IFRS

STAFF PAPER

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IASB® meeting

Project	**Lease Liability in a Sale and Leaseback**		
Paper topic	Project Direction		
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Introduction and purpose

1. In November 2020, the International Accounting Standards Board (IASB) published the Exposure Draft *Lease Liability in a Sale and Leaseback*, which proposed to amend IFRS 16 *Leases*. The comment period ended on 29 March 2021.

2. At its May 2021 meeting, the IASB discussed a summary of feedback on the Exposure Draft. The IASB did not make any decisions at that meeting, but members did provide their initials thoughts on the feedback.

3. In September 2021, we presented to the IFRS Interpretations Committee (Committee) our analysis and preliminary views on how to proceed on the project, having considered respondents' comments on the Exposure Draft. We developed our analysis and recommendations in this paper considering feedback from Committee members as well as in comment letters and from other meetings.

4. The purpose of this meeting is to:

   (a) provide the IASB with our analysis and recommendations on how to proceed on the project; and

   (b) ask the IASB whether it agrees with our recommendations.

Structure of this paper

5. This paper includes:
   - (a) context (see paragraphs 7–15);
   - (b) a summary of staff recommendations (paragraphs 16);
   - (c) the proposed amendments in the Exposure Draft (paragraphs 17–21);
   - (d) stakeholder input (paragraphs 22–38), which summarises:
     - (i) the main matters raised by respondents in their comment letters;
     - (ii) meetings with respondents;
     - (iii) our AlphaSense search; and
     - (iv) discussions at the September 2021 Committee meeting;
   - (e) staff analysis and recommendations (paragraphs 39–69), which set out:
     - (i) the proposals in the Exposure Draft we recommend the IASB retains;
     - (ii) the proposals in the Exposure Draft we recommend the IASB changes, including an analysis of:
       - (1) the main matters respondents raised;
       - (2) a matrix of alternative solutions; and
       - (3) how the staff recommendations could be implemented; and
   - (f) questions for the IASB (page 23).

6. There are two appendices to this paper:
   - (a) Appendix A—Agenda Decision June 2020.
   - (b) Appendix B—Illustration of the approaches to subsequent measurement.

Context

7. Paragraph 100(a) of IFRS 16 requires a seller-lessee to measure the right-of-use asset arising from a sale and leaseback transaction at the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains. Accordingly, in a sale and leaseback transaction the seller-lessee recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

8. The Committee was asked about the application of paragraph 100(a) of IFRS 16 to a sale and leaseback transaction that includes variable leaseback payments that do not depend on an index or rate. In responding to that question, the Committee published the Agenda Decision *Sale and Leaseback with Variable Payments* in June 2020 (reproduced in **Appendix A** to this paper).

9. The Agenda Decision explains that, in applying paragraph 100(a) of IFRS 16, a seller-lessee recognises a liability (a leaseback liability) at the date of the transaction, even if all the leaseback payments are variable and do not depend on an index or rate. The *initial measurement* of the leaseback liability is a consequence of how—applying paragraph 100(a)—the seller-lessee measures the right-of-use asset and the gain or loss on the sale and leaseback transaction. IFRS 16, however, includes no specific *subsequent measurement* requirements for sale and leaseback transactions.

10. Consequently, the Committee recommended—and the IASB decided—to undertake standard-setting to add requirements on how to subsequently measure the leaseback liability that arises in a sale and leaseback transaction.

Underlying assumptions

11. Throughout this paper, references to sale and leaseback transactions are only to those in which the transfer of the asset satisfies the requirements to be accounted for as a sale. The paper does not discuss sale and leaseback transactions in which the transfer of the asset fails to satisfy those requirements (to which paragraph 103 of IFRS 16 applies).

12. When leaseback payments comprise payments that meet the definition of lease payments in IFRS 16 (and are not variable payments)[1], we would expect the initial measurement of the leaseback liability when applying paragraph 100(a) of IFRS 16 to be similar to that of a lease liability when applying paragraphs 26–27 of IFRS 16. Consequently, we would expect a seller-lessee to apply paragraphs 36–38 of IFRS 16 when subsequently measuring such a leaseback liability largely as it would when subsequently measuring any other lease liability. Throughout the paper, we therefore discuss transactions for which leaseback payments include variable payments.

13. We expect the assumption in paragraph 12 to also be applicable for sale and leaseback transactions with variable payments based on an index or rate when the lease term is not long or the expected change in the index or rate is low.

