

ROUNDTABLE

CONSISTENT APPLICATION OF IFRS

BRUSSELS, 26 JANUARY 2007

ISSUES PAPER

NOTICE TO THE PUBLIC

This paper has been compiled using written contributions from individual participants to serve as a basis for the discussions at the meeting of 26 January 2007. Any opinions or recommendations expressed in these paragraphs are those of the proposer(s) concerned and not the views of the Roundtable or of the Commission.

No interpretations of IFRS should be inferred from the contents of this paper.

ROUNDTABLE

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ISSUES PAPER

A. Brief overview of issues proposed

ISSUE 1 - IAS 39 "derecognition cases"

Proposed by: FEE

IASB and IFRIC have provided guidance on this issue, but there are still concerns whether guidance is sufficient. In January 2007 IFRIC decided to take this issue on as a project.

IAS 39 provides criteria on when an asset has to be derecognised. IASB and IFRIC have published their views on certain aspects and in November 2006 IFRIC tentatively rejected taking the issue onto the agenda, arguing that IAS 39 was clear in this respect. However, in the IFRIC meeting on 11-12 January 2007 IFRIC decided to withdraw the tentative agenda rejection and, after clarification of the scope, to take an active project on the agenda.

The two particular aspects that had been raised were:

- (1) The meaning of "similar" for groups of financial instruments, which are derecognised in one common transaction but seem to be of a different nature (derivative and non-derivative instrument) and the possible implications for the subsequent derecognition test.
- (2) The second issue related to the types of transactions that are required to be treated as pass-through transfers in IAS 39, especially if there are conditions to the transfer.

There are concerns that the IASB and IFRIC views are partly inconsistent and therefore aspects regarding the application of the derecognition criteria are still unclear and cause uncertainty in practice.

ISSUE 2 – Regulatory Assets and Liabilities

Proposed by: FEE

Not dealt with by IASB/IFRIC

Utility companies are often subject to price regulation by regulatory bodies and/or governments. Regulators set the level of financial parameters e.g. unit selling prices, total income or return, and reset the level periodically depending on the past performance of a company. As a consequence utility companies might have to reduce or increase future prices in order to “cancel” any past surplus or deficit incurred (compared to the “normal” profit level established by the regulation).

The issue has been raised as to whether utility companies, in expectation of such a future increase or decrease in regulated prices, could or should recognise an asset/liability. If so, an additional question is whether in cases of increases this would trigger recognition of an intangible asset (IAS 38), a financial asset (IAS 32) or accrued income (IAS 11/18). In cases of decreases of regulated prices the question is whether a provision (IAS 37), a financial liability (IAS 32) or deferred income (IAS 11/18) should be recognised.

ISSUE 3 – IAS 17 Leases – exercise of renewal/extension option

Proposed by: FEE

Not explicitly dealt with by IASB/IFRIC

There are lease contracts that from the outset include renewal or extension options. If the exercise of such an option is not considered to be reasonably certain at the inception of the lease, the renewal or extension period is not included in the lease term taken into account for classification purposes. According to IAS 17.13, the renewal of the lease does not trigger a reassessment of the lease classification, because there is no change in the provisions of the lease. The question is whether the actual exercise of a renewal or extension option during the lease period should be ignored and the classification of the lease made at inception maintained for the renewal/extension period, or whether the renewal/extension period should be regarded as a new lease to be assessed for classification purposes.

B. Detailed description of issues proposed

ISSUE 1

IAS 39 – “derecognition cases”

Proposed by: FEE

Despite the explanations of the IASB’s views on two issues relating to the derecognition requirements of IAS 39 as reported in the September *IASB Update* and the November *IFRIC Update*, and the decision by the IFRIC Agenda Committee not to take the issues on to the IFRIC agenda, there are continuing concerns as to how the IAS 39 derecognition rules are to be applied. Indeed, one aspect of these concerns is that the Board’s decisions reported in the *IASB Update* and the *IFRIC Update* are not entirely consistent and it is unclear as to their relative status.

The Board’s views as published are set out below referenced by numbers, and some of the related concerns and questions, referenced by letters.

Meaning of ‘transfer’

As documented in the September *IASB Update*:

1 At its meeting, the Board agreed that a transfer of the contractual rights to receive all the cash flows is a transfer in accordance with paragraph 18(a), even if there is no legal transfer of the ownership of the financial asset. This includes where the transfer is of specifically identified cash flows, such as the interest or principal of a debt instrument.

