement of financial position at the date of initial application.

C13 If a lessee uses one or more of the specified practical expedients in paragraph C10, it shall disclose that fact.

Lessors

C14 Except as described in paragraph C15, a lessor is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying this Standard from the date of initial application.

C15 An intermediate lessor shall:

- (a) reassess subleases that were classified as operating leases applying IAS 17 and are ongoing at the date of initial application, to determine whether each sublease should be classified as an operating lease or a finance lease applying this Standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.
- (b) for subleases that were classified as operating leases applying IAS 17 but finance leases applying this Standard, account for the sublease as a new finance lease entered into at the date of initial application.

Sale and leaseback transactions before the date of initial application

C16 An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in IFRS 15 to be accounted for as a sale.

C17 If a sale and leaseback transaction was accounted for as a sale and a finance lease applying IAS 17, the seller-lessee shall:

- (a) account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and
 - (b) continue to amortise any gain on sale over the lease term.
- C18 If a sale and leaseback transaction was accounted for as a sale and operating lease applying IAS 17, the seller-lessee shall:
- (a) account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and
 - (b) adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the statement of financial position immediately before the date of initial application.

Amounts previously recognised in respect of business combinations

- C19 If a lessee previously recognised an asset or a liability applying IFRS 3 *Business Combinations* relating to favourable or unfavourable terms of an operating lease acquired as part of a business combination, the lessee shall derecognise that asset or liability and adjust the carrying amount of the right-of-use asset by a corresponding amount at the date of initial application.

References to IFRS 9

- C20 If an entity applies this Standard but does not yet apply IFRS 9 *Financial Instruments*, any reference in this Standard to IFRS 9 shall be read as a reference to IAS 39 *Financial Instruments: Recognition and Measurement*.

Covid-19-related rent concessions for lessees

- C20A A lessee shall apply *Covid-19-Related Rent Concessions* (see paragraph C1A) retrospectively, recognising the cumulative effect of initially applying that amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.
- C20B In the reporting period in which a lessee first applies *Covid-19-Related Rent Concessions*, a lessee is not required to disclose the information required by paragraph 28(f) of IAS 8.
- C20BA A lessee shall apply *Covid-19-Related Rent Concessions beyond 30 June 2021* (see paragraph C1C) retrospectively, recognising the cumulative effect of initially applying that amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.
- C20BB In the reporting period in which a lessee first applies *Covid-19-Related Rent Concessions beyond 30 June 2021*, a lessee is not required to disclose the information required by paragraph 28(f) of IAS 8.
- C20BC Applying paragraph 2 of this Standard, a lessee shall apply the practical expedient in paragraph 46A consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying *Covid-19-Related Rent Concessions* (see paragraph C1A) or *Covid-19-Related Rent Concessions beyond 30 June 2021* (see paragraph C1C).

Interest Rate Benchmark Reform—Phase 2

- C20C An entity shall apply these amendments retrospectively in accordance with IAS 8, except as specified in paragraph C20D.
- C20D An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Lease liability in a sale and leaseback

- C20E A seller-lessee shall apply *Lease Liability in a Sale and Leaseback* (see paragraph C1D) retrospectively in accordance with IAS 8 to sale and leaseback transactions entered into after the date of initial application.

Withdrawal of other Standards

- C21 This Standard supersedes the following Standards and Interpretations:
- (a) IAS 17 *Leases*;
 - (b) IFRIC 4 *Determining whether an Arrangement contains a Lease*;

- (c) SIC-15 *Operating Leases — Incentives*; and
- (d) SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

Illustrative Examples

These examples accompany, but are not part of, IFRS 16. They illustrate aspects of IFRS 16 but are not intended to provide interpretative guidance.

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Appendix

Amendments to guidance on other Standards

IE1 These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in IFRS 16 to particular aspects of a lease (or other contracts) on the basis of the limited facts presented. The analysis in each example is not intended to represent the only manner in which the requirements could be applied, nor are the examples intended to apply only to the specific industry illustrated. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IFRS 16.