Approaches to subsequent measurement of the leaseback liability

14. The paper refers to four approaches to subsequent measurement of the leaseback liability:

    (a) *Expected Payments approach*—the approach proposed in the Exposure Draft;

    (b) *Imputed Payments approach*—the imputed payments are periodic payments over the leaseback term that, when discounted, result in the carrying amount of the leaseback liability at the commencement date, measured applying paragraph 100(a) of IFRS 16. There are two variations to this approach:

        (i) the periodic payments are set as equal amounts over the leaseback term; or

        (ii) the periodic payments may differ based on the expected profile of payments over the leaseback term.

[1] IFRS 16 defines lease payments as 'payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following: (a) fixed payments (including in-substance fixed payments), less any lease incentives; (b) variable lease payments that depend on an index or a rate; (c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; (d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease. For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees…'

(c) *Componentised Liability approach*[2]—consistent with paragraph 100(a) of IFRS 16, the seller-lessee would 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 the seller-lessee retains. The seller-lessee would measure the leaseback liability applying the measurement requirements applicable to other lease liabilities and recognise any residual balance as a liability (referred to as the 'other component'), amortising it to profit or loss over the leaseback term.

(d) *Deferred Gain approach*[3]—the seller-lessee would measure *both* the right-of-use asset and the leaseback liability applying the measurement requirements applicable to other right-of-use assets and lease liabilities. Consistent with paragraph 100(a) of IFRS 16, a seller-lessee would recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. The seller-lessee would also recognise as a deferred gain (or loss) the unrecognised amount of the gain (or loss) on sale, amortising it to profit or loss over the term of the leaseback.

15. **Appendix B** to this paper describes and illustrates the four approaches.

Summary of staff recommendations

16. We recommend that the IASB:

(a) retains the proposals in the Exposure Draft to:

(i) clarify that the leaseback liability is a liability to which IFRS 16 applies;

(ii) not change the initial measurement requirements already in paragraph 100(a) of IFRS 16 for the right-of-use asset and the gain or loss arising from the sale and leaseback;

[2] Referred to as 'Deferred Income Approach A' when reported to the IASB at its May 2021 meeting (see Agenda Paper 12D).

[3] Referred to as 'Deferred Income Approach B' when reported to the IASB at its May 2021 meeting (see Agenda Paper 12D).

(iii) clarify that a seller-lessee subsequently measures the right-of-use asset arising from the leaseback applying paragraphs 29–35 of IFRS 16; and

(iv) include an illustrative example of a sale and leaseback transaction with variable payments; and

(b) change the proposals in the Exposure Draft to:

(i) not prescribe how, at the commencement date, a seller-lessee determines the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains;

(ii) require the seller-lessee to subsequently measure the leaseback liability applying paragraphs 36–46 of IFRS 16; and

(iii) specify, for the purposes of applying paragraphs 36–46, the term 'lease payments' may not be as defined in Appendix A to IFRS 16. Instead, the seller-lessee would apply the term 'lease payments' or 'revised lease payments' in such a manner that it does not recognise any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained.

The proposed amendments in the Exposure Draft

17. IFRS 16 includes no specific subsequent measurement requirements for sale and leaseback transactions. Consequently, it is not always clear how to subsequently measure the leaseback liability—in particular when the leaseback payments include variable payments linked to future performance or use of the underlying asset, which are excluded from the measurement of a lease liability[4] (see the underlying assumption in paragraph 12 above).

18. There is therefore a risk that, without additional requirements, a modification or change in the leaseback term could result in the seller-lessee measuring the leaseback liability differently from its initial measurement by excluding variable payments that do not depend on an index or rate. This in turn could result in the seller-lessee

[4] This paper uses 'lease liability' to refer to the liability that arises from a lease unrelated to a sale and leaseback transaction.

inadvertently recognising a gain or loss on the right of use the seller-lessee retains at the time of remeasurement, solely because of the remeasurement.

19. To address this risk, the Exposure Draft proposed:

    (a) not to change the initial measurement requirements in paragraph 100(a) of IFRS 16 for the right-of-use asset and the gain or loss arising from the sale and leaseback. When developing IFRS 16, the IASB developed sale and leaseback requirements—that differ from the requirements for leases unrelated to a sale and leaseback transaction—to reflect the economics of sale and leaseback transactions (as explained in paragraph BC266 of IFRS 16).

    (b) in applying these initial measurement requirements, to require a seller-lessee to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by comparing the present value of the expected lease payments to the fair value of the asset sold. The seller-lessee would initially measure the leaseback liability at the present value of the expected lease payments.