2 The Board specified that the pass through test would be applicable when the entity does not transfer all the contractual rights to cash flows of the financial asset, such as disproportionate transfers (see IAS 39 paragraph 16(b)).

3 The Board also agreed that conditions attached to a transfer, such as provisions ensuring the existence or value of transferred cash flows at the date of transfer, or even conditions relating to their future performance, do not prevent a transfer qualifying as such under paragraph 18(a).

4 The Board noted that conditions relating to the future performance of the asset would be highly relevant for the risks and rewards test. Therefore, transfers with attached conditions may still not qualify for derecognition, or (since the transferor will often retain control of the asset) they may result in the transferor retaining a ‘continuing involvement’.

As reported in the November *IFRIC Update*:

5 An entity transfers the contractual rights to receive the cash flows from an asset (as set out in paragraph 18(a)) when it transfers legal ownership to the asset or rights equivalent to legal ownership. This may be the case when an entity transfers specifically identified cash flows from an asset in accordance with paragraph 16.

6 Conditions attached to the transfer of an asset, for example representations and warranties regarding the existence of that asset, do not necessarily affect whether the entity has transferred the contractual rights to receive cash flows but they may affect the assessment of risks and rewards.

A Do decisions 3 and 6 mean that all the situations set out in the original Board paper, illustrating various contingent transfers, would qualify for a paragraph 18(a) transfer, including the offset arrangements? If not, then which situations would qualify and which would not?

B While decision 3 refers to “conditions relating to future performance”, decision 6 only refers to “representations and warranties, regarding the existence of that asset”. Should this be taken to mean that the original wording (in 3) has been reconsidered and replaced by the more restrictive view (in 6)? In the remainder of this paper it is assumed that the IASB has not changed its mind and restricted its view, and that guarantees of future performance would not prevent treatment as a paragraph 18(a) transfer.

C While decision 4 only refers to “conditions relating to future performance”, decision 6 refers to “representations and warranties regarding the existence of the asset”. Has the Board decided that all warranties as to the existence of an asset (such as the normal ones given when an asset is transferred to an SPE) now need to be considered in the risks and rewards test? This would be a change from current practice where, for instance, warranties concerning the quality of goods sold that result in a transferred receivable, are normally ignored. If the Board has decided that *all* warranties need to be considered in the risks and rewards test, it would be helpful to make this clear. If not, then it would be helpful to make clear which need to be considered and which do not.

D Is the issue of a note whose repayments are based on the cash received from a pool of assets, a paragraph 18(a) transfer of those assets? This situation could arise where such a note is issued by the entity that originally owns the assets, or by an SPE that SIC Interpretation 12 *Consolidation – Special Purpose Entities* requires the entity to consolidate. (The entity might be required to consolidate the SPE because, for instance, the entity provides a guarantee to the SPE or the SPE issues more than one note, one of which is subordinate and is issued to the originating entity.) In these cases it would be unlikely that the entity would be able to completely derecognise the assets, since it would have retained significant risks and rewards, but it may be able to demonstrate that it has transferred significant risks and rewards and so be able to account for the receivables only to the extent of its continuing involvement – if it can first demonstrate that it has achieved a transfer.

Some note issues may meet this criterion but many may not. To have “rights equivalent to legal ownership” (see 5, above) would presumably require the same *control* over the asset as well as the same *risks and rewards*, and so (for instance) if the note issuer retains the ability to pledge the asset (as is often the case), the transaction would presumably not be a paragraph 18(a) transfer. Otherwise, would the following be paragraph 18(a) transfers?

i) The issue of a note by an SPE that passes on the cash flows from a floating rate loan asset plus a swap, so that the note holders receive fixed rate interest. Is it possible to view the note holders as having rights equivalent to legal ownership of the asset plus the swap? The Board’s clarification (see 7, below) requires the transfer to be assessed for each of the asset and the swap separately if they are not similar assets, but the further clarification provided in November (see 10, below) suggests that it may be possible to look at the cash flows from more than one type of asset, together, at least for the pass through test.

(Presumably, it would be necessary to understand the mechanics of the swap in the event of a default or prepayment of the asset (see 10, below) – we assume, for the transaction to be treated as a transfer, the note holders would have to be in the same position as if they were the counterparty to the swap. For this to be the case, either the note holders or the swap counterparty would need to take the excess interest rate risk in the event of default or prepayment.)

ii) The issue of more than one tranche of note, so that the rights equivalent to legal ownership are shared differentially by more than one party.

iii) The issue of a note referenced on revolving assets, so that the note holders will not be repaid when the assets mature, but the proceeds will be reinvested in new assets. It would be difficult to argue that this gives rights equivalent to legal ownership, since the note holders have agreed to defer their right to the cash flows on the assets.

