

Invitation to Comment

The International Accounting Standards Board invites comments on the changes to IAS 17 *Leases* proposed in this Exposure Draft. It would particularly welcome answers to the question set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

The Board is not requesting comments on matters in IAS 17 not addressed in the Exposure Draft.

Question

This Exposure Draft proposes that contingent rent relating to an operating lease should be recognised as incurred. Do you agree with the proposal? If not, why?

Summary of Changes

IAS 17 *Leases* requires contingent rent relating to an operating lease to be estimated at the inception of the lease and recognised on a straight-line basis over the lease term. However, because of perceived ambiguities in the Standard, current practice has been to recognise contingent rent relating to an operating lease in the manner prescribed for finance leases (ie as incurred).

This Exposure Draft proposes that contingent rent relating to an operating lease should be recognised as incurred. This would achieve consistency in the treatment of contingent rent for finance and operating leases.

Proposed Amendments to IAS 17 Leases

In the Standard, paragraphs 33, 34, 39, 40, 50 and 51 are amended (new text is underlined).

Leases in the financial statements of lessees

Operating leases

- 33 Lease payments (excluding costs for services, taxes to be paid by and reimbursed to the lessor and contingent rent) under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.¹ Contingent rent shall be recognised as an expense in the periods in which it is incurred.
- 34 For operating leases, lease payments (excluding costs for services such as insurance and maintenance, taxes to be paid by and reimbursed to the lessor and contingent rent) are recognised as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

Leases in the financial statements of lessors

Finance leases

Subsequent measurement

- 39 The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Contingent rent shall be recognised as income in the periods in which it is earned.
- 40 A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services and contingent rent, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

Operating leases

- 50 Lease income (excluding receipts for services provided, tax payments reimbursed by the lessee and contingent rent) from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit

¹ See also SIC-15 *Operating Leases—Incentives*.

derived from the leased asset is diminished.¹ Contingent rent shall be recognised as income in the periods in which it is earned.

- 51 Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance, tax payments reimbursed by the lessee and contingent rent) is recognised on a straight-line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

¹ See also SIC-15 *Operating Leases—Incentives*.

Basis for Conclusions on Proposed Amendments to IAS 17 Leases

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

Contingent rent

- BC1 IAS 17 *Leases* requires an entity to estimate contingent rent relating to an operating lease at the inception of the lease and to recognise it on a straight-line basis over the lease term. However, in practice, such rent is recognised as incurred because of a perception that the requirements of the Standard are ambiguous and are inconsistent with the treatment of contingent rent relating to finance leases.
- BC2 The Board acknowledges that the requirements of IAS 17 relating to contingent rent are ambiguous. The Board therefore proposes to amend the Standard to require contingent rent relating to an operating lease to be recognised as incurred. The Board believes this will remove any divergence in practice and provide consistent treatment of contingent rent in finance and operating leases.