    (c) to specify the payments that comprise the expected lease payments and, with reference to these payments, add subsequent measurement requirements for the leaseback liability. Expected lease payments would differ from lease payments as defined in Appendix A to IFRS 16—they would include expectations of (i) variable payments linked to future performance or use of the underlying asset, and (ii) future changes in payments resulting from changes in the reference index or rate for variable payments that depend on an index or rate. **Appendix B** to this paper explains the mechanics of these proposals, which reflect the *Expected Payments approach*.

20. In proposing changes to the sale and lease requirements, for completeness the IASB also proposed:

    (a) to clarify that the leaseback liability is a liability to which IFRS 16 applies.

    (b) to clarify that a seller-lessee subsequently measures the right-of-use asset arising from the leaseback applying paragraphs 29–35 of IFRS 16.

(c) to include an illustrative example of a sale and leaseback transaction with variable payments.

21. In paragraphs BC18–BC19 of the Exposure Draft, the IASB acknowledged that, for a lease that is unrelated to a sale and leaseback transaction, a lessee excludes from the measurement of the lease liability variable payments that do not depend on an index or rate (and that are not in-substance fixed payments). When developing IFRS 16, the IASB had noted concerns about the high level of measurement uncertainty that would result from including such variable payments in the measurement of the lease liability and about the cost associated with such estimates because of the high volume of leases held by some lessees. However, for sale and leaseback transactions the IASB had expected that seller-lessees would be able to reasonably estimate expected lease payments because seller-lessees are in a different position from lessees that enter into leases unrelated to a sale and leaseback transaction. In particular, the IASB noted its expectation that any individual seller-lessee would enter into relatively few sale and leaseback transactions with variable payments whereas some lessees routinely enter into lease contracts with variable payments that are unrelated to a sale and leaseback transaction. The IASB also noted that a seller-lessee (as the owner of the asset until the transaction) must know the asset's fair value at that date.

Stakeholder input

Main matters raised in comment letters

22. From the 87 responses to the Exposure Draft, a large majority of respondents agreed that there is a need to amend IFRS 16 to enhance the subsequent measurement requirements for sale and leaseback transactions. However, only a minority of those respondents agreed with the proposed amendments. A large majority disagreed with, or expressed concerns about, aspects of the proposals.

23. Most respondents commented on the differing treatment of variable lease payments when measuring a leaseback liability compared with the measurement of other lease liabilities. Many said including variable lease payments in the measurement of leaseback liabilities raises practical and conceptual challenges. Noteworthy is the practical concern that including expected variable payments linked to future

performance or use of the underlying asset in the measurement of the leaseback liability might often involve a high level of measurement uncertainty and additional costs. We analyse this and other challenges within the 'Staff analysis and recommendations' section of this paper (see paragraphs 39–69 below).

24. Respondents suggested alternative possible ways forward, the two main alternatives being the *Componentised Liability approach* and the *Deferred Gain approach*.

Meetings with respondents

25. We held follow-up meetings with a number of respondents, in particular to understand better their comments on practical challenges and the alternatives suggested (both on initial recognition and subsequently). We met with nine respondents (including preparers, accounting firms, professional bodies and national standard-setters) who provided more detailed observations on their comments in comment letters.

26. We learned that:

    (a) seller-lessees do not enter into high volumes of sale and leaseback transactions, although those transactions are typically highly structured and for large amounts. A seller-lessee would typically enter into, at most, only a few sale and leaseback transactions at any one time. One entity explained that, during one period in its past, management had a policy of improving liquidity by entering into sale and leaseback transactions and, even when it had such a policy, the entity (as the seller-lessee) entered into around 20 sale and leaseback transactions in that period. This contrasts with leases unrelated to a sale and leaseback transaction of which lessees can have thousands or many more (as many as half a million).

    (b) respondents' practical concerns about the difficulty in estimating variable payments—in particular, those linked to future performance or use of the underlying asset—are mainly based on their experiences with leases unrelated to a sale and leaseback transaction, rather than with sale and leaseback transactions.

(c) sale and leaseback transactions with variable payments linked to future performance or use of the underlying asset are not common, although some respondents suggested that the frequency may increase in the future.

(d) respondents had not developed their alternative solutions beyond what was reported to the IASB at the May 2021 meeting. For example, they had not considered presentation in the statement of profit or loss or how the solution might work for a change in lease term or a lease modification.