In the remainder of this paper it is assumed that the issue of a note referenced to an asset will not normally qualify as a paragraph 18(a) transfer of the asset. If this is correct, the transaction would need to satisfy the pass through test to be regarded as a transfer.

E It is understood that the pass through test would need to be applied when the entity does not transfer *all* the contractual rights to receive the cash flows. The Board specifies that this will be the case with a transfer of a *disproportionate* share of the cash flows (see 2, above). However, it is unclear what a transfer of a disproportionate share of cash flows means. Paragraph 16(b) states that the derecognition tests should be applied to a financial asset in its entirety when an entity transfers (i) the rights to the first or last 90% of the cash flows, or (ii) the rights to 90% of the cash flows but provides a guarantee to compensate the transferee for credit losses up to a certain percentage of the principal transferred. In contrast according to the Board, the pass through test does not need to be applied where the entity transfers the right to receive a *pro rata* 90% of the cash flows (without any guarantee) or (see 3, above) 100% of the cash flows even if it guarantees losses up to a certain percentage of the principal (but see B, above).

Does this mean that guarantees prevent a transfer from complying with paragraph 18(a) only when less than 100% of the cash flows are transferred? It is not clear why a transfer of the right to 90% of the cash flows with the provision of a guarantee of losses up to a certain level would need to satisfy the pass through test (and would probably fail), but the transfer of 100% of the cash flows with a similar guarantee would be a paragraph 18(a) transfer.

Groups of similar assets

7 As documented in the September *IASB Update*, the Board agreed that derivative financial assets (which are often transferred together with non derivative financial assets) are not ‘similar’ to non-derivative financial assets for the purpose of IAS 39 paragraph 16. Therefore, an entity would apply the IAS 39 derecognition tests to derivative and non-derivative financial assets separately, even if they are transferred at the same time.

8 It was further reported in the November *IFRIC Update* that, for example, if an entity enters into an arrangement to pass the cash flows from both a mortgage and a mortgage guarantee to a third party, the mortgage and the guarantee cannot be considered similar, and so the pass through tests will need to be applied separately.

F Although not referred to in the *IASB Update*, based on the Board’s discussion it appeared that this decision would also apply to other assets transferred with loans, such as guarantees or credit insurance acquired from another party. The example given in 8 above confirms this, but it is strange that an example involving a mortgage and a mortgage guarantee is used to illustrate a decision involving derivative and non-derivative instruments. Mortgage guarantees are not normally derivatives, or even financial assets within the scope of IAS 39. However, we believe it makes sense for them to be treated in the same way as (non-derivative) financial assets.

G It is not clear as to the consequence of considering a loan separately from a credit guarantee or insurance. Imagine a scenario where a loan is insured up to 90% of its value before the transfer and the transferor sells the loan together with the credit insurance. If the risks and rewards assessment is applied separately to the loan (without considering the credit insurance), all the credit risk is transferred and it can be derecognised. Whereas, if the test is applied “globally” to the loan and credit insurance together, in practice, the credit risk transfer may be small or nil. Some people read the IASB conclusion (in 7 above) to mean that the loan and the insurance are to be assessed separately rather than jointly while others have not come to the same conclusion that this is what the Board had intended. Also, decision 8 only refers to the pass through test and not to the risks and rewards test.

9 The Board also agreed that transferred derivatives that could be financial assets or financial liabilities depending on movements in market value (eg interest rate and credit default swaps) need to meet *both* the financial asset and financial liability derecognition requirements of IAS 39. Consequently, swaps may be derecognised only when any obligation is discharged, cancelled or expires.

H Since in most securitisations there is no cancellation or discharge, the transferor would not normally be able to derecognise any swaps ‘transferred’ to an SPE. This conclusion follows logically from the Standard, but it is less clear what it means in practice. In the situation when the rights to a financial asset and a swap are transferred together (so that the transferor retains no risk), if the financial asset is derecognised but not the swap, does the entity continue to recognise the swap plus a “notional” swap with the transferee on back-to-back terms, to reflect the rights and obligations contracted with the transferee?

