IFRS

STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Sale and leaseback with variable payments (IFRS 16)**
Paper topic	Comment letters on tentative agenda decision

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Introduction

1. In March 2020, the IFRS Interpretations Committee (Committee) discussed a submission about a sale and leaseback transaction with variable payments. The submitter asked how, applying IFRS 16 *Leases*, the seller-lessee measures the right-of-use (ROU) asset arising from the leaseback and, thus, determines the gain or loss at the date of the transaction. In the transaction described in the submission:

   (a) an entity (seller-lessee) enters into a sale and leaseback transaction whereby it transfers an item of property, plant, and equipment (PPE) to another entity (buyer-lessor) and leases the asset back for five years.

   (b) the transfer of the PPE satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale of the PPE. The amount paid by the buyer-lessor to the seller-lessee in exchange for the PPE equals the PPE's fair value at the date of the transaction.

   (c) payments for the lease (which are at market rates) include variable payments, calculated as a percentage of the seller-lessee's revenue generated using the PPE during the five-year lease term. The seller-lessee has determined that the variable payments are not in substance fixed payments as described in IFRS 16.

2. The Committee concluded that IFRS 16 provides an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback

transaction submitted. Consequently, the Committee tentatively decided not to add the matter addressed in the submission to its standard-setting agenda and, instead, published a tentative agenda decision.

3. The purpose of this paper is to:

   (a) analyse the comments on the tentative agenda decision; and

   (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision.

4. There are three appendices to this paper:

   (a) Appendix A—proposed wording of the agenda decision;

   (b) Appendix B—analysis of other comments; and

   (c) Appendix C—nature of the liability in a sale and leaseback transaction.

5. The Committee's discussions at its March meeting highlighted that IFRS 16 is not as complete as it might be regarding the subsequent measurement of the liability that arises in a sale and leaseback transaction. The Committee therefore recommended that the International Accounting Standards Board (Board) amend IFRS 16 to specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the liability that arises in such a transaction. The Board discussed the Committee's recommendation at its April and May 2020 meetings and has decided to propose an amendment to IFRS 16 in this respect. Further details about the Board's project can be found here.

Comment letter summary

6. We received 20 comment letters by the comment letter deadline. All comment letters received, including any late comment letters, are available on our website.[1] This paper includes analysis of only the comment letters received by the comment letter deadline, which are reproduced in Agenda Paper 3A.

[1] At the date of posting this agenda paper, there were no late comment letters.

7. The Malaysian Accounting Standards Board, the Canadian Accounting Standards Board (AcSB) and Mazars agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons set out in the tentative agenda decision.

8. The Accounting Standards Board of Japan agrees with the Committee's analysis and conclusions. However, it says those conclusions cannot be derived directly from IFRS 16—it therefore recommends amending IFRS 16 to address the matter.

9. Deloitte, KPMG, PwC and EY agree with the Committee's analysis and conclusions on how the seller-lessee measures the ROU asset and liability, and determines any gain or loss, at the date of the transaction. However, these respondents express concerns about describing the liability that arises in the sale and leaseback transaction as a lease liability to which IFRS 16 applies.

10. The remaining respondents disagree with the Committee's analysis and conclusions. These include two national standard-setters, four accounting bodies, two preparers, three individuals, and a group of faculty members from one university. In particular:

    (a) the Institute of Certified Public Accountants of Uganda (ICPAU) and the Saudi Organization for Certified Public Accountants (SOCPA) disagree with the Committee's conclusion on the initial measurement of the ROU asset and liability at the date of the transaction—these respondents say that conclusion conflicts with the requirements in paragraphs 23-28 of IFRS 16.

    (b) the other respondents disagree with the Committee's conclusion on the initial measurement of the liability at the date of the transaction—these respondents say that conclusion conflicts with the requirements in paragraphs 26-28 of IFRS 16.

11. A few of those who disagree also have concerns (similar to those of Deloitte, KPMG, PwC and EY) about describing the liability that arises in the sale and leaseback transaction as a lease liability.

12. Some of the respondents who disagree suggest not finalising the agenda decision but, instead, amending IFRS 16 to address the accounting at the date of the sale and leaseback transaction.

13. A few respondents who agree with some or all of the Committee's analysis and conclusions suggest clarifications to the agenda decision.