AlphaSense search

27. To obtain further evidence about the volume of material sale and leaseback transactions with variable payments, we used the financial search engine, AlphaSense, to identify these transactions. We performed the search in June 2021. The search considered entities' most recent interim or annual financial statements, circulars, integrated reports, merger and acquisition-related documents, and prospectuses. The search was limited to documents in English. We searched for various forms of 'sale and leaseback' and 'variable payments'.

28. Our search identified one seller-lessee that disclosed two sale and leaseback transactions for which the leaseback payments are based entirely on a percentage of its revenue generated using the underlying asset. Although other entities in the search reported entering into sale and leaseback transactions, there was no reference to variable payments linked to these transactions.

September 2021 Committee meeting

29. We presented to the Committee the main matters of concern, input from meetings with respondents and the results from our AlphaSense search (as outlined in paragraphs 22-28). We asked Committee members to comment on our preliminary views about the possible ways forward with respect to:

(a) the subsequent measurement of the leaseback liability (paragraphs 30–35); and

(b) the population of transactions to which any new requirements would apply (paragraphs 36–38 of the paper).

Subsequent measurement of the leaseback liability

30. Our preliminary views presented to the Committee assumed that any solution to deal with the subsequent measurement of the leaseback liability would retain the initial measurement requirements in paragraph 100(a) of IFRS 16 and aim to 'fill the gap' in the current requirements. In other words, the IASB would not reconsider the sale and leaseback requirements in IFRS 16 as part of this narrow-scope project.

31. Within this project boundary, we asked Committee members for their views on the four possible approaches to subsequently measuring the leaseback liability (see paragraph 14 of this paper). Our preliminary views were that we could support the *Expected Payments approach* or the *Imputed Payments approach* but would not recommend the *Componentised Liability approach* or the *Deferred Gain approach* for reasons explained in this paper.

Committee members' views

32. Many Committee members said the *Expected Payments approach* is conceptually better than the other three approaches. A few of these members supported this approach because they view it as acceptable until such time that the IASB might reconsider the sale and leaseback requirements holistically.

33. A few Committee members expect that neither a seller-lessee nor a buyer-lessor would enter into these arrangements without a reasonable expectation of the future leaseback payments (and the rate of return). They therefore did not have the same practical concerns about the *Expected Payments approach* as some respondents to the Exposure Draft. One Committee member explained that, even though a seller-lessee may be able to make a reasonable estimate, it does not remove concerns about measurement uncertainty (see paragraph 23 above) because the seller-lessee's estimate may still be subject to significant risk of variability.

34. A few Committee members questioned whether the IASB should prescribe a particular approach to subsequent measurement. As an alternative, they suggested that the IASB offer, as examples, approaches that would address the risk the proposals aimed to address (see paragraph 18 of this paper) and then permit a seller-lessee to choose which approach to apply to meet that objective.

35. A few members said both the *Componentised Liability approach* and *Deferred Gain approach* have some merit, due to their practicality.

Population of transactions

36. In the light of concerns raised by respondents to the Exposure Draft, we presented to the Committee two possible ways to narrow the scope of application of any new requirements:

    (a) the new requirements could apply only to sale and leaseback transactions with variable payments not based on an index or rate; or

    (b) the new requirements could apply only to sale and leaseback transactions for which the initial measurement of the leaseback liability applying paragraph 100(a) of IFRS 16 differs materially from the initial measurement of that liability applying paragraphs 26-28 of IFRS 16.

Committee members' views

37. Many Committee members supported narrowing the scope of any new requirements to a subset of sale and leaseback transactions. A few members said a narrower scope would be needed only if the IASB specifies an approach to subsequent measurement (as opposed to the IASB permitting seller-lessees to choose an approach—see paragraph 34 above).

38. A majority of members supporting a narrower scope supported application of any new requirements to sale and leaseback transactions with variable payments not based on an index or rate.

Staff analysis and recommendations

39. Paragraphs 40–69 of the paper set out our recommendations on how to proceed on the project by analysing:

    (a) the proposals in the Exposure Draft we recommend the IASB retains (paragraphs 40–44); and

    (b) the proposals in the Exposure Draft we recommend the IASB changes (paragraphs 45–69).

