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International Accounting Standards Board®

International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D3

Determining whether an Arrangement contains a Lease

Comments to be received by 19 March 2004

IFRIC Draft Interpretation D3 *Determining whether an Arrangement contains a Lease* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **19 March 2004**.

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This draft Interpretation is available from www.iasb.org.

INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Determining whether an Arrangement contains a Lease*. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **19 March 2004**.

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IFRIC *International Financial Reporting Interpretations Committee*

IFRIC DRAFT INTERPRETATION D3

Determining whether an Arrangement contains a Lease

IFRIC [draft] Interpretation X *Determining whether an Arrangement contains a Lease* ([draft] IFRIC X) is set out in paragraphs 1-12. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the *IFRIC Mandate and Operating Procedures*. [Draft] IFRIC X is accompanied by Illustrative Examples and a Basis for Conclusions.

Reference

- IAS 17 *Leases*

Background

1 An entity may enter into an arrangement, comprising a transaction or a series of linked or related transactions, that does not take the legal form of a lease but conveys a right to use an item (eg an item of property, plant or equipment) for an agreed period of time in return for a payment or series of payments. Examples of arrangements in which one entity (the supplier) may convey such a right to use an item to another entity (the purchaser), often together with related services, include:

- outsourcing arrangements, including some of those that are described as the outsourcing of the data processing functions of an entity;

- arrangements in the telecommunications industry, where suppliers of network capacity enter into contracts to provide purchasers with rights to capacity;
- take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (eg where purchasers are committed to acquiring substantially all of the output of a supplier's power generator); and
- service concession arrangements,* in which a supplier (eg a private entity) provides the use of an item of infrastructure to a purchaser (eg a government).

2 This [draft] Interpretation provides guidance for determining whether such arrangements are, or contain, leases that should be accounted for in accordance with IAS 17 *Leases*. It does not provide guidance for determining how such a lease should be classified under that Standard.

3 In some arrangements, the supplier transfers the right to use an item that is a component or portion of a larger item (eg a right to use 50 per cent of the capacity of a pipeline). The issue of how to determine if and when a right to use a component of a larger item should be accounted for as a lease is not dealt with in this [draft] Interpretation. Nevertheless, in some cases it may be appropriate for suppliers and purchasers to treat a right to use a component of an item as a lease in a manner consistent with this [draft] Interpretation.

Scope

4 This [draft] Interpretation does not apply to arrangements that are, or contain, leases excluded from the scope of IAS 17.

Issues

5 The issues addressed in this [draft] Interpretation are:

(a) how to determine whether an arrangement is, or contains, a lease as defined in IAS 17;

(b) when the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made; and

* as described in SIC-29 *Disclosure—Service Concession Arrangements.*

(c) if an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

Consensus

Determining whether an arrangement is, or contains, a lease

6 An arrangement is, or contains, a lease if all three of the following criteria are met:

(a) the arrangement depends upon a specific item or items (the item), for example an item of property, plant or equipment. The item may be explicitly identified by the contractual provisions of the arrangement, in which case this criterion will usually be met. The criterion will also be met if the item is implicitly identified by the contractual provisions and surrounding facts and circumstances. This will be the case if it is not economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative items.

(b) the arrangement conveys a right to use the item for an agreed period of time such that the purchaser is able to exclude others from using the item. This criterion will be met in arrangements to purchase the output from, or other utility of, an item where there is only a remote possibility that parties other than the purchaser could take more than an insignificant amount of the output or other utility of that item, other than with the consent of the purchaser.

(c) payments under the arrangement are made for the time that the item is made available for use rather than for actual use of the item (as, for example, would be the case if all or part of the payments are unavoidable unless the supplier fails to perform). In some arrangements, the obligation to make payments may be implicit in the circumstances, as the purchaser may have no alternative but to acquire substantially all of the output or other utility of the item.