Derivatives and the pass through test

10 In the November *IFRIC Update* it was reported that the Board had decided that if two assets are not similar, the pass through tests in IAS 39, when relevant, must be applied to the two assets separately. One of the pass through tests required by IAS 39 is to consider whether the transferor has any obligation to pay amounts to the eventual recipients if it does not collect equivalent amounts from the asset being considered for derecognition. When assessing whether any such obligation exists for the mortgage, the entity must consider the possible effects of a default on the mortgage. The fact that, in the event of a default on the mortgage, the transferor is required to pay over the receipts from the guarantee to the eventual recipients does not cause the mortgages to fail the pass-through tests as the obligation to pay over receipts from the guarantee arises from the transfer of the guarantee not from a default on the mortgages. However, if the transferor is required to pay over amounts to eventual recipients in the event of a default on the guarantee, such an obligation is considered to be the result of a default on the mortgage, and would therefore result in the mortgage failing the pass through tests.

I The clarification provided in the *IFRIC Update* is helpful, but it is not readily apparent how to apply it to the more complex scenario when an SPE holds a floating rate loan and an interest rate swap, and issues a fixed rate note, since a swap is not necessarily an asset. Can the swap be regarded as an “original asset” (and therefore treated in the same way as a guarantee) if and when it is an asset, and the swap counterparty viewed as a “transferee” or “eventual recipient” if and when the swap is a liability? At the outset, as it is known that the swap will be *either* an asset or liability, can the transaction then satisfy the pass through test? If a more complex situation, when there are not only guarantees and swaps but also liquidity

facilities etc, as are seen in many ‘real’ transactions, can the transaction ever satisfy the pass through test?

Examples

When the Board’s guidance and the existing literature are applied to particular transactions and arrangements, the accounting treatment seems to differ depending upon the legal form of a transaction. Imagine a scenario in which an entity transfers loans and at the same time guarantees up to 10% of the portfolio in the event of default. Depending upon the detailed structure of the transaction this could result in at least four different accounting analyses:

a) If any entity just sells the portfolio of loans and provides the 10% guarantee, then it appears (from the Board’s decision – see 3 above, but possibly not – see B, above) that the sale would qualify as a transfer under paragraph 18(a): the entity has passed on the contractual rights to all the cash flows. The entity would then move on to the risks and rewards test and would either continue to recognise the asset, or record the guarantee as a continuing involvement (ie 10% of the loans), depending upon whether or not “significant” risks and rewards have been transferred.

b) If the loans are securitised by being passed to a consolidated SPE which issues notes referenced on the loans, assuming that the securitisation will not qualify as a paragraph 18(a) transfer (see D, above) the transaction will need to be assessed under the pass through test. As long as the entity has no obligation to pay anything to the note holders that it does not recover from the loans (and is required to pass on the cash it receives, without delay), this test would normally be satisfied. The retention by the transferor of a junior or equity note that receives the last 10% of any cash flows will not normally cause a problem, since the entity will not be required to pass on any payments that it does not receive. As with example a), the entity will (in its consolidated accounts) either continue to recognise the loans or record its continuing involvement (in this case, the value of the junior note), depending upon the significance of the risks and rewards transferred.

c) If the entity transfers loans to a consolidated securitisation SPE but provides a guarantee to the SPE, it will be necessary (again assuming there will have been no paragraph 18(a) transfer) to satisfy the pass through test. Since the entity could be required to make payments to the note holders that it may not receive, it will fail the test. As a consequence, the entity will continue to recognise the loans in its consolidated accounts.

d) The last fact pattern, based on AG52 of IAS 39, is marginally different in that only 90% of the loans are sold. If the entity transfers the right to the cash flows of 90% of the loans, so that collections are allocated between the entity and the transferee proportionally, but any defaults are deducted from the entity’s retained portion until that interest is exhausted, this is deemed to be a transfer of a disproportionate share of the cash flows (see IAS 39.16(b)). Therefore, it will be necessary to apply the pass through test. This should be satisfied (as the entity has no obligation to pay the transferee any cash that it does not receive) and, assuming that there has been a transfer of significant risks, the entity will need to account for the loans according to its continuing involvement, ie following the approach set out in paragraph AG52. Although the ultimate cash flows may be similar to those in the examples described above, in this case, the entity is required to continue to record its retained proportion of the loans, plus its continuing involvement in the 90% that has been transferred (ie the guarantee achieved through subordination of the retained proportion). The effect is to require the entity to “double count” the retained asset by recording the 10% twice.

The view has been expressed that in the absence of a clear view on the above questions, it should not be possible for IFRIC to issue a rejection notice saying that IAS 39 is clear.