Proposals we recommend the IASB retains

40. We recommend the IASB retains the following proposals in the Exposure Draft:

    (a) to clarify that the leaseback liability is a liability to which IFRS 16 applies;

    (b) to not change the initial measurement requirements in paragraph 100(a) of IFRS 16 for the right-of-use asset and the gain or loss arising from the sale and leaseback;

    (c) to clarify that a seller-lessee subsequently measures the right-of-use asset arising from the leaseback applying paragraphs 29–35 of IFRS 16; and

    (d) to include an illustrative example of a sale and leaseback transaction with variable payments.

41. The recommendations in paragraph 40(a), (c) and (d) were largely supported by respondents to the Exposure Draft—respondents either generally agreed with them[5] or did not comment. Our recommendation in paragraph 40(b) sets the 'framework' or 'project boundary' within which we developed the recommendations analysed in the rest of the paper.

42. Although raising concerns about the measurement requirements (see paragraph 23 of this paper), many respondents supported the requirement in paragraph 100(a) of IFRS 16 to limit the amount of the gain or loss recognised on a sale and leaseback transaction to only the portion that relates to the rights transferred to the buyer-lessor. The most common reason respondents cited was that this treatment reflects the economics of a sale and leaseback transaction.

43. However, some respondents shared the view expressed in AV3 of the Alternate View; they said a seller-lessee should recognise the full amount of the gain or loss to the extent the leaseback payments include variable payments that do not meet the definition of lease payments in IFRS 16. The IASB did not reconsider the initial measurement requirements for sale and leaseback transactions already in IFRS 16 as part of this project and, thus, proposed no change to them. Changing the sale and leaseback requirements already in IFRS 16 would, in our view, require a holistic

[5] With respect to the illustrative example proposed, a few respondents suggested some changes to the example while a few others requested more examples.

consideration of the accounting for sale and leaseback transactions—a consideration that we recommend not take place before the Post-implementation Review of IFRS 16. We therefore recommend in paragraph 40(b) that the IASB not change the initial measurement requirements in paragraph 100(a) of IFRS 16.

44. The *Deferred Gain approach* would modify the current requirements in paragraph 100(a) of IFRS 16 related to the initial measurement of the right-of-use asset arising from a leaseback and would, therefore, move the project outside of the IASB's intended boundary. This approach would be a more significant change to the sale and leaseback requirements in IFRS 16 than proposed in the Exposure Draft and, for this reason, we think any consideration of this approach would be inappropriate before the Post-implementation Review of IFRS 16. The remainder of this paper, therefore, excludes the *Deferred Gain approach* as a possible way forward.

Proposals we recommend the IASB changes

45. We recommend the IASB changes the following proposals in the Exposure Draft:

<table>
<tr><th>Proposals in the Exposure Draft</th><th>Staff recommendations</th></tr>
<tr><td>-to require a seller-lessee to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by comparing the present value of the expected lease payments to the fair value of the asset sold.</td><td>-not to prescribe how, at the commencement date, a seller-lessee determines the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains.</td></tr>
<tr><td rowspan="2">-to specify the payments that comprise the expected lease payments and, with reference to these payments, add subsequent measurement requirements for the leaseback liability (Appendix B to this paper illustrates the mechanics of these proposals under the Expected Payment approach).</td><td>-to require the seller-lessee to subsequently measure the leaseback liability applying paragraphs 36–46 of IFRS 16.</td></tr>
<tr><td>-to specify, for the purposes of applying paragraphs 36–46, the term 'lease payments' may not be as defined in Appendix A to IFRS 16. Instead, the seller-lessee would apply the term 'lease payments' or 'revised lease payments' in such a manner that it does not recognise any amount of the gain or loss that</td></tr>
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	relates to the right of use retained to the extent that the right of use is retained.

46. In developing our recommendations in paragraph 45 above, we analysed:

(a) the main matters respondents raised (paragraphs 47–49);

(b) a matrix of the possible alternative solutions (paragraphs 50–62); and

(c) how our recommendations could be implemented (paragraphs 63–69).

Analysis of the main matters respondents raised

47. A large majority of respondents disagreed with, or expressed conceptual and practical concerns about, the differing treatment of variable lease payments when measuring a leaseback liability compared with the measurement of other lease liabilities:

(a) conceptually, many respondents questioned the basis for the difference in the measurement of leaseback liabilities and other lease liabilities while others commented that this difference in measurement would reduce comparability and understandability for users of financial statements.

(b) many respondents disagreed with the use of expected lease payments—which would include expectations of (i) variable payments linked to future performance or use of the underlying asset, and (ii) future changes in payments resulting from changes in the reference index or rate for variable payments that depend on an index or rate—because they said it would introduce a high level of measurement uncertainty. They said this would be the case, in particular, for long-term leasebacks, assets for which limited historical information is available and—for variable payments that depend on an index or rate—where the relevant macroeconomic information is not readily available.