Identifying a lease (paragraphs 9–11 and B9–B30)

IE2 The following examples illustrate how an entity determines whether a contract is, or contains, a lease.

Example 1 — Rail cars

Example 1A: 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).

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

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 (see paragraph B18). 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.

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 paragraph B24(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.

Example 1B: 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 are 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.

The contract does not contain a lease of rail cars or of an engine. 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 each car and the engine throughout the period of use (see paragraph B14(a)). Alternative cars and engines are readily available to Supplier and Supplier can substitute each car and the engine without Customer's approval.
- (b) Supplier would benefit economically from substituting each car and the engine (see paragraph B14(b)). There would be minimal, if any, cost associated with substituting each car or the 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 each car 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.

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits from use, of an identified car 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.

Example 2 — Concession space

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 period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

The contract does not contain a lease.

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 (see paragraph B14(a)). 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 (see paragraph B14(b)). 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.

Example 3 — Fibre-optic cable

Example 3A: 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).

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

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 (see paragraph B18).

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 paragraph B24(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.

Example 3B: 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, makes decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).

The contract does not contain a lease.

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 (see paragraph B20). Consequently, Customer does not have the right to use an identified asset.

Example 4 — Retail unit

Customer enters into a contract with a 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 relocate to another retail unit. In that case, Supplier is required to provide Customer with a retail unit of similar quality and specifications to Retail Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of retail space at a rate sufficiently favourable to cover the costs of relocating Customer and other tenants in the retail space. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise.

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.

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

Retail Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the retail unit, but could benefit economically from substitution only in specific circumstances.

Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise (see paragraph B16).

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 use of Retail Unit A.
- (b) Customer has the right to direct the use of Retail Unit A because the conditions in paragraph B24(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.

Example 5 — Truck rental

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 does not have the 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.

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

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

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 B24(b)(i) exist. How and for what purpose the truck will be 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.

Example 6 — Ship

Example 6A: 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 or operating the ship itself during the term of the contract.

The contract does not contain a lease.

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.

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 one of many customers transporting cargo on the ship.

Example 6B: 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 what cargo will be transported, and whether, 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 of the contract or operating the ship itself during the term of the contract.

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

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.

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 paragraph B24(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 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 ship is used. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the ship is used.

Example 7 — Aircraft

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 or operating the aircraft itself 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.

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

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 because the conditions in paragraph B14(b) do not exist. 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.

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 paragraph B24(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.

Example 8 — Contract for shirts

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 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).

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.

The contract does not contain a lease.

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

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 period of use.

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 period of use. 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.

Example 9 — Contract for energy / power

Example 9A: 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.

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

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.

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 paragraph B24(b)(ii) 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.

Example 9B: 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.

The contract does not contain a lease.

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.

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.

Example 9C: 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 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.
The contract contains a lease. Customer has the right to use the power plant for 10 years.
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.
Customer has the right to control the use of the power plant throughout the 10-year period of use because:
<p>(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.</p> <p>(b) Customer has the right to direct the use of the power plant because the conditions in paragraph B24(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 (ie the timing and quantity, if any, of power produced) 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.</p>
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.

Example 10 — Contract for network services

Example 10A: 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.

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

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.

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 the use of the servers in providing network services to Customer.

Example 10B: 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 period of use. 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.

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

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning (see paragraph B18).

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 paragraph B24(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.

Leases of low-value assets and portfolio application (paragraphs 5–6, B1 and B3–B8)

IE3 The following example illustrates how a lessee might (a) apply paragraphs B3–B8 of IFRS 16 to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in IFRS 16.

Example 11 — Leases of low-value assets and portfolio application

A lessee in the pharmaceutical manufacturing and distribution industry (Lessee) has the following leases:

- (a) *leases of real estate (both office buildings and warehouses).*
- (b) *leases of manufacturing equipment.*
- (c) *leases of company cars, both for sales personnel and senior management and of varying quality, specification and value.*
- (d) *leases of trucks and vans used for delivery purposes, of varying size and value.*
- (e) *leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).*
- (f) *leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers over time as Lessee has needed to increase the storage capacity of the servers.*

(g) *leases of office equipment:*

- (i) *office furniture (such as chairs, desks and office partitions);*
- (ii) *water dispensers; and*
- (iii) *high-capacity multifunction photocopier devices.*

Leases of low-value assets

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

- (a) leases of IT equipment for use by individual employees; and
- (b) leases of office furniture and water dispensers.

