Project	**Leases**
Topic	**Sale and leaseback transactions: Accounting by the lessee**

Purpose

1. In the leases ED, the boards proposed that if a sale and leaseback transaction meets the conditions for a sale, then the seller/lessee would account for the sale under applicable guidance for sales accounting and would account for the leaseback under the proposed guidance in the leases ED. All lessees would recognise a right-of-use asset, a liability to make lease payments, amortisation expense and interest expense.

2. The boards have since discussed whether there should be two approaches to lessee accounting to reflect entities lease assets in addition to financing reasons. Both of these approaches would lead to a lessee recognising assets and liabilities arising from a lease, but there would be a difference in the expense recognition pattern.

3. The purpose of this paper is to discuss how the seller/lessee should account for the lease element in a sale and leaseback transaction under both lessee approaches (assuming there will be two approaches to lessee accounting).

Staff Analysis

4. In the ED, the boards noted the following when determining that a purchaser/lessor in a sale and leaseback transaction would always follow the performance obligation approach for the leaseback:

> BC66 Because a combined transaction is accounted for as a sale and leaseback only when the transferee/lessee remains exposed to significant risks and benefits associated with the underlying asset during or after the expected lease term, the lessor would apply the performance obligation approach to the lease component…

5. Therefore, we considered whether a similar decision should be made from the seller/lessee's perspective where, in a sale and leaseback transaction, the leases guidance explicitly state which lessee approach should be used to account for the leaseback.

6. We considered whether to prescribe that all sellers/lessees would have a financing-type of lease when accounting for the leaseback. This would create consistent accounting for all lessees that enter into sale and leaseback transactions and it may be less complex, particularly if the boards require a partial asset approach for sale and leaseback. Some could also view that this may better reflect the economics for most sale and leaseback transactions because they think of it as a form of 'financing', thus the lessee accounting should reflect a financing-type lease accounting approach.

7. It could be viewed that if the boards required sellers/lessees to comply with the proposed lessee accounting guidance to determine which lessee approach to be applied to account for the leaseback, that it may encourage more leaseback transactions to be structured to be 'non-financing leases'. This may change the profit or loss recognition profile for the seller/lessee from the financing profile associated with owning the underlying asset before the sale and leaseback transaction to a straight-line lease profit or loss.

8. However, we rejected an approach where the boards mandate a particular type of lessee accounting in a sale and leaseback transaction because it may not faithfully reflect the economics for some types of scenarios. For example, entity A sells a building to entity B but leases it back for two years. The

building has a useful life of 50 years. The contract does not specify any continuing involvement criteria (eg bargain purchase options, residual value guarantees in this contract). Requiring all of such leases to be financing-type leases will not improve comparability with other types of leases.

9. Consequently, we think that prescribing a particular type of accounting for a lessee will not improve comparability and will not necessarily reflect the underlying economics of the transaction.

Staff recommendation and question to the boards

10. We recommend that the boards require a seller/lessee to apply the proposed leases guidance to determine which approach to apply to the leaseback element of a sale and leaseback transaction.

Question 1
We recommend that the boards do not prescribe a particular type of lessee accounting model for entities that are participating in a sale and leaseback transaction. Do the boards agree?

11. Depending on outcomes of the targeted outreach on the definition of a lease and two approaches to lessee accounting (as the boards redeliberate those issues), the boards may need to revisit these decisions.

12. Once the boards discuss the lessor model in more detail in redeliberations, the boards will be asked about the tentative conclusions in the leases ED regarding the accounting by the purchaser/lessor for a sale and leaseback.