# COMMISSION REGULATION (EC) No 1910/2005

## of 8 November 2005

## amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards International Financial Reporting Standard 1 and 6, IASs 1, 16, 19, 24, 38, and 39, International Financial Reporting Interpretations Committee's Interpretations 4 and 5

**(Text with EEA relevance)**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards [1], and in particular Article 3(1) thereof,

Whereas:

(1) By Commission Regulation (EC) No 1725/2003 [2] certain international standards and interpretations that were extant at 14 September 2002 were adopted, including International Accounting Standard (IAS) 19 *Employee benefits*.

(2) On 9 December 2004, the International Accounting Standards Board (IASB) published *International Financial Reporting Standard (IFRS) 6 Exploration for and evaluation of mineral resources*, hereinafter 'IFRS 6', as an interim solution to enable entities within this sector to comply with IFRSs without the need for major changes to accounting practice. IFRS 6 permits entities that incur exploration and evaluation expenditure exemptions from some of the requirements of other IFRSs. In specified circumstances, such entities are allowed to continue with their existing accounting treatment for exploration and evaluation expenditure. IFRS 6 includes further guidance on the impairment indicators for exploration and evaluation assets and the impairment testing of such assets.

(3) On 16 December 2004 the IASB issued an amendment to IAS 19 *Employee benefits*. It introduces a further option regarding the recognition of actuarial gains and losses for defined benefit pension plans. It now allows actuarial gains and losses to be recognised, in full, in a statement of recognised income and expense outside the income statement, that is, actuarial gains and losses can be recognised directly in equity. The amendment also specifies how group entities should account for defined benefit group plans in their separate financial statements and requires additional disclosures.

(4) On 2 December 2004 the International Financial Reporting Interpretations Committee (IFRIC) published IFRIC Interpretation 4 *Determining whether an arrangement contains a lease*, hereinafter 'IFRIC 4'. IFRIC 4 sets out criteria for determining whether an arrangement is, or contains, a lease, for example some take-or-pay contracts. IFRIC 4 clarifies under which circumstances these arrangements that do not take the legal form of a lease should, nonetheless, be accounted for in accordance with IAS 17 *Leases*.

(5) On 16 December 2004 the International Financial Reporting Interpretations Committee (IFRIC) published IFRIC Interpretation 5 *Rights to interests arising from decommissioning, restoration and environmental funds*, hereinafter 'IFRIC 5'. IFRIC 5 sets out how a contributor should account for its interest in a fund and how a contributor should account for additional contributions.

(6) The consultation with technical experts in the field confirm that IFRS 6, IAS 19, and IFRIC 4 and 5 meet the technical criteria for adoption set out in Article 3(2) of Regulation (EC) No 1606/2002.

(7) The adoption of IFRS 6, IAS 19, IFRIC 4 and 5 implies, by way of consequence, amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IAS 1 *Presentation of Financial Statements*, IAS 16 *Property, Plant and Equipment*, IAS 24 *Related Party Disclosures*, IAS 38 *Intangible Assets* and IAS 39 *Financial Instruments: Recognition and Measurement* in order to ensure consistency between international accounting standards.

(8) Regulation (EC) No 1725/2003 should therefore be amended accordingly.

(9) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee,

[1] OJ L 243, 11.9.2002, p. 1.
[2] OJ L 261, 13.10.2003, p. 1. Regulation as last amended by Regulation (EC) No 1751/2005 (OJ L 282, 25.10.2005, p. 3).

HAS ADOPTED THIS REGULATION:

*Article 1*

Annex to Regulation (EC) No 1725/2003 is amended as follows:

1. International Financial Reporting Standard (IFRS) 6 *Exploration for and evaluation of mineral resources* is inserted as set out in the Annex to this Regulation;

2. IAS 19 *Employee benefits* is amended in accordance with Amendment to IAS as set out in the Annex to this Regulation;

3. International Financial Reporting Interpretations Committee's Interpretation (IFRIC Interpretation) 4 *Determining whether an arrangement contains a lease* is inserted as set out in the Annex to this Regulation;

4. IFRIC Interpretation 5 *Rights to interests arising from decommissioning, restoration and environmental funds* is inserted as set out in the Annex to this Regulation;

5. International Financial Reporting Standard (IFRS) 1, IAS 16 and IAS 38 are amended in accordance with Appendix B of IFRS 6 as set out in the Annex to this Regulation;

6. IFRS 1, IAS 1 and IAS 24 are amended in accordance with Appendix F of Amendment to IAS 19 as set out in the Annex to this Regulation;

7. IFRS 1 is amended in accordance with the Appendix of IFRIC 4 as set out in the Annex to this Regulation;

8. IAS 39 is amended in accordance with the Appendix of IFRIC 5 as set out in the Annex to this Regulation.

*Article 2*

Each company shall apply the standards and interpretations set out in the Annex as from the commencement date of its 2006 financial year, at the latest.

*Article 3*

This Regulation shall enter into force on the third day following its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 8 November 2005.