48. Having considered these comments, we note that there are reasons to support retaining the proposals in the Exposure Draft set out in paragraph 45 above, including:

(a) the proposals would not *create* a difference in the measurement of leaseback liabilities and other lease liabilities; the requirements in IFRS 16 already include this difference. The question the proposals aimed to address is how to *subsequently measure* the liability that arises in the sale and leaseback transaction *when* the amount of that liability on initial recognition differs from the initial measurement of other lease liabilities.

(b) the IASB decided to exclude variable payments linked to future performance or use of an underlying asset from the measurement of lease liabilities because of concerns about the high level of measurement uncertainty that would result from including them *and* the high volume of leases held by some lessees. The IASB's explanation in paragraph BC169 of IFRS 16 therefore refers not to the potential measurement uncertainty for one or two leases, but to that potential uncertainty for a high volume of leases. Feedback received (see paragraphs 26(a) and 28 of this paper) confirmed seller-lessees do not enter into high volumes of sale and leaseback transactions. In this respect, we view the practical considerations for leases unrelated to a sale and leaseback transaction as different from sale and leaseback transactions.

(c) in paragraph BC19 of the Exposure Draft, the IASB observed that seller-lessees would need to have access to information that would enable them to reasonably estimate the expected lease payments to assess whether to enter into the transaction and the price at which to enter into it. Feedback received did not provide evidence that this observation was incorrect (see paragraphs 26(b) and 33). In addition, we would expect it to be unusual for a buyer-lessor to agree to buy an asset, and then lease it back to the seller-lessee for any significant period of time in exchange for variable payments for which there is significant risk of variability in payments.

(d) some respondents supported the proposals and said prescribing a single method would bring consistency, clarity, and comparability to the measurement of the right-of-use asset and leaseback liability for transactions that are often individually of high value and highly structured.

49. With all of that said, we think the following indicate a need to consider whether to change some aspects of the proposals. We have considered these matters in developing our recommendations:

(a) Feedback received suggested that leaseback terms could be long (for example, 20-30 years). This might be case, in particular, for leasebacks of land or buildings with payments that depend on an index or rate. In these cases, it may be difficult to estimate payments over the leaseback term if relevant macroeconomic information is not readily available.

(b) The need for subsequent measurement requirements (see paragraph 17) is not the same for sale and leaseback transactions with variable payments based on an index or rate. IFRS 16 requires a lessee to include in the measurement of lease liabilities variable payments based on an index or rate; the Standard therefore already has subsequent measurement requirements for liabilities recognised when lease payments are variable depending on an index or rate. Although application of the sale and leaseback requirements in paragraph 100(a) of IFRS 16 could result in the initial recognition and measurement of a leaseback liability at an amount that differs from the initial measurement of a lease liability unrelated to a sale and leaseback transaction, feedback did not indicate that this is a significant practical concern.

(c) The proposals aimed to prevent the seller-lessee from inadvertently recognising a gain or loss on the right of use the seller-lessee retains solely because of a remeasurement, and did so by proposing prescriptive measurement requirements for the leaseback liability. In the light of the feedback received, it is worth considering whether the IASB could achieve its objective in a way that is less prescriptive.

The possible alternative solutions

50. Considering the feedback received, we developed the following matrix of alternative solutions. The underlined text indicates the alternatives within the matrix that represent our recommendations in paragraph 45 of this paper. In the paragraphs that follow, we discuss the three factors that make up the matrix—the alternative standard-

setting options, the approaches to subsequent measurement and the scope of the proposals.

(1) Alternative standard-setting options / **(3) Scope of transactions**	*Prescribe subsequent measurement requirements*	*Illustrate but do not mandate an approach to subsequent measurement*	*Prohibit the recognition of the gain or loss, without prescribing an approach to subsequent measurement*
All sale and leaseback transactions	**(2) Approaches to subsequent measurement:** • Expected Payments • Imputed Payments • Componentised Liability		
Sale and leaseback transactions with variable payments that do not depend on an index or a rate			

Alternative standard-setting options

51. Committee members' views about the possible approaches to subsequent measurement of the leaseback liability (see paragraphs 32–35 of this paper) helped us develop three alternatives to subsequent measurement requirements for the leaseback liability. The IASB could:

(a) prescribe subsequent measurement requirements. This alternative would either retain the proposals in the Exposure Draft, ie prescribe the *Expected Payments approach*, or replace the proposals in the Exposure Draft with one or both of the variations to the *Imputed Payments approach*.