Staff analysis of main comments

14. We have separately analysed comments that relate to:

    (a) the initial measurement of the ROU asset and liability (paragraphs 16-37);

    (b) the nature of the liability that arises in a sale and leaseback transaction (paragraphs 38-44); and

    (c) clarifications to the agenda decision (paragraph 45).

15. Appendix B to this paper analyses all other comments.

Initial measurement of the ROU asset and liability

Background

16. The tentative agenda decision states:

> The Committee observed that the requirements applicable to the transaction described in the request are in paragraph 100 of IFRS 16. Paragraph 100 states that 'if the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset: (a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor…'.
>
> Consequently, to measure the right-of-use asset arising from the leaseback, the seller-lessee determines the proportion of the PPE transferred to the buyer-lessor that relates to the right of use retained—it does so by comparing, at the date of the transaction, the right of use it retains via the leaseback to the rights comprising the entire PPE. [...]

> The gain or loss the seller-lessee recognises at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the PPE's previous carrying amount), the amount of gain or loss recognised relates only to the rights transferred to the buyer-lessor. […]
>
> The seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the lease liability is a consequence of how the right-of-use asset is measured—and the gain or loss on the sale and leaseback transaction determined—applying paragraph 100(a) of IFRS 16.

17. Paragraphs 23–28 of IFRS 16 specify the general requirements for how a lessee initially measures the ROU asset and lease liability that arise on entering into a lease. The cost of the ROU asset comprises (a) the amount of the initial measurement of the lease liability; (b) any lease payments made at or before the commencement date; (c) any initial direct costs; and (d) an estimate of decommissioning costs (paragraph 24). The lease payments included in the measurement of the lease liability comprise (a) fixed payments (including in-substance fixed payments); (b) variable lease payments that depend on an index or rate; (c) amounts expected to be payable under residual value guarantees; (d) the exercise price of a purchase option if reasonably certain to be exercised; and (d) payments of penalties for terminating the lease if such termination is reflected in the lease term (paragraph 27).

18. As noted in paragraph 16 above, when the transfer of an asset (as part of a sale and leaseback transaction) meets the requirements to be accounted for as a sale, paragraph 100(a) of IFRS 16 specifies the requirements for how the seller-lessee (a) measures the ROU asset; and (b) determines the amount of any gain or loss to be recognised at the date of the transaction.

Respondents' comments

Disagreement regarding the measurement of the ROU asset and liability arising in the sale and leaseback transaction

19. The ICPAU and the SOCPA say paragraphs 23–28 apply to all leases—both those that arise in a sale and leaseback transaction and those that do not. In their view, the requirements in paragraph 100(a) should be read in the context of paragraphs 23-28. For example, the SOCPA says:

> … If there is no right of use asset recognised according to paragraph 24, there is no need to apportion the gain on sale between right retained and right transferred. Considering this, we see paragraph 100 as a guidance on how to apportion the gain on sale between the right transferred and the right retained only where there is a right of use asset as measured by paragraph 24. When there is a right of use asset (as measured by paragraph 24), it shall be reduced by the amount of unrecognised gain that relates to the right retained by the seller-lessee. This is supported by paragraph BC266 of the basis for conclusions accompanying IFRS 16, which tells us that paragraph 100 is mainly about recognition of the gain.

20. These respondents suggest amending IFRS 16 to require the seller-lessee to defer and amortise the amount of the gain relating to the right of use it retains when all leaseback payments are variable and linked to future performance or use.

Disagreement regarding the measurement of the liability arising in the sale and leaseback transaction

21. Seven respondents (BP, Masahiro Hoshino, OLAM International Limited (OLAM), Shady Mehelba, the Institute for the Accountancy Profession in Sweden, the Institute of Chartered Accountants of India (ICAI), the Accounting Standards Committee of Germany) note that the Committee's conclusion on the initial measurement of the liability that arises in the sale and leaseback transaction results in the recognition of a liability for variable lease payments linked to future performance or use. They say such a conclusion conflicts with the measurement requirements in paragraph 27 of

IFRS 16, and the Board's considerations in developing those requirements (as explained in paragraph BC169). Paragraph BC169 states:

> …For some Board members, this decision [to exclude variable lease payments linked to future performance or use from the measurement of lease liabilities] was made solely for cost-benefit reasons. Those Board members were of the view that all variable lease payments meet the definition of a liability for the lessee. However, they were persuaded by the feedback received from stakeholders that the costs of including variable lease payments linked to future performance or use would outweigh the benefits, […]. Other Board members did not think variable lease payments linked to future performance or use meet the definition of a liability for the lessee until the performance or use occurs. […]

22. Some of these respondents explicitly agree with the Committee's conclusion that an entity applies paragraph 100(a) of IFRS 16 (and not paragraphs 23–25) to the initial measurement of the ROU asset. However, they say paragraph 100(a) includes no requirements on the initial measurement of the liability that arises in a sale and leaseback transaction—accordingly, paragraphs 26–28 of IFRS 16 continue to apply to any liability that arises in such a transaction.