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

7 The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement on the basis of the facts and circumstances existing at that time. A reassessment shall be made if, and only if, the provisions of the arrangement are changed. Subsequent

changes in circumstances, for example the supplier obtaining additional items with which to fulfil the arrangement, shall not result in a reassessment of the arrangement.

Separating payments for the lease from other payments

8 If an arrangement contains a lease, the classification, recognition, measurement and disclosure requirements of IAS 17 shall be applied by both the purchaser and supplier to the lease element of the arrangement. Other elements of the arrangement shall be accounted for in accordance with other Standards.

9 For the purposes of applying the requirements of IAS 17, payments under the arrangement shall be separated into those for the lease and those for other elements (eg for services and the cost of inputs) on the basis of their relative fair values.

10 In some cases, separating the payments for the lease from payments for other elements in the arrangement will require the purchaser to use an estimation technique. For example, a purchaser may estimate the lease payments by reference to a lease agreement for a comparable item that contains no other elements, or by estimating the payments for the other elements in the arrangement by reference to comparable agreements and then deducting these payments from the total payments under the arrangement. In rare cases a purchaser may conclude that it is impracticable to separate the payments reliably. In these instances it shall:

(a) in the case of a finance lease, recognise an asset at an amount equal to the fair value of the underlying item that was identified in paragraph 6(a) as the subject of the lease; or

(b) in the case of an operating lease, disclose all payments under the arrangement when disclosing the minimum lease payments, and state that the disclosed payments also include payments for other elements in the arrangement.

Effective date

11 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [1 January 2005]. Earlier application is encouraged. If an entity applies this [draft] Interpretation for a period beginning before [1 January 2005], it shall disclose that fact.

Transition

12 Changes in accounting policies shall be accounted for according to the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*[*]

[*] If an entity applies this [draft] Interpretation for a period beginning before [1 January 2005], the entity shall follow the requirements of the previous version of IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, unless the entity is applying the revised version of that Standard for that earlier period.

Illustrative Examples

These [draft] examples accompany, but are not part of, the [draft] Interpretation.

Example of an arrangement that contains a lease

Facts

E1 A purchaser enters into a take-or-pay contract to buy industrial gas from a supplier. The supplier provides the gas by using a plant that it has built, and that it operates, on the purchaser's site. Although the supplier has a right to provide gas using other plants and could acquire the gas from other sources, it is not economically feasible or practical for it to do so. The supplier also has the right to provide gas to other customers from the plant on the purchaser's site but there is only a remote possibility that it will exercise that right. The arrangement provides for both fixed, unavoidable payments and variable payments designed to cover the supplier's actual input costs based on a target level of efficiency. If the plant is not available for use, the purchaser is not required to make payments and the supplier incurs penalties.

Assessment

E2 In this example, the arrangement depends upon a specific item, namely the plant on the purchaser's site. While the supplier has a right to provide gas using other plants, it is not economically feasible or practical for the supplier to fulfil the arrangement other than by providing use of the plant on the purchaser's site. A specific item has therefore been implicitly identified.

E3 The arrangement conveys the right to use the plant for an agreed period of time such that the purchaser is able to exclude others from using the plant. This is because at the inception of the arrangement there is only a remote possibility that parties other than the purchaser could take more than an insignificant amount of the output from the plant.

E4 The purchaser is required to pay for the time that the plant is made available rather than for actual use of the plant. The fixed payment terms mean that the purchaser is obliged to make payments to the supplier regardless of whether it uses the plant (ie takes the output); it can avoid payments only if the plant is not available for use.

E5 The arrangement, therefore, contains a lease of the plant, which is accounted for in accordance with IAS 17.*

Example of an arrangement that does not contain a lease

Facts

E6 A purchaser enters into a take-or-pay contract to buy industrial gases from a supplier. The supplier is a large company operating similar plants at various locations. The amount of gas that the purchaser is committed to buy is roughly equivalent to the total output of one of the plants. Because a good distribution network is available, the supplier is able to provide gas from various locations to fulfil its supply obligation.