(b) offer as examples the *Expected Payment approach* and both variations to the *Imputed Payments approach*. The IASB would not mandate a particular approach.

(c) develop requirements that prohibit a seller-lessee from recognising any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained. This alternative would indirectly permit a seller-lessee to use, for example, either the *Expected Payments approach* or both variations to the *Imputed Payments approach* for subsequent measurement—these approaches would prevent the seller-lessee from inadvertently recognising an additional gain or loss on the sale and leaseback transaction solely because of a remeasurement of the leaseback liability.

52. Of these options, we consider two to be preferable to others:

(a) Retain the proposals in the Exposure Draft—ie the *Expected Payments approach*—but narrow the scope of application to only sale and leaseback transactions that include variable payments not based on an index or rate (paragraph 51(a)).

(b) Develop requirements that prohibit the recognition of any amount of the gain or loss that relates to the right of use retained (paragraph 51(c)).

Retain the proposals in the Exposure Draft with a narrower scope

53. The IASB could retain the proposals in the Exposure Draft for the reasons set out in paragraph 48 of this paper. We continue to agree with the IASB's explanation in paragraphs BC18-BC19 of the Exposure Draft that seller-lessees are typically in a different position from lessees that enter into a lease unrelated to sale and leaseback transactions—feedback received either confirmed the IASB's observations or provided no evidence to the contrary with respect to sale and leaseback transactions that include variable payments linked to future performance or use of the underlying asset.

54. However, we understand that for sale and leaseback transactions with variable payments that depend on an index or rate, leaseback terms might be long and therefore, in some situations, estimating those variable payments may be difficult (see paragraph 49(a)). We also note that there is less need for subsequent measurement requirements for these sale and leaseback transactions, as explained in paragraph 49(b) of this paper.

55. Consequently, we view retaining the proposals in the Exposure Draft but with a narrower scope as an option that would meet the IASB's objective, while taking into account feedback received.

Develop requirements that prohibit the recognition of a gain or loss

56. However, on balance, in our view the standard-setting option in paragraph 51(c) would best address the feedback received. This is because:

    (a) the requirements would clearly state the objective of any approach to subsequent measurement as opposed to only offering examples of approaches (paragraph 51(b)). It would also allow a seller-lessee to determine the appropriate approach to subsequent measurement for each sale and leaseback transaction, considering for example the level of uncertainty with respect to the leaseback payments to be made (see paragraphs 49(a)). There may be little difference in the outcomes of applying one approach versus another to particular sale and leaseback transactions, which indicates less need to develop requirements that would permit only one approach.

    (b) a seller-lessee may be able to use its accounting policy applicable to leases unrelated to a sale and leaseback transaction when the sale and leaseback includes leaseback payments that depend on an index or rate (see paragraph 13 and 49(b)). We would expect a seller-lessee to be able to do so (and thus meet the specified objective) for a leaseback for which the term is not long or the expected change in the index or rate is low (eg transactions entered into in a jurisdiction with low inflation).

Approaches to subsequent measurement

57. The *Expected Payment approach*, *Imputed Payments approach* and the *Componentised Liability approach* would each prohibit a seller-lessee from inadvertently recognising an additional gain or loss on a sale and leaseback transaction because of a modification or change in lease term (see the net effect on profit or loss presented in paragraph B16 in Appendix B to this paper).

58. However, in our view the *Componentised Liability approach* would not provide useful information to users of financial statements about expected future cash flows

arising from sale and leaseback transactions. Paragraphs B11–B15 of Appendix B discuss this in more detail. Considering our recommendation in paragraph 45, a seller-lessee would also be unable to apply the *Componentised Liability approach* (see paragraph 68).

59. Our recommendations would, therefore, permit the seller-lessee to use either the *Expected Payments approach* or both variations of the *Imputed Payments approach*.

Scope of the proposals

60. Finally, we considered whether to narrow the scope of application of any new requirements—paragraph 36 of this paper identifies two ways to do so.

61. Because we concluded that the best standard-setting option is the alternative in paragraph 51(c), we see no need to narrow the scope.

62. As noted in the paragraph 55, if the IASB were to decide to prescribe subsequent measurement requirements, then we would recommend narrowing the scope of the proposals to only sale and leaseback transactions that include variable payments not based on an index or rate.

How can our recommendations be implemented?