23. OLAM says the period of the leaseback in sale and leaseback transactions in industries such as agriculture could be long (eg 25-30 years). It says lessees enter into leases with variable lease payments based on future performance or use because of the uncertainty associated with that future performance or use, ie lessees wish to share the risks of the uncertainty about the economic benefits to be derived from using an underlying asset with the lessor. OLAM says it could therefore be impracticable to estimate the right of use retained by the seller-lessee in such situations.

24. Deloitte suggests providing guidance on factors that could be used to determine the relative proportion of the asset that relates to the right of use retained by the seller-lessee. Further, Deloitte suggests clarifying whether the seller-lessee includes payments it makes for real estate taxes and insurance in a triple net lease when determining the proportion of the asset that relates to the right of use it retains.

25. Some of these respondents suggest amending IFRS 16 to address the accounting at the date of the transaction because, in their view, the Committee's conclusions change or interpret IFRS 16. For example, the Swedish Financial Reporting Board (SFRB) says:

> In our opinion the committee has interpreted the standard and added new principles regarding measurement that cannot be found in the standard. […] A change in the definition of what payments to include in the lease liability shall not be dealt with in a tentative agenda decision. Such a change should be made via an amendment of the standard.

26. Similarly, Masahiro Hoshino says the agenda decision conflicts with principles in IFRS 16 and the Committee should not address the matter because it does not meet the criterion in paragraph 5.16(c) of the *Due Process Handbook*—ie in his view, the matter cannot be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.

Staff analysis

Initial measurement of the ROU asset (and gain or loss) in a sale and leaseback transaction

27. Paragraph 98 of IFRS 16 states 'if an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 99-103'. Paragraph 98 therefore *requires* a seller-lessee to apply the requirements in paragraphs 99-103, rather than the requirements in other parts of IFRS 16, to the lease arising in a sale and leaseback transaction. The applicable requirements for the sale and leaseback transaction described in the submission are specified in paragraph 100(a) of IFRS 16 (see paragraph 16 of this paper).

28. Paragraph BC266 explains that the Board developed the initial measurement requirements in paragraph 100(a) to reflect the economics of a sale and leaseback transaction—ie although the seller-lessee may have transferred legal ownership of the asset to the buyer-lessor, by entering into a lease of that same asset for a period of time, the seller-lessee has not in fact transferred all the rights embedded in legal

ownership of the asset. It has transferred only its interest in the value of the asset at the end of the leaseback, and has retained its right to use the asset for the period of the leaseback. The seller-lessee therefore does not remeasure the right of use retained and recognises only the amount of the gain or loss that relates to the rights transferred to the buyer-lessor.

29. Having decided to develop sale and leaseback requirements that reflect the economics of the transaction (as described in paragraph BC266), the Board therefore developed sale and leaseback requirements that are different from those for a standalone lease. In other words, measuring the ROU asset at a proportion of the previous carrying amount of the asset sold (as is required by paragraph 100(a)) *does not*—and *cannot*—result in measuring the ROU asset as required by paragraphs 23-25 of IFRS 16. This is true for all sale and leaseback transactions, regardless of the form of the leaseback payments.

30. Accordingly, we continue to agree with the Committee's conclusion that the seller-lessee applies the requirements in paragraph 100(a)—and not those in paragraphs 23–25 of IFRS 16—to the initial measurement of the ROU asset that arises in the sale and leaseback transaction in the submission.

31. Paragraph 100(a) requires the seller-lessee to measure the ROU asset at the proportion of the previous carrying amount of the asset that relates to the right of use it retains. IFRS 16 does not prescribe a particular method for calculating that proportion. However, as discussed in paragraph 19 of Agenda Paper 2 of the Committee's March 2020 meeting (March agenda paper), the Board's explanation in paragraph BC266 is helpful in assessing what would be an appropriate and reasonable method to use. In our view, providing guidance on factors to consider in this respect would go beyond the requirements in IFRS 16 and beyond the question being considered by the Committee.