Lessee elects to apply the requirements in paragraph 6 of IFRS 16 in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers.

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in IFRS 16 to its leases of real estate, manufacturing equipment, company cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its company cars, trucks and vans into portfolios.

Lessee's company cars are leased under a series of master lease agreements. Lessee uses eight different types of company car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of company car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of IFRS 16 to each master lease agreement would not result in a materially different effect than applying the requirements of IFRS 16 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of IFRS 16 to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of company cars in similar territories. Lessee reasonably expects that the effect of applying IFRS 16 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying IFRS 16 to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of IFRS 16 to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van.

lease. Consequently, Lessee applies the requirements of IFRS 16 to different portfolios of truck and van leases, rather than to 6,500 individual leases.

Allocating consideration to components of a contract (paragraphs 12–16 and B32–B33)

IE4 The following example illustrates the allocation of consideration in a contract to lease and non-lease components by a lessee.

Example 12 — Lessee allocation of consideration to lease and non-lease components of a contract

Lessor leases a bulldozer, a truck and a long-reach excavator to Lessee to be used in Lessee's mining operations for four years. Lessor also agrees to maintain each item of equipment throughout the lease term. The total consideration in the contract is CU600,000 (a), payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. The variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. The consideration includes the cost of maintenance services for each item of equipment.

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying paragraph 12 of IFRS 16. Lessee does not elect the practical expedient in paragraph 15 of IFRS 16. Lessee considers the requirements in paragraph B32 of IFRS 16 and concludes that the lease of the bulldozer, the lease of the truck and the lease of the long-reach excavator are each separate lease components. This is because:

- (a) Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative truck or excavator to use in its operations); and
- (b) although Lessee is leasing all three items of equipment for one purpose (ie to engage in mining operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract. Lessee applies the guidance in paragraphs 13–14 of IFRS 16 to allocate the consideration in the contract to the three lease components and the non-lease components.

Several suppliers provide maintenance services for a similar bulldozer and a similar truck. Accordingly, there are observable standalone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the maintenance of the bulldozer and the truck of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The long-reach excavator is highly specialised and, accordingly, other suppliers do not lease or provide maintenance services for similar excavators. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar long-reach excavators from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount of CU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. That variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. Consequently, Lessee estimates the stand-alone price of the maintenance services for the long-reach excavator to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the bulldozer, the truck and the long-reach excavator of CU170,000, CU102,000 and CU224,000, respectively.

Lessee allocates the fixed consideration in the contract (CU600,000) to the lease and non-lease components as follows:

<u>CU</u>	<u>Bulldozer</u>	<u>Truck</u>	<u>Long-reach excavator</u>	<u>Total</u>
Lease	170,000	102,000	224,000	496,000
Non-lease				104,000
Total fixed consideration				600,000

Lessee allocates all of the variable consideration to the maintenance of the long-reach excavator, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in IFRS 16, treating the allocated consideration as the lease payments for each lease component.

Lessee measurement (paragraphs 18–41 and B34–B41)

IE5 The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 13 — Measurement by a lessee and accounting for a change in the lease term

Part 1 — Initial measurement of the right-of-use asset and the lease liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives the lease incentive from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset			CU405,391	
Lease liability				CU355,391
Cash (lease payment for the first year)				CU50,000

Right-of-use asset			CU20,000	
Cash (initial direct costs)				CU20,000
Cash (lease incentive)			CU5,000	
Right-of-use asset				CU5,000