Assessment

E7 In this example, the arrangement does not depend upon a specific item. This is because it is economically feasible and practical for the supplier to fulfil the arrangement by providing use of more than one plant. A specific item has therefore not been identified either explicitly or implicitly.

E8 The arrangement does not convey a right to use that is a lease, because the purchaser is not acquiring the output from a specific plant and therefore is not able to exclude others from using a specific plant.

E9 Payments under the arrangement are unavoidable, because the contract is a take-or-pay arrangement (ie the purchaser is obliged to make payments to the supplier regardless of whether it takes delivery of the gas). However, no specific item has been identified and therefore the arrangement does not contain a lease.

* In particular, the lease is classified as either an operating lease or a finance lease in accordance with paragraphs 7-19 of IAS 17. As specified by paragraph 9 of this [draft] Interpretation, the minimum lease payments in this example would not include payments for the cost of inputs and for the operation of the plant.

Basis for Conclusions

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

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

BC2 The IFRIC noted that arrangements have developed in recent years that do not take the legal form of a lease but which convey rights to use items for agreed periods of time in return for a payment or series of payments. Examples of such arrangements are set out in paragraph 1 of this draft Interpretation. The IFRIC observed that these arrangements share many features of a lease because a lease is defined in paragraph 4 of IAS 17 *Leases* as "an agreement whereby the lessor conveys to the lessee *in return for a payment or series of payments the right to use an asset for an agreed period of time*" (emphasis added). The IFRIC agreed that all arrangements meeting the definition of a lease should be accounted for in accordance with IAS 17 (subject to the scope of that Standard) regardless of whether they take the legal form of a lease. In other words, just as the Standing Interpretations Committee concluded in SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* that an arrangement that is described as a lease is not necessarily accounted for as a lease, the IFRIC concluded that an arrangement can be within the scope of IAS 17 even if it is not described as a lease.

BC3 The IFRIC observed that many of the arrangements likely to fall within the scope of this draft Interpretation involve services as well as a right to use an item. However, the IFRIC concluded that IAS 17 is applicable to the lease element of the arrangement because paragraph 3 of IAS 17 specifies that the Standard applies to "agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets." The IFRIC therefore concluded that it should provide guidance to assist in determining whether an arrangement is, or contains, a lease.

BC4 The IFRIC observed that in certain arrangements a right to use a component or portion of a larger item is granted. The IFRIC agreed that, consistent with existing Standards, a physically distinguishable component of a larger item may be the subject of a lease under this draft Interpretation. For example, it noted that IAS 16 *Property, Plant and Equipment* requires major components of some items of property, plant and equipment to be treated as separate assets and that IAS 17 requires a lease of land and buildings to be split into its two components, with each component evaluated separately. The IFRIC also noted that a purchaser that has, for example, a right to use a quarter of the capacity of a pipeline (or a right to use the entire pipeline for a quarter of the time) in a throughput arrangement is in substantially the same position as a purchaser that has a right to use an entire pipeline that is a quarter of the size. The IFRIC therefore agreed that, in principle, the subject of a lease can be defined by reference to the capacity (or output) of a larger item or by reference to the time that the larger item is made available, rather than by reference only to physical attributes. However, the question of identifying components of larger items, by reference to output or time, raises issues that go beyond the scope of this draft Interpretation. The IFRIC therefore decided to focus on the main issue addressed in this draft Interpretation and not to address the wider issue of how to determine if and when a right to use a component of a larger item should be accounted for as a lease. Nonetheless, the IFRIC agreed that it should highlight that the Interpretation may also apply to arrangements involving the right to use a component of an item.