Initial measurement of the liability in a sale and leaseback transaction

32. We also continue to agree with the Committee's conclusion regarding the initial measurement of the liability arising in a sale and leaseback transaction. Although paragraph 100(a) does not explicitly specify how to measure that liability, the initial measurement is a consequence of how the ROU asset is measured—and the gain or

loss on the transaction determined—applying paragraph 100(a). Measuring the liability in any other way would require the seller-lessee to adjust the measurement of either the ROU asset or the gain or loss on the transaction. This would in turn result in measuring the ROU asset, or gain or loss, in a way that would not comply with paragraph 100(a).

33. To illustrate using the example in the tentative agenda decision (see Appendix A), the seller-lessee recognises the following at the date of the transaction:

Dr. Cash	CU 1,800,000	
Dr. Right-of-use asset	CU 250,000	
Cr. PPE		CU 1,000,000
Cr. Liability[2]		CU 450,000
Cr. Gain on rights transferred		CU 600,000

34. In this example, if we were to assume that the seller-lessee applies paragraphs 26–28 of IFRS 16 in initially measuring the liability, it would measure the liability at CU0 (because all payments for the leaseback are variable and do not depend on an index or rate). However, in order to recognise the ROU asset and gain on rights transferred at amounts as required by paragraph 100(a), it is necessary to measure the liability at an amount that reflects the required measurement of the ROU asset and the associated gain.

35. Accordingly, we conclude that an entity does not apply the requirements in paragraphs 26–28 of IFRS 16 to the initial measurement of the liability that arises in a sale and leaseback transaction. The Board's considerations in paragraph BC169 explain the rationale for the requirements in paragraphs 26–28 of IFRS 16, which apply to the initial measurement of a lease liability in a standalone lease—that explanation in paragraph BC169 does not override the applicable requirements in the Standard on sale and leaseback transactions.

36. Finally, we note that the Committee's conclusion, and our analysis, apply only to the liability that arises in a sale and leaseback transaction. The Committee's conclusion

[2] Paragraphs 38-44 of this paper discuss the nature of this liability.

neither refers to the definition of lease payments in IFRS 16 nor comments on any of the requirements in IFRS 16 that apply to standalone leases (including those in paragraphs 26–28).

Requests for standard-setting

37. We continue to agree with the Committee's conclusion that the requirements in paragraph 100(a) provide an adequate basis for an entity to measure the ROU asset and liability that arise in a sale and leaseback transaction at the date of the transaction. Accordingly, we continue to agree with the Committee that standard-setting is not required to address this matter.

Nature of the liability that arises in a sale and leaseback transaction

Respondents' comments

38. Seven respondents (PwC, EY, Deloitte, KPMG, David Hardidge, the ICAI, Universidad Loyola Andalucia) express concerns about the Committee's conclusion that the liability arising in the sale and leaseback transaction is a lease liability to which IFRS 16 applies. These respondents say:

(a) it is unclear whether the seller-lessee applies IFRS 16 to the liability that arises in the sale and leaseback transaction or, instead, applies another IFRS Standard (such as IFRS 9 *Financial Instruments*) to that liability. One respondent says the liability is a contract liability to which IFRS 15 applies. Another says if described as a lease liability, then the requirements in paragraphs 26-28 of IFRS 16 would appear to be applicable.

(b) the conclusion conflicts with Illustrative Example 24 (IE24) accompanying IFRS 16—IE24 refers to the liability arising in a sale and leaseback transaction as a financial liability.

(c) the conclusion could raise practical questions about the subsequent accounting for the liability, particularly when the leaseback payments include those that do not meet definition of lease payments in IFRS 16. This is because the subsequent measurement requirements in IFRS 16 did not contemplate such situations.

39. Some of these respondents note the Committee's recommendation for the Board to address the subsequent measurement of the liability that arises in a sale and leaseback transaction. They suggest that the agenda decision not describe the liability as a lease liability and, instead, that the Board consider the nature of the liability as part of its narrow-scope standard-setting project on sale and leaseback transactions. The AcSB suggests the agenda decision explain why the liability is a lease liability.

Staff analysis

40. The liability that arises in a sale and leaseback transaction meets the definition of a financial liability in IAS 32 *Financial Instruments: Presentation*—ie it is a contractual obligation to deliver cash to another entity. The question is therefore, in essence, one about whether that liability is in the scope of IFRS 16 or IFRS 9. Paragraphs 27–34 of the March agenda paper (reproduced in Appendix C) explain why, in our view, the liability a seller-lessee recognises at the date of the transaction is a lease liability to which IFRS 16 applies.