Part 2 — Subsequent measurement and accounting for a change in the lease term

In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimise costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period — Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance CU	Lease payment CU	5% interest expense CU	Ending balance CU	Beginning balance CU	Depreciation charge CU	Ending balance CU
1	355,391	—	17,770	373,161	420,391	(42,039)	378,352
2	373,161	(50,000)	16,158	339,319	378,352	(42,039)	336,313
3	339,319	(50,000)	14,466	303,785	336,313	(42,039)	294,274
4	303,785	(50,000)	12,689	266,474	294,274	(42,039)	252,235
5	266,474	(50,000)	10,823	227,297	252,235	(42,039)	210,196
6	227,297	(50,000)	8,865	186,162	210,196	(42,039)	168,157

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest rate of 5 per cent per annum). Interest expense of CU8,865 is recognised in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,174. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognised as follows.

Right-of-use asset		CU192,012		
Lease liability				CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (ie CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

Year	Lease liability			Right-of-use asset			
	Beginning balance CU	Lease payment CU	6% interest expense CU	Ending balance CU	Beginning balance CU	Depreciation charge CU	Ending balance CU
7	378,174	(50,000)	19,690	347,864	360,169	(40,019)	320,150
8	347,864	(50,000)	17,872	315,736	320,150	(40,019)	280,131
9	315,736	(50,000)	15,944	281,680	280,131	(40,019)	240,112
10	281,680	(50,000)	13,901	245,581	240,112	(40,019)	200,093
11	245,581	(55,000)	11,435	202,016	200,093	(40,019)	160,074
12	202,016	(55,000)	8,821	155,837	160,074	(40,019)	120,055
13	155,837	(55,000)	6,050	106,887	120,055	(40,019)	80,036
14	106,887	(55,000)	3,113	55,000	80,036	(40,018)	40,018
15	55,000	(55,000)	—	—	40,018	(40,018)	—

Variable lease payments (paragraphs 27, 39, 42(b) and 43)

IE6 The following example illustrates how a lessee accounts for variable lease payments that depend on an index and variable lease payments not included in the measurement of the lease liability.

Example 14 — Variable lease payments dependent on an index and variable lease payments linked to sales

Example 14A — Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

During the first two years of the lease, Lessee recognises in aggregate the following related to the lease.

Interest expense	CU33,928	
Lease liability		CU33,928
Depreciation charge	CU81,078 (CU405,391 ÷ 10 × 2 years)	
Right-of-use asset		CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognises the following.

Lease liability	CU50,000	
Cash		CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 per cent per annum = CU355,391 + CU33,928 – CU50,000).

At the beginning of the third year of the lease the Consumer Price Index is 135.

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 ($CU50,000 \times 135 \div 125$). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, ie the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 per cent per annum, which is CU366,464. Lessee increases the lease liability by CU27,145, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognised as follows.

Right-of-use asset		CU27,145	
Lease liability			CU27,145
Lease liability			CU54,000
Cash			CU54,000

Example 14B — Assume the same facts as Example 14A except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee's sales generated from the leased property.

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognised at the same amounts as in Example 14A. This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset		CU405,391	
Lease liability			CU355,391
Cash (lease payment for the first year)			CU50,000

Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000 from the leased property.

Lessee incurs an additional expense related to the lease of CU8,000 ($CU800,000 \times 1$ per cent), which Lessee recognises in profit or loss in the first year of the lease.

Lease modifications (paragraphs 44–46)

IE7 Examples 15–19 illustrate the requirements of IFRS 16 regarding lease modifications for a lessee.

Example 15 — Modification that is a separate lease

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

Example 16 — Modification that increases the scope of the lease by extending the contractual lease term

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (ie CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of-use asset.

Example 17 — Modification that decreases the scope of the lease

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU129,884.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (ie 2,500 square metres corresponding to 50 per cent of the original right-of-use asset).

50 per cent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309. Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 – CU92,001 = CU13,308) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Example 18 — Modification that both increases and decreases the scope of the lease

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is CU150,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206

4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

Decrease in the lease term

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square metres of office space (ie a remaining three-year lease term rather than the original five-year lease term). The remaining right-of-use asset for the original 2,000 square metres of office space is CU220,802 (ie $CU368,004 \div 5 \times 3$ years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square metres of office space is CU267,301 (ie present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 ($CU368,004 - CU220,802$), and the carrying amount of the lease liability by CU153,935 ($CU421,236 - CU267,301$). Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset ($CU153,935 - CU147,202 = CU6,733$) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease liability		CU153,935	
Right-of-use asset			CU147,202
Gain			CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 ($CU267,301 - CU262,431$), as an adjustment to the right-of-use asset.