ISSUE 2

Regulatory assets and liabilities

Proposed by: FEE

Issue

In what circumstances, if any, should utility companies that are subject to price regulation record an asset or liability reflecting an expected future increase or decrease in regulated prices?

Background and examples

In many countries, utility companies are subject to price regulation. The form of the regulation varies between countries. Typically, the regulator sets the level of a financial parameter, e.g., unit selling price, total income or return, and resets the level periodically. In resetting the level of the parameter, the regulator will have regard to a number of factors which, in some cases, may include the recent financial results of the utility company. The period for which the level of the parameter remains fixed is sometimes called a “control period”.

In August 2005, IFRIC decided not to add a project on regulatory assets to its agenda. IFRIC was asked whether US SFAS 71 *Accounting for the Effects of Certain Types of Regulation* could be applied for selection of an accounting policy in the absence of specific guidance in IFRSs. IFRIC concluded that the recognition criteria in SFAS 71 were not fully consistent with recognition criteria in IFRS, and would require the recognition of assets under certain circumstances which would not meet the recognition criteria of relevant IFRSs. Thus the requirements of SFAS 71 were not indicative of the requirements of IFRSs. The rejection note was silent with respect to regulatory liabilities.

The following examples illustrate the features of some but not all of the arrangements found in practice. In each case, assume that the regulator limits the annual increase in the unit prices that the utility company may charge by applying a $CPI - X$ formula, where CPI is the consumer price index and X is a factor set by the regulator. For example, if the unit price in year 1 is 100, consumer price inflation is 5% and the regulator sets the value of X at 1%, then unit prices in year 2 will be $100 \times (1.05 - 0.01) = 104$.

Example A

In country A, the regulator seeks to set the value of X at a level such that company’s forecast revenues will cover the operating costs that the regulator considers that an efficient operator would incur, and allow the company to earn a sufficient return on its asset base to raise finance in the capital markets to fund its capital expenditure. If the company’s actual costs are higher or lower than the regulator’s forecast of the costs that an efficient operator would incur, or the company’s actual revenues are higher or lower than expected, then the resulting surplus or deficit accrues to the company during the control period.

There is no direct relationship between the actual results of the company in one control period and the value of X in the next control period. However, the company considers that, in practice, its actual results influence the regulator’s view as to the appropriate value of X in the next control period. That is, if the company is seen to make excessive returns in one control period, then the regulator will be more likely to reduce the value of X in the next

control period. Conversely, if the company is seen to make inadequate returns in one control period, then the regulator will be more likely to increase the value of X in the next control period.

Example B

In country B, the regulator sets the value of X such that the company is expected to make a margin of y percent based on its forecast revenues and costs for the control period.

If the company's actual return differs from y percent in the control period, then the regulator will adjust the value of X in the next control period. The adjustment will be calculated such that, based on forecast revenues and costs in the next control period, the company's cumulative return will be restored to y percent. That is, if the company records an "excess margin" in one control period, then it will return that "excess margin" to customers in the next control period through lower prices. Conversely, if the company records a "reduced margin" from customers in one control period, then it will recover that "reduced margin" from customers in the next control period through higher prices.

However, any such return / recovery of excess / reduced margin is contingent on future activity and sales.

Example C

Price regulation in country B is similar to price regulation in country C, except that in country C additional conditions apply if the company ceases operations or transfers its license to another entity.

In this case, if the company has earned a cumulative margin that is higher than y percent, then on cessation of operations it must pay to the regulator (or the successor licensee) an amount that reduces its cumulative margin to y percent. Conversely, if the company has earned a cumulative margin that is lower than y percent, then on cessation of operations it is entitled to receive a payment from the regulator (or the successor licensee) an amount that restores its cumulative margin to y percent.

Issues for discussion

In what circumstances, if any, would the expectation of a future increase in regulated prices justify the recognition of:

- An intangible asset under IAS 38?
- A financial asset under IAS 32?
- Accrued income under IAS 11 / 18?

In what circumstances, if any, would the expectation of a future decrease in regulated prices justify the recognition of:

- A provision under IAS 37?
- A financial liability under IAS 32?
- Deferred income under IAS 11 / 18?

Is it necessary to meet the recognition criteria in the standards listed above in order to recognise regulatory assets / liabilities, or is it permissible under the hierarchy in IAS 8 to apply the US GAAP guidance in FAS 71?

ISSUE 3

IAS 17 Leases – exercise of renewal/extension option

Proposed by: FEE

Issue

Does the exercise of a renewal or extension option (the exercise of which was not considered reasonably certain at the inception of the lease) require the assessment of the classification of the lease with respect to the renewal/extension period?