41. We also see no inconsistency between this conclusion and the illustration in IE24. IE24 illustrates the accounting when a sale and leaseback transaction includes above-market terms. In describing the liability that arises in the sale and leaseback transaction, the illustrative example states:

> The present value of the annual payments […] amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease…

42. The journal entries in the example illustrate that the seller-lessee recognises a financial liability of CU1,459,200—we note however that it does not state that the seller-lessee applies IFRS 9 in accounting for that entire financial liability. A lease liability to which IFRS 16 applies meets the definition of a financial liability.

43. That said, in considering the feedback, we think the agenda decision could refer to the liability more generally as a financial liability instead of a lease liability to which IFRS 16 applies. This would align with the approach taken in IE24 accompanying IFRS 16. We note that the Board's project on sale and leaseback transactions will clarify the nature of the liability. At its April 2020 meeting, the Board agreed with the Committee's recommendation to undertake a narrow-scope standard-setting project to

specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the liability that arises in a sale and leaseback transaction. The Board made that decision noting—and agreeing with—the Committee's tentative conclusions about the initial measurement and nature of the liability arising in a sale and leaseback transaction. In specifying how to apply the subsequent measurement requirements in IFRS 16, we expect the Board's proposed amendment to specify that the liability is a lease liability to which IFRS 16 applies.

44. Accordingly, we recommend removing references to 'lease' from the description of the liability in the agenda decision.

Clarifications to the agenda decision

45. The following table summarises respondents' suggested clarifications to the agenda decision together with our analysis:

Respondents' comments	**Staff analysis and conclusions**
(a) KPMG suggests stating that an entity would not comply with IFRS 16 if it were to measure the ROU asset at zero.	We agree that it could be useful to specify, within the example in the agenda decision, that the seller-lessee cannot measure the ROU asset at zero. We therefore recommend doing so.
(b) KPMG suggests clarifying that all payments for the lease are variable payments to avoid any implication that payments may include a mix of fixed and variable payments.	The Committee's discussion and conclusions relate to transactions for which the payments for the leaseback *include* variable payments. The example in the agenda decision is one in which all payments for the leaseback are variable. However, the Committee's conclusions would apply equally when some or all of the leaseback payments are variable. We therefore recommend no change in this respect.
(c) David Hardidge suggests explaining how a seller-lessee determines the gain or loss in a sale and leaseback transaction,	We think the tentative agenda decision explains in sufficient detail how a seller-lessee determines the gain or loss (see paragraph 16 of this paper). We therefore recommend no

Respondents' comments	Staff analysis and conclusions
to avoid any misunderstanding that the liability that arises in a sale and leaseback transaction includes a deferred gain.	change in this respect.
(d) The AcSB suggests explaining in the agenda decision why the Committee recommended amending IFRS 16 to specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the liability that arises in a sale and leaseback transaction.	The agenda decision explains how the seller-lessee accounts for the sale and leaseback transaction at the date of the transaction. The Committee's recommendation to the Board regarding the subsequent measurement of the liability was reported in IFRIC Update in March 2020, but not as part of the tentative agenda decision. The agenda decision is likely to remain in place for several years and beyond when the Board might issue an amendment to IFRS 16. At that point, it could be confusing to have such an explanation in the agenda decision. We therefore recommend no change in this respect.
(e) David Hardidge suggests illustrating separately individual components of the journal entry to avoid any confusion.	In our view, the journal entry illustrated is understandable; splitting the journal entry into components could possibly be confusing. We therefore recommend no change in this respect.
(f) KPMG recommends referring to paragraphs 99-102 of IFRS 16 as the applicable requirements and not just to paragraph 100.	The requirements in paragraphs 101–102 apply when the consideration for the sale of the asset in a sale and leaseback transaction is not at fair value. This is not the case for the transaction considered by the Committee. We therefore recommend no change in this respect.

Other comments

46. Appendix B to this paper summarises other comments received, together with our analysis of those comments. Based on our analysis, we recommend no changes to the agenda decision in respect of these comments.

Staff recommendation

47. On the basis of our analysis, we recommend finalising the agenda decision as published in IFRIC Update in March 2020, with the changes discussed in paragraphs 44 and 45(a) of this paper. Appendix A to this paper sets out the proposed wording of the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording of the agenda decision

A1. We propose the following wording if the Committee decides to finalise the agenda decision (new text is underlined, and deleted text is struck through).

Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)

The Committee received a request about a sale and leaseback transaction with variable payments. In the transaction described in the request:

a. an entity (seller-lessee) enters into a sale and leaseback transaction whereby it transfers an item of property, plant and equipment (PPE) to another entity (buyer-lessor) and leases the asset back for five years.

b. the transfer of the PPE satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale of the PPE. The amount paid by the buyer-lessor to the seller-lessee in exchange for the PPE equals the PPE's fair value at the date of the transaction.

c. payments for the lease (which are at market rates) include variable payments, calculated as a percentage of the seller-lessee's revenue generated using the PPE during the five-year lease term. The seller-lessee has determined that the variable payments are not in substance fixed payments as described in IFRS 16.

The request asked how, in the transaction described, the seller-lessee measures the right-of-use asset arising from the leaseback, and thus determines the amount of any gain or loss recognised at the date of the transaction.

The Committee observed that the requirements applicable to the transaction described in the request are in paragraph 100 of IFRS 16. Paragraph 100 states that 'if the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset: (a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor…'.

Consequently, to measure the right-of-use asset arising from the leaseback, the seller-lessee determines the proportion of the PPE transferred to the buyer-lessor that relates to the right of use retained—it does so by comparing, at the date of the transaction, the right of use it retains via the leaseback to the rights comprising the entire PPE. IFRS 16 does not prescribe a method for determining that proportion. In the transaction described in the request, the seller-lessee could determine the proportion by comparing, for example, (a) the present value of expected payments for the lease (including those that are variable), to (b) the fair value of the PPE at the date of the transaction.

The gain or loss the seller-lessee recognises at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the PPE's previous carrying amount), the amount of the gain or loss recognised relates only to the rights transferred to the buyer-lessor. Applying paragraph 53(i) of IFRS 16, the seller-lessee discloses gains or losses arising from sale and leaseback transactions.

The seller-lessee also recognises a ~~lease~~ liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the ~~lease~~ liability is a consequence of how the right-of-use asset is measured—and the gain or loss on the sale and leaseback transaction determined—applying paragraph 100(a) of IFRS 16.

Illustrative example

Seller-lessee enters into a sale and leaseback transaction whereby it transfers an asset (PPE) to Buyer-lessor, and leases that PPE back for five years. The transfer of the PPE satisfies the requirements in IFRS 15 to be accounted for as a sale of the PPE.

The carrying amount of the PPE in Seller-lessee's financial statements at the date of the transaction is CU1,000,000, and the amount paid by Buyer-lessor for the PPE is CU1,800,000 (the fair value of the PPE at that date). All the payments for the lease (which are at market rates) are variable, calculated as a percentage of Seller-lessee's revenue generated using the PPE during the five-year lease term. At the date of the transaction, the present value of the expected payments for the lease is CU450,000. There are no initial direct costs.

Seller-lessee determines that it is appropriate to calculate the proportion of the PPE that relates to the right of use retained using the present value of expected payments for the lease. On this basis, the proportion of the PPE that relates to the right of use retained is 25%, calculated as CU450,000 (present value of expected payments for the lease) ÷ CU1,800,000 (fair value of the PPE). Consequently, the proportion of the PPE that relates to the rights transferred to Buyer-lessor is 75%, calculated as (CU1,800,000 - CU450,000) ÷ CU1,800,000.

Applying paragraph 100(a), Seller-lessee:

a. *measures the right-of-use asset at CU250,000, calculated as CU1,000,000 (previous carrying amount of the PPE) × 25% (proportion of the PPE that relates to the right of use it retains).*

b. *recognises a gain of CU600,000 at the date of the transaction, which is the gain that relates to the rights transferred to Buyer-lessor. This gain is calculated as CU800,000 (total gain on sale of the PPE (CU1,800,000 – CU1,000,000)) × 75% (proportion of the PPE that relates to rights transferred to Buyer-lessor).*

Applying paragraph 100(a), the right-of-use asset would not be measured at zero because zero would not reflect the proportion of the previous carrying amount of the PPE (ie CU1,000,000) that relates to the right of use retained by Seller-lessee.

At the date of the transaction, Seller-lessee accounts for the transaction as follows:

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*CU250,000*	
Cr. PPE		*CU1,000,000*
Cr. ~~Lease~~Financial liability		*CU450,000*
Cr. Gain on rights transferred		*CU600,000*

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add the matter to its standard-setting agenda.