Lease liability		CU4,870	
Right-of-use asset			CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in scope of CU131,216 (ie present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset		CU131,216	
Lease liability			CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

	Lease liability				Right-of-use asset		
	Beginning balance	7% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	CU	CU	CU	CU	CU	CU
6	393,647	27,556	(150,000)	271,203	347,148	(115,716)	231,432
7	271,203	18,984	(150,000)	140,187	231,432	(115,716)	115,716
8	140,187	9,813	(150,000)	—	115,716	(115,716)	

Example 19 — Modification that is a change in consideration only

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

Subleases (paragraph B58)

IE8 Examples 20–21 illustrate the application of the requirements in IFRS 16 for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 20 — Sublease classified as a finance lease

Head lease — An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).

Sublease — At the beginning of Year 3, the intermediate lessor subleases the 5,000 square metres of office space for the remaining three years of the head lease to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in paragraphs 61–66 of IFRS 16.

When the intermediate lessor enters into the sublease, the intermediate lessor:

- (a) derecognises the right-of-use asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;
- (b) recognises any difference between the right-of-use asset and the net investment in the sublease in profit or loss; and
- (c) retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognises both finance income on the sublease and interest expense on the head lease.

Example 21 — Sublease classified as an operating lease

Head lease — An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).

Sublease — At commencement of the head lease, the intermediate lessor subleases the 5,000 square metres of office space for two years to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in paragraphs 61–66 of IFRS 16.

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

During the term of the sublease, the intermediate lessor:

- (a) recognises a depreciation charge for the right-of-use asset and interest on the lease liability; and
- (b) recognises lease income from the sublease.

Lessee disclosure (paragraphs 59 and B49–B50)

IE9 Example 22 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B49 of IFRS 16 about variable lease payments. This example shows only current period information. IAS 1 *Presentation of Financial Statements* requires an entity to present comparative information.

Example 22 — Variable payment terms

Lessee with a high volume of leases with some consistent payment terms

Example 22A: a retailer (Lessee) operates a number of different branded retail stores — A, B, C and D. Lessee has a high volume of property leases. Lessee's group policy is to negotiate variable payment terms for newly established stores. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the proportion of total lease payments that arise from variable payments, and the sensitivity of those variable lease payments to changes in sales, is the information that is relevant to users of its financial statements. This information is similar to that reported to Lessee's senior management about variable lease payments.

Some of the property leases within the group contain variable payment terms that are linked to sales generated from the store. Variable payment terms are used, when possible, in newly established stores in order to link rental payments to store cash flows and minimise fixed costs. Fixed and variable rental payments by store brand for the period ended 31 December 20X0 are summarised below.

	Stores	Fixed payments	Variable payments	Total payments	Estimated annual impact on total brand rent of a 1% increase in sales
	No.	CU	CU	CU	%
Brand A	4,522	3,854	120	3,974	0.03%
Brand B	965	865	105	970	0.11%
Brand C	124	26	163	189	0.86%
Brand D	<u>652</u>	<u>152</u>	<u>444</u>	<u>596</u>	<u>0.74%</u>
	<u>6,263</u>	<u>4,897</u>	<u>832</u>	<u>5,729</u>	<u>0.15%</u>

Refer to the management commentary for store information presented on a like-for-like basis and to Note X for segmental information applying IFRS 8 *Operating Segments* relating to Brands A–D.

Example 22B: a retailer (Lessee) has a high volume of property leases of retail stores. Many of these leases contain variable payment terms linked to sales from the store. Lessee's group policy sets out the circumstances in which variable payment terms are used and all lease negotiations must be approved centrally. Lease payments are monitored centrally. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the different types of contractual terms it uses with respect to variable lease payments, the effect of those terms on its financial performance and the sensitivity of variable lease payments to changes in sales is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about variable lease payments.