Scope

BC5 The objective of this draft Interpretation is to determine whether an arrangement contains a lease that falls within the scope of IAS 17. The lease is then accounted for in accordance with that Standard. Because this draft Interpretation is not intended to override any of the requirements of IAS 17, the IFRIC agreed that it should clarify that if an arrangement is found to be, or contains, a lease or licensing agreement that is excluded from the scope of IAS 17, an entity need not apply IAS 17 to that lease or licensing agreement.

BC6 The IFRIC considered whether the scope of this draft Interpretation might overlap with IAS 39 *Financial Instruments: Recognition and Measurement*. In particular it noted the view that an arrangement for output might meet the definition of a derivative under IAS 39 but also be determined to contain a lease under this draft Interpretation. The IFRIC concluded that there should not be an overlap because an arrangement for output that is a derivative would not meet all three criteria in paragraph 6 of this draft Interpretation. In particular, the IFRIC noted that such an arrangement would be unlikely to depend upon a specifically identified item.

Consensus

BC7 This draft Interpretation states that an arrangement that meets all three of the draft Interpretation's criteria is, or contains, a lease that should be accounted for under IAS 17.

Arrangement depends upon a specific item (paragraph 6(a))

BC8 The first criterion is that the arrangement depends upon a specific item or items (eg an item of property, plant or equipment). The IFRIC concluded that this follows from the definition of a lease, which refers to a "right to use *an* asset" (emphasis added). The IFRIC also observed that dependence on a specifically identified item is a feature that distinguishes a lease from other arrangements that also convey rights to use items but are not leases (eg some service arrangements).

BC9 The IFRIC noted that if a specific item is explicitly identified by the arrangement, the first criterion would usually be met. However, it noted that in some arrangements the first criterion might not be met even if an item had been explicitly identified. For example, an arrangement to supply a readily available product that the supplier is entitled, and realistically able, to supply from more than one source does not contain a lease.

BC10 The IFRIC also observed that an arrangement can depend on a specific item, even though that item is not explicitly identified in the arrangement. This would be the case if the circumstances are such that it is not economically feasible or practical for the supplier to perform its obligation by providing the use of alternative items. In such cases the IFRIC agreed that a specific item has been implicitly identified by the arrangement and the surrounding facts and circumstances. Examples of when this could apply are when the supplier owns only one suitable item; the item used to fulfil the contract needs to be at a particular location or specialised to the purchaser's needs; and the supplier is a special purpose entity formed for a limited purpose.

BC11 The IFRIC observed that some of the arrangements covered by this draft Interpretation may require the supplier to replace the underlying item with a similar item if the original item is unavailable (eg because it is unexpectedly inoperable). The IFRIC agreed, however, that such a requirement is in effect a warranty obligation and therefore should not generally preclude lease treatment by affecting the assessment of whether the arrangement depends on a specific item.

Arrangement conveys a right to use the item (paragraph 6(b))

BC12 The second criterion is that the arrangement conveys a right to use the item for an agreed period of time such that the purchaser is able to exclude others from using the item. This criterion follows from the definition of a lease in IAS 17, namely an agreement that "conveys … the right to use an asset for an agreed period of time."

BC13 The IFRIC concluded that the essential characteristic of a right to use an asset is the right to derive future economic benefits from the underlying item (ie the subject of the right to use). The IFRIC therefore agreed that the right to use the item must allow the purchaser to exclude others from using that item. This is because a purchaser has the right to derive economic benefits from the item if it has the ability to restrict the access of others to those economic benefits.

BC14 The IFRIC noted that some view a right to use as referring to a purchaser's ability to *operate* the underlying item. However, the IFRIC rejected this view for two main reasons. First, the IFRIC observed that in many straightforward leases the lessee does not operate the underlying item, but rather outsources its operation (eg to an asset manager). Secondly, the IFRIC concluded that this view incorrectly focuses on the underlying item (eg an item of property, plant or equipment) rather than the *right to use* that item (ie the economic benefits to be derived from the item). The IFRIC observed that not all rights to use that are leases are recognised as assets under IAS 17. Nonetheless, the IFRIC also observed that if a lessee recognises an asset for its rights under a lease, the lessee is recognising its right to use and not the underlying item.