Appendix B—Analysis of other comments

B1. The table below summarises other comments, together with our analysis and conclusions.

Respondents' comments	**Staff analysis and conclusions**
Other comments related to the matter considered by the Committee	
(a) Other variable payments David Hardidge suggests addressing how a seller-lessee measures the ROU asset and gain or loss in a sale and leaseback transaction with variable payments that depend on an index or rate.	*We recommend no change to the agenda decision in this respect.* This suggestion is beyond the scope of the question considered by the Committee. However, we note that the Board's project on subsequent measurement proposes to address sale and leaseback transactions with variable payments that depend on an index or rate.
(b) Loss on sale of underlying asset The SOCPA suggests amending IFRS 16 to require a seller-lessee to immediately recognise (and not limit) any loss that arises on a sale and leaseback transaction.	*We recommend no action in response to this matter.* This suggestion is beyond the scope of the question considered by the Committee.

(c) Inconsistent to publish agenda decision and recommend standard-setting The SFRB says it is inconsistent to have both an agenda decision and a narrow-scope standard-setting project on the same transaction.	*We recommend no action in response to this matter.* The submission asked about the accounting for a sale and leaseback transaction with variable payments linked to future performance or use at the date of the transaction. The Committee concluded that IFRS 16 provides an adequate basis for an entity to account for the transaction *at the date of the transaction*. Accordingly, in accordance with paragraphs 5.14-5.22 of the *Due Process Handbook*, it published a tentative agenda decision. As explained in paragraph 5 of the paper, the Committee also recommended amending IFRS 16 to address the subsequent measurement of the liability that arises in a sale and leaseback transaction. This matter is related to, but distinct from, the question asked to the Committee. We therefore see no inconsistency.
(d) Income taxes Masahiro Hoshino recommends addressing how an entity applies IAS 12 *Income Taxes* to the right-of-use asset and liability that arise in a sale and leaseback transaction when the entity receives tax deductions for payments made.	*We recommend no action in response to this matter.* This matter is beyond the scope of the question considered by the Committee. However, we note that the Board has an ongoing project considering how an entity accounts for deferred tax related to assets and liabilities that arise in a transaction, such as a lease. Further information about that project can be found here.

Other comments related to the Board's project on subsequent measurement	
(e) Interaction between BC262 and BC266 of IFRS 16 Deloitte suggests addressing what it views as a conflict between paragraphs BC262 and BC266. It says paragraph BC262 conveys the notion that the ROU asset is a different asset from the underlying asset transferred to the buyer-lessor—this supports derecognition of the underlying asset and recognition of a ROU asset on entering into a sale and leaseback transaction. However, in measuring the ROU asset and resulting gain or loss, paragraph BC266 views the ROU asset that arises from the leaseback as a portion of the underlying asset sold.	*We recommend no action in response to this matter.* Paragraph BC262(a) states '…the buyer-lessor is considered to obtain control of the underlying asset, and immediately transfer the right to control the use of that asset to the seller-lessee for the lease term…'. Paragraph BC266 states '…However, from an economic standpoint, the seller-lessee has sold only its interest in the value of the underlying asset at the end of the leaseback—it has retained its right to use the asset for the duration of the leaseback. The seller-lessee had already obtained that right to use the asset at the time that it purchased the asset—the right of use is an embedded part of the rights that an entity obtains when it purchases, for example, an item of property, plant and equipment…'. In our view, paragraph BC266 does not conflict with paragraph BC262—it simply explains that the Board took an economic perspective when developing the measurement requirements applicable to sale and leaseback transactions.

(f) Discount rate KPMG notes that the Committee did not discuss the discount rate the seller-lessee uses to discount the variable lease payments. It says the methodology used in the March agenda paper implied this would be a market rate. It asks about how this interacts with the requirement in IFRS 16 for a lessee to use either the rate implicit in the lease or the lessee's incremental borrowing rate.	*We recommend no action in response to this matter.* IFRS 16 (and consequently the tentative agenda decision) does not prescribe a particular method for calculating the proportion of the asset transferred to the buyer-lessor that relates to the right of use retained by the seller-lessee. The Board's project on subsequent measurement will not propose additional requirements about the calculation of that proportion; however, it will specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16, including the discount rate used.
(g) Contract modifications Deloitte suggests that the Board's project on subsequent measurement address lease modifications.	*We recommend no action in response to this matter.* At its April 2020 meeting, the Board decided to include modifications to a sale and leaseback transaction as part of its narrow-scope standard-setting project.
(h) Nature of amendment The ICAI says any possible amendment to IFRS 16 addressing subsequent measurement in a sale and leaseback transaction does not meet the annual improvements criteria in the *Due Process Handbook*.	*We recommend no action in response to this matter.* At its April and May 2020 meetings, the Board discussed its project on subsequent measurement and decided to propose a narrow-scope amendment to IFRS 16 in this respect—the proposed narrow-scope amendment is not part of the next cycle of annual improvements to IFRS Standards.