Background

IAS 17.13 requires the reassessment of the classification of a lease when the parties change the provisions of the lease (other than by renewing the lease) in a manner that would have changed the classification of the lease at inception, if the changes had been in effect at inception. Therefore, the exercise of a renewal or extension option existing at the inception of the lease does not trigger a reassessment of the original lease. The question is whether the extension/renewal of the initial lease should be regarded as giving rise to a new lease contract (to be assessed for classification purposes under IAS 17) or whether it is merely a component of the initial lease, in which case it will follow the classification of the initial lease.

US GAAP (SFAS 13 *Leases*) contains similar wording to IAS 17.13 regarding circumstances requiring a reassessment of lease classification but goes on to give explicit guidance on how to deal with the exercise of a renewal/extension option that was not already included in the lease term. In this situation, the extension period is regarded as a new lease. However, IAS 17 does not include this requirement.

IFRIC 4 *Determining Whether an Arrangement Contains a Lease* deals only with the criteria for determining whether an arrangement falls within the scope of IAS 17, it does not deal with the classification of a lease within IAS 17. However, IFRIC 4 does contain explicit wording regarding the exercise of a renewal/extension option in an arrangement and its impact on the need to reassess the arrangement. This wording is similar to the US GAAP requirements mentioned above: the extension period, if not taken into account in the original term of the lease, is considered to be a new agreement requiring an assessment on whether the arrangement contains a lease.

Example

Entity A has a non-cancellable lease of a machine for a 4-year period. The economic life of the machine is 8 years.

An option to renew or extend the lease for a further 4 years at the same rental was included in the original provisions of the lease. At the inception of the lease, the entity was not reasonably certain that it would exercise the option, so excluded the extension period from the lease term. The lease was assessed as an operating lease.

After 3 years, the entity notifies the leasing company that it wishes to exercise the option to extend the lease for the further 4-year period. Should the lessee treat the extension period as a new lease and (re-)assess classification accordingly?

Conclusion

View 1 - no reassessment

There is no modification of the original provisions of the lease. The extension option is part of those provisions and the likelihood of its exercise was considered in the original classification. The extension is accounted for as a renewal of the original lease and retains the original lease classification. The classification for the remaining term of the original lease term and the extension period continues.

View 2 - treat the renewal/extension period as a new lease

There is no modification of the initial lease provisions so there is no need to re-assess the lease classification during the original 4-year lease period. The accounting for the remaining term of the original 4-year lease term should continue without modification.

The 4-year extension is assessed as a separate lease agreement and classified accordingly, with effect from the beginning of the extension period.

References

IAS 17.13

Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease if the changed terms had been in effect at the inception of the lease, the revised agreement is regarded as a new agreement over its term. However, changes in estimates (for example, changes in the estimates of the residual life or the residual value of the leased property), or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease for accounting purposes.

FAS 13.9 (emphasis added)

*If at any time the lessee and lessor agree to change the provisions of the lease, other than by renewing the lease or extending its term, in a manner that would have resulted in a different classification of the lease had the changed terms been in effect at the inception of the lease, the revised agreement shall be regarded as a new agreement over its term and the criteria in paragraphs 7 and 8 shall be applied for the purposes of classifying the new lease. Likewise . . . any action that extends the lease beyond the expiry of the existing lease term (see paragraph 5(f)), **such as the exercise of a lease renewal option other than those already included in the lease term**, shall be considered as a new agreement, which will be classified according to the provisions of paragraphs 6-8. Changes in estimates (for example, changes in the estimates of the residual life or the residual value of the leased property), or changes in circumstances (for example, default by the lessee), however, shall not give rise to a new classification of a lease for accounting purposes.*

FAS 13.14 (emphasis added)

*[For a capital lease], a change in the provisions of the lease, **a renewal or extension of an existing lease**, and a termination of a lease prior to the expiration of the lease term shall be accounted for as follows:*

(a) if the provisions of the lease are changed

*(b) . . . **a renewal or extension of an existing lease shall be accounted for as follows:***

i. if the renewal or extension is classified as a capital lease, it shall be accounted for as described in subparagraph (a) above.

*ii. **if the renewal or extension is classified as an operating lease, the existing lease shall continue to be accounted for as a capital lease to the end of its original term, and the renewal or extension shall be accounted for as any other operating lease.***

(c) A termination .

IFRIC 4.10

A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any of the following conditions are met:

...

(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.

...