BC15 Having agreed that the essential characteristic of a right to use an asset is the right to derive future economic benefits from the underlying item, the IFRIC concluded that a right to use can be conveyed in arrangements in which purchasers have rights to acquire all, or substantially all, of the output from, or other utility of, an item (or, put another way, when parties other than the purchaser could not take more than an insignificant amount of that output or other utility). This is because the IFRIC noted that the future economic benefits to be derived from the underlying item can be conveyed through the output produced by the item, even though that item might be physically in the possession of, and operated by, the supplier or a third party. Furthermore, the IFRIC noted that if a purchaser has rights to substantially all of the output of an item, it effectively has the ability to exclude other parties from benefiting from the output. In other words, the purchaser has the ability to restrict the access of other parties to the future economic benefits to be derived from the underlying item.

BC16 A minority of IFRIC members disagreed with the conclusion that a right to substantially all of the output of a specific item gives rise to a right to use that item. These members argued that there is a difference between obtaining the economic benefits of the *output* of an item and obtaining the economic benefits of the item that produces the output. In particular, they argued that for an entity to obtain the economic benefits of an item specified by the arrangement, the entity needs more than just rights to substantially all of the output or other utility of the item. In other words, they argued that additional criteria are required to determine whether an arrangement for the output from an item is, or contains, a lease.

BC17 The majority of the IFRIC, however, noted that the asset under consideration is the right to future economic benefits and not the underlying item in the arrangement, and that these economic benefits can be conveyed through the output produced by the underlying item. As noted above, the lease asset under IAS 17 is the right to use; the view of the majority of the IFRIC is that this asset should not be confused with the underlying item. In addition, during its deliberations, the IFRIC considered but rejected the need for additional criteria for determining whether an arrangement contains a lease. In particular, the IFRIC considered the view that the risks and rewards incidental to ownership of the underlying item should be assessed to determine whether an entity's right to use gives rise to a lease. For example, it noted the argument that determining whether a lease exists requires an assessment of whether the pricing of an arrangement is such that the purchaser's unavoidable payments approximate the supplier's fixed cost of owning and operating the underlying item. However, the IFRIC concluded that the transfer of risks and rewards incidental to ownership is not a prerequisite for a lease transaction. Rather, the IFRIC's view is that risks and rewards incidental to ownership of an item are characteristics relevant to lease *classification* and not to whether an arrangement *contains* a lease.

Payments are made for the time that the item is made available (paragraph 6(c))

BC18 The third criterion is that payments under the arrangement are made for the time that the item is made available for use rather than for actual use of the item. The IFRIC noted that the definition of a lease states that payments are made for "the *right* to use an asset" (emphasis added). It therefore concluded that if the effect of an arrangement is that payments are made only for *using* the item, rather than for the time that the item is made available, then that arrangement does not contain a lease. The IFRIC observed that in many take-or-pay (and throughput) arrangements, purchasers are contractually committed to pay the supplier regardless of whether they actually use the underlying item (ie take delivery of the product or service). It therefore concluded that, in such arrangements, purchasers are paying for a right to use. It also noted that, while there might be no contractual commitment, in substance the same effect arises in practice if the purchaser has no alternative but to take substantially all of the output from, or other utility of, the item.

BC19 The IFRIC observed that some arrangements covered by this draft Interpretation might contain provisions that would allow for non-payment by the purchaser in the event of non-performance by the supplier. The IFRIC concluded that, because such provisions compensate the purchaser for the unavailability of the item, they should not be interpreted to mean that payments are made for actual use of the item rather than the right to use. Indeed, the IFRIC noted that such provisions would indicate that a right to use had previously been conveyed.