Appendix C—Nature of the liability in a sale and leaseback transaction

C1. The paragraphs below reproduce paragraphs 27-34 of Agenda Paper 2 to the Committee's March 2020 meeting.

Financial liability

27. […] Applying IFRS 16's sale and leaseback requirements, the seller-lessee recognises a liability at the date of the sale and leaseback transaction. That liability reflects the seller-lessee's obligation to make payments to the buyer-lessor over the lease term, and therefore meets the definition of a financial liability in IAS 32 *Financial Instruments: Presentation*—ie it is a contractual obligation to deliver cash to another entity.

28. At the November meeting, some Committee members asked:

(a) whether the seller-lessee accounts for the financial liability as a lease liability applying IFRS 16 or, instead, applying IFRS 9 *Financial Instruments*; and

(b) if accounted for as a lease liability, how the seller-lessee applies IFRS 16 to that lease liability, particularly in the transaction described in the submission for which leaseback payments are variable calculated as a percentage of the seller-lessee's revenue.

29. We note that a financial liability arises for the seller-lessee in *all* sale and leaseback transactions (assuming—as we would expect—that the seller-lessee is obliged to make payments to the buyer-lessor over the lease term). Therefore, the question of whether to apply IFRS 16 or IFRS 9 to that financial liability is relevant for *all* sale and leaseback transactions. It is not only a question when some or all of the leaseback payments are variable.

Does IFRS 16 apply to the financial liability that arises in a sale and leaseback transaction?

30. A lease liability meets the definition of a financial liability. Therefore, whether IFRS 16 or IFRS 9 applies to the financial liability that arises in a sale and leaseback transaction is a question of scope. Paragraph 2.1(b) of IFRS 9

excludes from its scope 'rights and obligations under leases to which IFRS 16 *Leases* applies'. We therefore first considered whether the financial liability is a lease liability to which IFRS 16 applies.

31. IFRS 16 defines a lease as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. Paragraph 9 of IFRS 16 explains that 'a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration'. Accordingly, when a contract is or contains a lease, the lessee (a) obtains the right to control the use of an identified asset for a period of time; and (b) pays consideration in exchange for that right.

32. Paragraph 98 of IFRS 16 states (*emphasis* added) '…both the seller-lessee and the buyer-lessor shall account for the transfer contract *and the lease* applying paragraphs 99-103.' Paragraph BC262(a) states (*emphasis* added):

> …Consequently, if there are no features in a sale and leaseback transaction that prevent sale accounting, the buyer-lessor is considered to obtain control of the underlying asset, and immediately transfer *the right to control the use* of that asset to the seller-lessee for the lease term. The fact that the buyer-lessor purchases the underlying asset from the entity that is the lessee in the *subsequent leaseback* does not change the buyer-lessor's ability to obtain control of the underlying asset.

33. Consequently, in a sale and leaseback transaction (that satisfies IFRS 15's requirements to account for the transfer as a sale), the seller-lessee transfers the underlying asset to the buyer-lessor and then immediately obtains the right to control the use of the asset in exchange for payments to the buyer-lessor. The transaction therefore contains a lease. Because of this, we conclude that any payments the seller-lessee makes to the buyer-lessor over the lease term are in exchange for its right to use the underlying asset—in other words, the seller-lessee's obligation to make payments to the buyer-lessor relate to the lease. Accordingly, the liability is a lease liability to which IFRS 16 applies.

34. This conclusion aligns with paragraph 100(a) of IFRS 16 that specifies a seller-lessee's measurement of 'the right-of-use asset arising from the

leaseback'—if the seller-lessee has obtained a ROU asset at the date of a sale and leaseback transaction, then it follows that the seller-lessee's obligation to make payments to the buyer-lessor over the lease term is a liability that relates to obtaining that right of use.