*For the Commission*

Charlie McCREEVY

*Member of the Commission*

*ANNEX*

INTERNATIONAL FINANCIAL REPORTING STATNDARDS

| | |
|---|---|
| IFRS 6 | International Financial Reporting Standard (IFRS) 6 *Exploration for and evaluation of mineral resources* |
| IAS 19 | Amendment to IAS 19 *Employee benefits* |
| IFRIC 4 | IFRIC Interpretation 4 *Determining whether an arrangement contains a lease* |
| IFRIC 5 | IFRIC Interpretation 5 *Rights to interests arising from decommissioning, restoration and environmental funds* |

# IFRIC INTERPRETATION 4

## Determining whether an arrangement contains a lease

### REFERENCES

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

IAS 16 *Property, Plant and Equipment* (as revised in 2003)

IAS 17 *Leases* (as revised in 2003)

IAS 38 *Intangible assets* (as revised in 2004)

### BACKGROUND

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

   — outsourcing arrangements (e.g. the outsourcing of the data processing functions of an entity).

   — arrangements in the telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity.

   — take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (e.g. a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).

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

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

### SCOPE

4. This 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 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

   (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. Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

   (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and

   (b) the arrangement conveys a right to use the asset.

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

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

8. An asset has been implicitly specified if, for example, the supplier owns or leases only one asset with which to fulfil the obligation and it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets.

*Arrangement conveys a right to use the asset*

9. An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

   (a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

   (b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

   (c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

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

10. The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement, on the basis of all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:

    (a) there is a change in the contractual terms, unless the change only renews or extends the arrangement;

    (b) a renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with paragraph 4 of IAS 17. A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement before the end of the term of the original arrangement shall be evaluated under paragraphs 6-9 only with respect to the renewal or extension period;

(c) there is a change in the determination of whether fulfilment is dependent on a specified asset;

(d) there is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.

11. A reassessment of an arrangement shall be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting shall be applied (or cease to apply) from:

(a) in the case of (a), (c) or (d) in paragraph 10, when the change in circumstances giving rise to the reassessment occurs;

(b) in the case of (b) in paragraph 10, the inception of the renewal or extension period.

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

12. If an arrangement contains a lease, the parties to the arrangement shall apply the requirements of IAS 17 to the lease element of the arrangement, unless exempted from those requirements in accordance with paragraph 2 of IAS 17. Accordingly, if an arrangement contains a lease, that lease shall be classified as a finance lease or an operating lease in accordance with paragraphs 6 to 19 of IAS 17. Other elements of the arrangement not within the scope of IAS 17 shall be accounted for in accordance with other Standards.

13. For the purpose of applying the requirements of IAS 17, payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. The minimum lease payments as defined in paragraph 4 of IAS 17 include only payments for the lease (i.e. the right to use the asset) and exclude payments for other elements in the arrangement (e.g. for services and the cost of inputs).

14. In some cases, separating the payments for the lease from payments for other elements in the arrangement will require the purchaser to use an estimation technique. For example, a purchaser may estimate the lease payments by reference to a lease agreement for a comparable asset that contains no other elements, or by estimating the payments for the other elements in the arrangement by reference to comparable agreements and then deducting these payments from the total payments under the arrangement.

15. If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:

(a) in the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value of the underlying asset that was identified in paragraphs 7 and 8 as the subject of the lease. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest (*);

(b) in the case of an operating lease, treat all payments under the arrangement as lease payments for the purposes of complying with the disclosure requirements of IAS 17, but:

(i) disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and

(ii) state that the disclosed payments also include payments for non-lease elements in the arrangement.

(*) I.e. the lessee's incremental borrowing rate of interest as defined in paragraph 4 of IAS 17.

## EFFECTIVE DATE

16. An entity shall apply this interpretation for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies this interpretation for a period beginning before 1 January 2006, it shall disclose that fact.

## TRANSITION

17. IAS 8 specifies how an entity applies a change in accounting policy resulting from the initial application of an interpretation. An entity is not required to comply with those requirements when first applying this interpretation. If an entity uses this exemption, it shall apply paragraphs 6 to 9 of the interpretation to arrangements existing at the start of the earliest period for which comparative information under IFRSs is presented on the basis of facts and circumstances existing at the start of that period.

*Appendix*

**Amendments to IFRS 1 *first-time adoption of International Financial Reporting Standards***

*The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2006. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.*

A1. IFRS 1 *first-time adoption of International Financial Reporting Standards* and its accompanying documents are amended as described below.

In paragraph 12, the reference to paragraphs 13 to 25E is changed to 13 to 25F.

In paragraph 13, subparagraphs (i) and (j) are amended, and subparagraph (k) inserted, to read as follows:

(i) insurance contracts (paragraph 25D);

(j) decommissioning liabilities included in the cost of property, plant and equipment (paragraph 25E); and

(k) leases (paragraph 25F).

After paragraph 25E a new heading and paragraph 25F are inserted as follows:

LEASES

**IFRIC 4 *Determining whether an arrangement contains a lease***

25F A first-time adopter may apply the transitional provisions in IFRIC 4 *Determining whether an arrangement contains a lease*. Therefore, a first-time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date.