BC20 The IFRIC noted that its proposals would mean that many take-or-pay arrangements, in which purchasers are committed to purchase substantially all of the output from specific items, might contain leases. As noted above, the requirement to pay regardless of how much output is taken means that payments are made for the right to use. The IFRIC also agreed that the overall effect of such a take-or-pay arrangement is similar to that of a lease plus contracts for related services and supplies (such as contracts for the operation of the item and the purchase of inputs).

BC21 The IFRIC observed that if an arrangement contains a lease, and the lease is an operating lease, applying this proposed Interpretation is likely to result in the same assets, liabilities and expenses being recognised as if no lease had been identified. However, the IFRIC noted that IAS 17 requires lessors and lessees to recognise operating lease payments on a straight-line basis over the lease term (unless another systematic basis is more representative), and thus adjustments to the recognition profile of the payments for the lease element might be required in some instances. Also, the IFRIC noted that the proposed Interpretation would often result in additional disclosure, because IAS 17 specifies that the lessor and lessee should disclose the future minimum lease payments. The IFRIC observed that, for a purchaser, the arrangements discussed in this draft Interpretation typically represent significant future commitments, and yet these commitments are not required to be disclosed in the financial statements by Standards other than IAS 17. The IFRIC agreed that by bringing such arrangements within the scope of IAS 17, users of financial statements would be provided with relevant information that is useful for assessing the purchaser's solvency, liquidity and adaptability. The IFRIC acknowledged that the disclosed information might relate only to the lease element of the arrangement; however, it agreed that it would consider addressing disclosure of executory contracts more generally in a separate project.

Assessment or reassessment of whether an arrangement contains a lease (paragraph 7)

BC22 The draft Interpretation requires the assessment of whether an arrangement contains a lease to be made at the inception of the arrangement on the basis of the facts and circumstances existing at that time. The IFRIC concluded that this was consistent with IAS 17 under which a lease is classified as operating or finance at its inception. It also noted that under IAS 17, while a change in the provisions of the lease might result in the lease being reclassified, a change in circumstances does not. The IFRIC therefore concluded that if a supplier subsequently obtained additional assets with which it could fulfil the arrangement, this should be treated as a change of circumstances (because it does not change the provisions of the arrangement) and therefore should not result in a reassessment of whether the arrangement contains a lease.

BC23 The IFRIC considered the argument that a reassessment should be required if circumstances change in such a way that the originally identified item ceases to be implicitly specified. This could happen, for example, if the purchaser subsequently obtained additional items that it could use to fulfil the arrangement. However, the IFRIC concluded that it would be unduly burdensome to require a purchaser constantly to reassess its supplier's position. The IFRIC also noted that its conclusion was consistent with the view that the asset is the right to use, which is therefore unaffected by a subsequent change to the underlying item that is used to satisfy that right.

Separating payments for the lease from other payments in the arrangement (paragraphs 8-10)

BC24 The IFRIC discussed the issue of identifying the minimum lease payments for the purposes of applying IAS 17. It concluded that where an arrangement contains both a lease and other elements (eg services), payments should be separated into those for the lease and those for other elements based on their respective fair values. This is because fair value is the most relevant and faithful representation of the underlying economics of the transaction. The IFRIC noted that this requirement could be more onerous for purchasers, particularly where a purchaser has no access to the supplier's pricing information. The IFRIC therefore agreed that it should provide some limited guidance to assist purchasers in separating the lease from other elements in the arrangement. Nonetheless, the IFRIC acknowledged that in rare cases it might be impracticable for the purchaser to separate the payments reliably. The IFRIC noted that if this was the case and the lease was a finance lease, then the requirements of IAS 17 would ensure that the purchaser would not capitalise an amount greater than the fair value of the asset (since paragraph 20 of IAS 17 requires a lessee to recognise a finance lease asset at the fair value of the leased property or, if lower, the present value of the minimum lease payments). If the lease is an operating lease and it is impracticable to separate the payments reliably, the IFRIC agreed, as a practical accommodation, that the purchaser should disclose all the payments under the arrangement when disclosing the minimum lease payments, and state that these also include payment for other elements in the arrangement.

