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Project	<b>Leases</b>
Topic	<b>Sale and leaseback transactions: Cover memo</b>

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## Purpose

1. This cover memo outlines the issues raised by respondents to the *Leases* exposure draft (ED) in regards to sale and leaseback transactions.

## What are sale and leaseback transactions?

2. In a sale and leaseback transaction, one entity (the seller/lessee) transfers an asset it owns to another party (the buyer/lessor) and then leases back all, or a portion of, the same asset.
3. Sale and leaseback transactions currently occur in a number of scenarios:
  - (a) to obtain financing:
    - (i) to generate cash flows; or
    - (ii) to obtain a particular accounting outcome (popularly known as off-balance sheet accounting): This is not as much of an issue under the boards' proposed right-of-use model because the lessee will generally (irrespective of whether it is a financing or non-financing type of lease), recognise the right-of-use asset and a liability to make lease payments;

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- (b) the entity is transitioning to something new. For example, the entity is moving to new premises but is leasing the old premises for a couple of years in transition.
  - (c) to reduce exposure to the risks of owning the asset.
4. Sale and leaseback transactions can give rise to significant gains on day 1.
  5. Existing accounting in both US GAAP and IFRSs for sale and leaseback transactions depends on the classification of the leaseback. If the lessee classifies the leaseback as an operating lease and other specified conditions are met, any gain or loss on sale is recognised immediately. If the leaseback is classified as a finance lease, the lessee defers and amortises any gain on sale over the lease term.

**General model proposed in the ED and respondents' views**

6. The ED proposed that:
  - (a) If a contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee.
  - (b) If the transfer does not meet the conditions for a sale, the transferor will account for the contract as financing. The transferor will not derecognise the transferred asset and will recognise any amounts received as a financial liability.
  - (c) Sale and leaseback transactions would occur if the contracts are:
    - (i) entered into at or near the same time;
    - (ii) negotiated as a package with a single commercial objective; or
    - (iii) performed either concurrently or consecutively.
7. Almost all respondents agreed with analysing a sale and leaseback arrangement firstly to determine whether the transfer of the underlying asset qualifies as a sale and secondly in the context of the guidance on accounting for leases.

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8. Many respondents also agreed that if the transfer of the underlying asset does not qualify as a sale that the transferor should account for the contract as a financing.
9. We recommend confirming these basic approaches to sale and leaseback accounting. We also propose that the guidance on when contracts should be combined is updated to have the consistent words with the revenue recognition requirements to minimise confusion on when contracts should be combined.
10. However, respondents were concerned with three issues proposed in the ED relating to sale and leaseback accounting:
  - (a) The criteria or conditions for classification as a sale and leaseback transaction:
    - (i) Many respondents were concerned that the threshold for recognising a transaction as a sale and leaseback is set too high and is inconsistent with the *Revenue Recognition* exposure draft. A respondent observed:

‘...That paragraph includes many of the same concepts that exist in current U.S. GAAP to evaluate whether a sale of real estate or integral equipment has occurred. The boards should be mindful that ... the Exposure Draft would now expand these concepts to all sale leaseback transactions. ...  
Furthermore, we believe many of the criteria that have been carried over from the current sale-leaseback guidance were written strictly as anti-abuse guidance; as such their application could produce results that are not intuitive. For example, it appears that under paragraph B31(j), if the seller/lessee had an option to purchase a 20 percent interest in the buyer, the transfer would not be considered a sale..’ [CL692]
    - (ii) Some respondents were concerned about the operationality of the conditions. If the boards were to maintain those conditions, clarification or further guidance would be need.
  - (b) To qualify as a sale and leaseback, the transferred asset must be an entire leased asset (a ‘whole asset’ approach) rather than a bundle of rights and obligations associated with an asset (a ‘partial asset’ approach).

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Consistently with those concerns, these respondents also questioned whether, a transferee could apply a partial derecognition approach because it may provide more useful information in some situations.

- (c) Why the transferee should recognise profit or loss on the sale and leaseback transaction on an up-front basis rather than over the lease term.

11. These issues are discussed in:

- (a) IASB Agenda Paper 11D / FASB Memorandum 148 on how to classify sales/leaseback transaction.
- (b) IASB Agenda Paper 11E / FASB Memorandum 149 on how to account for profit/loss when a sale/leaseback transaction occurs and when they are not at fair value.
- (c) IASB Agenda Paper 11F / FASB Memorandum 150 for partial or whole asset approaches and how they apply to the lessee and lessor accounting models.
- (d) IASB Agenda Paper 11G / FASB Memorandum 151 on what is the accounting for the seller/lessee if the boards pursue a two-lessee accounting approach.