Many of the property leases within the group contain variable payment terms that are linked to the volume of sales made from leased stores. These terms are used, when possible, in order to match lease payments with stores generating higher cash flows. For individual stores, up to 100 per cent of lease payments are on the basis of variable payment terms and there is a wide range of sales percentages applied. In some cases, variable payment terms also contain minimum annual payments and caps.

Lease payments and terms for the period ended 31 December 20X0 are summarised below.

	Stores	Fixed payments	Variable payments	Total payments
	No.	CU	CU	CU
Fixed rent only	1,490	1,153	—	1,153
Variable rent with no minimum	986	—	562	562

Variable rent with minimum	<u>3,089</u>	<u>1,091</u>	<u>1,435</u>	<u>2,526</u>
	<u>5,565</u>	<u>2,244</u>	<u>1,997</u>	<u>4,241</u>

A 1 per cent increase in sales across all stores in the group would be expected to increase total lease payments by approximately 0.6–0.7 per cent. A 5 per cent increase in sales across all stores in the group would be expected to increase total lease payments by approximately 2.6–2.8 per cent.

Lessee with a high volume of leases with a wide range of different payment terms

Example 22C: a retailer (Lessee) has a high volume of property leases of retail stores. These leases contain a wide range of different variable payment terms. Lease terms are negotiated and monitored by local management. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee concludes that information about how its property lease portfolio is managed is the information that is relevant to users of its financial statements. Lessee also concludes that information about the expected level of variable lease payments in the coming year (similar to that reported internally to senior management) is also relevant to users of its financial statements.

Many of the property leases within the group contain variable payment terms. Local management are responsible for store margins. Accordingly, lease terms are negotiated by local management and contain a wide range of payment terms. Variable payment terms are used for a variety of reasons, including minimising the fixed cost base for newly established stores or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the group:

- (a) the majority of variable payment terms are based on a range of percentages of store sales;
- (b) lease payments based on variable terms range from 0–20 per cent of total lease payments on an individual property; and
- (c) some variable payment terms include minimum or cap clauses.

The overall financial effect of using variable payment terms is that higher rental costs are incurred by stores with higher sales. This facilitates the management of margins across the group.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

IE10 Example 23 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B50 of IFRS 16 about extension options and termination options. This example shows only current period information. IAS 1 requires an entity to present comparative information.

Example 23 — Extension options and termination options

Lessee with a high volume of leases, that have a wide range of different terms and conditions, which are not managed centrally

Example 23A: Lessee has a high volume of equipment leases with a wide range of different terms and conditions. Lease terms are negotiated and monitored by local management. Lessee concludes that information about how it manages the use of termination and extension options is the information that is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee also concludes that information about (a) the financial effect of reassessing options and (b) the proportion of its short-term lease portfolio resulting from leases with annual break clauses is also relevant to users of its financial statements.

Extension and termination options are included in a number of equipment leases across the group. Local teams are responsible for managing their leases and, accordingly, lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Extension and termination options are included, when possible, to

provide local management with greater flexibility to align its need for access to equipment with the fulfilment of customer contracts. The individual terms and conditions used vary across the group.

The majority of extension and termination options held are exercisable only by Lessee and not by the respective lessors. In cases in which Lessee is not reasonably certain to use an optional extended lease term, payments associated with the optional period are not included within lease liabilities.

During 20X0, the financial effect of revising lease terms to reflect the effect of exercising extension and termination options was an increase in recognised lease liabilities of CU489.

In addition, Lessee has a number of lease arrangements containing annual break clauses at no penalty. These leases are classified as short-term leases and are not included within lease liabilities. The short-term lease expense of CU30 recognised during 20X0 included CU27 relating to leases with an annual break clause.