Convergence with US GAAP

BC25 The IFRIC believes that the consensus in this draft Interpretation is similar to that reached by the US Emerging Issues Task Force (EITF) in May 2003 in Issue No. 01-8 *Determining Whether an Arrangement Contains a Lease*. In summary, under Issue 01-8, an arrangement contains a lease if:

(a) fulfilment of the arrangement is dependent on the use of specific property, plant or equipment (PPE) which might be explicitly or implicitly specified; and

(b) the arrangement conveys a right to use PPE. An arrangement conveys a right to use PPE if the purchaser has the right to control the use of the underlying PPE. The right to control the use of the underlying PPE is conveyed if:

   (i) the purchaser has the ability or right to operate the PPE or direct others to operate the PPE while obtaining or controlling more than a minor amount of the output or other utility of the PPE;

   (ii) the purchaser has the ability or right to control physical access to the PPE while obtaining or controlling more than a minor amount of the output or other utility of the PPE; or

   (iii) facts and circumstances indicate it is remote that one or more parties other than the purchaser will take more than a minor amount of the output or other utility that will be produced or generated by the PPE and the price of the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery.

BC26 Although the wording of Issue 01-8 and the draft Interpretation differ, the IFRIC's view is that a similar assessment of whether an arrangement contains a lease is likely under both interpretations. In particular, the IFRIC observed that the EITF similarly concluded that a right of use can be conveyed in arrangements in which purchasers have rights to acquire the output that will be produced by an asset (see criterion (b)(iii) in the summary above). While Issue 01-8 includes an additional criterion (ie the price of the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery), the IFRIC noted the EITF's view that this additional criterion is designed to distinguish output contracts in which the purchaser is essentially paying for a product or service from those that convey a right to use. The IFRIC's view is that this objective is met by the combination of the criteria in paragraphs 6(b) and 6(c) of its draft Interpretation. The IFRIC also noted that in the case of most take-or-pay arrangements for all, or substantially all, of the output from a specific item, the price would not be fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery. Accordingly, such an arrangement would be assessed as containing a lease under both the draft Interpretation and Issue 01-8.

BC27 The principal differences between the draft Interpretation and Issue 01-8 are:

(a) Issue 01-8 refers to "property, plant or equipment" consistently with the definition of a lease in the US standard SFAS 13 *Leases*. In contrast, this draft Interpretation refers to item or items, because IAS 17 covers a broader range of leases than SFAS 13.

(b) Issue 01-8 requires a reassessment of whether the arrangement contains a lease in more cases than under the draft Interpretation, including when there is a change in the determination as to whether the arrangement depends on a specific item. The IFRIC's reasons for its different conclusion on this point are set out in paragraphs BC22 and BC23.

Effective date and transition (paragraphs 11-12)

BC28 The IFRIC observed that application of the proposed Interpretation to more complex arrangements would not be straightforward and could be burdensome. It therefore considered whether it should propose that the Interpretation be applied either only to new arrangements entered into after the effective date, or to all existing arrangements at the effective date, but only for future accounting periods (ie without restating comparatives). The IFRIC noted that both of these transition methods would have the advantage of not requiring a lengthy implementation period. However, it noted that some of the arrangements that would be affected by the proposed Interpretation last for many years and therefore applying the proposed Interpretation to new arrangements alone would result in similar transactions being accounted for differently for many years with a consequent loss of comparability. It also noted that both of these transition methods would be inconsistent with the requirements for leases required by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The IFRIC therefore concluded that the proposed Interpretation should be applied retrospectively to all existing arrangements. However, recognising the difficulties of implementation, it proposes that the Interpretation should apply for periods beginning on or after 1 January 2005. The IFRIC believes that the exposure period of the draft Interpretation together with the implementation period should allow sufficient time for entities to apply this proposed Interpretation in 2005.