Lessee with a high volume of leases with some consistent terms and options

Example 23B: a restaurateur (Lessee) has a high volume of property leases containing penalty-free termination options that are exercisable at the option of Lessee. Lessee's group policy is to have termination options in leases of more than five years, whenever possible. Lessee has a central property team that negotiates leases. Lessee concludes that information about termination options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about (a) the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) the proportion of termination options that have been exercised historically is the information that is relevant to users of its financial statements. Lessee also notes that presenting this information on the basis of the same restaurant brands for which segment information is disclosed applying IFRS 8 is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about termination options.

Many of the property leases across the group contain termination options. These options are used to limit the period to which the group is committed to individual lease contracts and to maximise operational flexibility in terms of opening and closing individual restaurants. For most leases of restaurants, recognised lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarised below.

Business segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (undiscounted)		
		Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
	<u>CU</u>	<u>CU</u>	<u>CU</u>	<u>CU</u>

Brand A	569	71	94	165
Brand B	2,455	968	594	1,562
Brand C	269	99	55	154
Brand D	1,002	230	180	410
Brand E	914	181	321	502
	5,209	1,549	1,244	2,793

The table below summarises the rate of exercise of termination options during 20X0.

Business segment		Termination option exercisable during 20X0	Termination option not exercised	Termination option exercised
		No. of leases	No. of leases	No. of leases
Brand A		33	30	3
Brand B		86	69	17
Brand C		19	18	1
Brand D		30	5	25
Brand E		66	40	26
		234	162	72

Example 23C: Lessee has a high volume of large equipment leases containing extension options that are exercisable by Lessee during the lease. Lessee's group policy is to use extension options to align, when possible, committed lease terms for large equipment with the initial contractual term of associated customer contracts, whilst retaining flexibility to manage its large equipment and reallocate assets across contracts. Lessee concludes that information about extension options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that (a) information about the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) information about the historical rate of exercise of extension options is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about extension options.

Many of the large equipment leases across the group contain extension options. These terms are used to maximise operational flexibility in terms of managing contracts. These terms are not reflected in measuring lease liabilities in many cases because the options are not reasonably certain to be exercised. This is generally the case when the underlying large equipment has not been allocated for use on a particular customer contract after the exercise date of an extension option. The table below summarises potential future rental payments relating to periods following the exercise dates of extension options.

Business segment		Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (discounted)	Historical rate of exercise of extension options
		CU	CU	%
Segment A		569	799	52%
Segment B		2,455	269	69%
Segment C		269	99	75%
Segment D		1,002	111	41%
Segment E		914	312	76%
		5,209	1,590	67%

Sale and leaseback transactions (paragraphs 98–103)

IE11 Example 24 illustrates the application of the requirements in paragraphs 99–102 of IFRS 16 for a seller-lessee and a buyer-lessor.

Example 24 — Sale and leaseback transaction with fixed payments and above-market terms

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IFRS 15 Revenue from Contracts with Customers to be accounted for as a sale of the building. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback.

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. Applying paragraph 101(b) of IFRS 16, the amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) is CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease — corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Buyer-lessor classifies the lease of the building as an operating lease.

Seller-lessee

Applying paragraph 100(a) of IFRS 16, at the commencement date Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. Seller-lessee calculates this amount as: CU1,000,000 (the carrying amount of the building) \times CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset) \div CU1,800,000 (the fair value of the building).

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of the building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU559,645 (CU800,000 \times CU1,259,200) \div CU1,800,000 relates to the right to use the building retained by Seller-lessee; and
- (b) CU240,355 (CU800,000 \times (CU1,800,000 – CU1,259,200) \div CU1,800,000) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash		CU2,000,000
Right-of-use asset		CU699,555
Building		CU1,000,000
Lease Liability		CU1,259,200
Financial liability		CU200,000
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building		CU1,800,000
Financial asset		CU200,000
(18 payments of CU16,447, discounted at 4.5 per cent per annum)		
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

IE12 Example 25 illustrates the application of the requirements in paragraph 102A and paragraphs 29-46 of IFRS 16 in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate.

Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800,000 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for five years. Lease payments—payable annually—comprise fixed payments and variable payments that do not depend on an index or rate.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IFRS 15 Revenue from Contracts with Customers *to be accounted for as a sale of the building. Accordingly, Seller-lessee accounts for the transaction as a sale and leaseback.*

The interest rate implicit in the lease cannot be readily determined. Seller-lessee's incremental borrowing rate is 3 per cent per annum.

Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use it retains as 25 per cent.^(a) Consequently, at the commencement date Seller-lessee accounts for the transaction as follows.

Cash	CU1,800,000				
Right-of-use asset ($CU1,000,000 \times 25$ per cent)	CU250,000				
Building					CU1,000,000
Lease Liability					CU450,000
Gain on rights transferred ($((CU1,800,000 - CU1,000,000) \times 75$ per cent)					CU600,000

Seller-lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

In measuring the lease liability applying paragraphs 36-46 of IFRS 16, Seller-lessee develops an accounting policy for determining 'lease payments' in a way that it would not recognise any amount of the gain that relates to the right of use it retains. Depending on the circumstances (including the method Seller-lessee used—applying paragraph 100(a) of IFRS 16—for determining the measurement of the right-of-use asset and the gain recognised on the transaction at the commencement date), either Approach 1 or Approach 2 could meet the requirements in paragraph 102A.

Approach 1—Expected lease payments at the commencement date

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect the expected lease payments at the commencement date that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at that date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

Year	Lease Liability				Right-of-use asset		
	Beginning balance	Lease payments ^(b)	3 per cent interest expense ^(c)	Ending balance	Beginning balance	Depreciation charge	Ending balance

	CU	CU	CU	CU	CU	CU	CU	CU
1	450,000	(95,902)	13,500	367,598	250,000	(50,000)	200,000	
2	367,598	(98,124)	11,028	280,502	200,000	(50,000)	150,000	
3	280,502	(99,243)	8,415	189,674	150,000	(50,000)	100,000	
4	189,674	(100,101)	5,690	95,263	100,000	(50,000)	50,000	
5	95,263	(98,121)	2,858	0	50,000	(50,000)	0	

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,197 (CU99,321 – CU98,124) in profit or loss.

Approach 2—Equal lease payments over the lease term

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect equal periodic payments over the lease term that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at the commencement date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

Year	Lease Liability				Right-of-use asset			
	Beginning balance	Lease payments ^(d)	3 per cent interest expense ^(e)	Ending balance	Beginning balance	Depreciation charge	Ending balance	
	CU	CU	CU	CU	CU	CU	CU	CU
1	450,000	(98,260)	13,500	365,240	250,000	(50,000)	200,000	
2	365,240	(98,260)	10,957	277,937	200,000	(50,000)	150,000	
3	277,937	(98,260)	8,338	188,015	150,000	(50,000)	100,000	
4	188,015	(98,260)	5,640	95,395	100,000	(50,000)	50,000	
5	95,395	(98,260)	2,865	0	50,000	(50,000)	0	

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,061 (CU99,321 – CU98,260) in profit or loss.

- (a) Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use retained by comparing, at the commencement date, the right of use it retains via the leaseback to the rights comprising the entire building. Paragraph 100(a) does not prescribe a particular method for determining that proportion.
- (b) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date and, when discounted, result in the carrying amount of the lease liability at that date of CU450,000.

(c) Applying paragraph 102A and paragraph 36(a) of IFRS 16, Seller-lessee increases the carrying amount of the lease liability to reflect interest on the lease liability using its incremental borrowing rate.

(d) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect equal periodic payments over the lease term that, when discounted, result in the carrying amount of the lease liability at the commencement date of CU450,000.

Appendix

Amendments to guidance on other Standards

This appendix describes the amendments to guidance on other Standards that the IASB made when it finalised IFRS 16.

Amended paragraphs are shown with deleted text struck through and new text underlined.

IFRS 15 Revenue from Contracts with Customers

In the Illustrative Examples, paragraph IE321 is amended.

Example 62 — Repurchase agreements

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IE321 In accordance with paragraphs B70–B71 of IFRS 15, the entity accounts for the transaction as a lease in accordance with IAS 17 IFRS 16 Leases.

Footnotes

(a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU).

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