63. Our recommendations:

    (a) prohibit a seller-lessee from recognising any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained; and

    (b) permits a seller-lessee to use either the *Expected Payments approach* or both variations of the *Imputed Payments approach* for subsequent measurement.

64. In the absence of prescribed measurement requirements for the leaseback liability, we are of the view that the subsequent measurement requirements for lease liabilities already in IFRS 16 would allow a seller-lessee to implement the recommendations, with one change.

65. Almost all the subsequent measurement requirements in paragraphs 36–46 of IFRS 16 could be applied without a need for the seller-lessee to determine an approach to subsequent measurement for a leaseback liability. For example, in applying

paragraphs 36(a) and 38(a) of IFRS 16, a seller-lessee would increase the carrying amount of the liability to reflect interest on the leaseback liability using its incremental borrowing rate.

66. The requirement in paragraphs 36(b) of IFRS 16—to reduce the carrying amount of the liability to reflect the lease payments made (ie the lease payments that are included in the measurement of the liability)—would require the seller-lessee to determine an approach to subsequent measurement. A seller-lessee would be unable to apply the definition of lease payments in Appendix A to IFRS 16 for this purpose when the initial measurement of the leaseback liability applying paragraph 100(a) of IFRS 16 differs from initial measurement applying paragraphs 26-27 of IFRS 16. In that situation, a seller-lessee would be required to determine what ‘lease payments’ are within its approach to subsequent measurement of the leaseback liability. The seller-lessee would similarly need to determine what ‘revised lease payments’ are when remeasuring the leaseback liability (for example, if the leaseback contract is modified).

67. To put the recommendations in paragraph 63 into practice, we therefore concluded that our recommendations should:

(a) require the seller-lessee to apply paragraphs 36–46 of IFRS 16 when subsequently measuring the leaseback liability; and

(b) clarify that—to enable it to apply the abovementioned paragraphs—the seller-lessee would need to apply the term ‘lease payments’ or ‘revised lease payments’ in a manner that meets the objective within the requirements.

68. Considering our recommendation in paragraph 67(a) above, a seller-lessee would be unable to determine an approach to subsequent measurement similar to the *Componentised Liability approach* because the requirements in paragraph 36-46 of IFRS 16 neither require nor permit any componentisation of the leaseback liability. For example, paragraph 37 of IFRS 16 would require interest on the leaseback liability to be a “constant periodic rate of interest on the remaining balance of the [singular] lease liability” (emphasis added).

69. The recommendation in paragraph 67(b) above would allow a seller-lessee to apply the term ‘lease payments’ in such a way that it results in an approach to subsequent measurement that is like the *Expected Payments approach* or both variations of the *Imputed Payments approach*. For example:

(a) when the seller-lessee—in applying paragraph 100(a) of IFRS 16—uses the present value of the expected lease payments to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained, it could apply the term ‘lease payments’ as the expected lease payments determined at the commencement date or, if applicable, a remeasurement date; and

(b) in other cases, the seller-lessee could apply the term ‘lease payments’ as the payments over the leaseback term that, when discounted, result in the carrying amount of the leaseback liability at the commencement date.

Questions for the IASB

Does the IASB agree with the recommendations set out in this paper, specifically:

(a) the recommendations that it retains the proposals in the Exposure Draft set out in paragraph 40 in the paper?

(b) the recommendations that it changes the proposals in the Exposure Draft in the manner set out in paragraph 45 in the paper?

Appendix A—Agenda Decision June 2020

A1. This appendix reproduces the Agenda Decision *Sale and Leaseback with Variable Payments* published in June 2020.

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), with (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 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 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).

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*CU250,000*	
Cr. PPE		*CU1,000,000*
Cr. 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— Illustration of approaches to subsequent measurement

B1. This appendix illustrates the four approaches to subsequent measurement of the leaseback liability described in paragraph 14 of the paper by:

(a) describing and illustrating the two approaches permitted within our recommendations: the *Expected Payments approach* and the *Imputed Payment approach* (paragraphs B4–B7);

(b) describing and illustrating the two approaches not permitted within our recommendations: the *Componentised Liability approach* and the *Deferred Gain approach* (paragraphs B8–B10);

(c) explaining why the *Componentised Liability approach* would not, in our view, provide useful information (paragraphs B11–B15); and

(d) presenting all four approaches together (paragraph B16).

B2. The *Expected Payments approach* reflects the proposals in the Exposure Draft. We indicate in paragraph B4 where our recommendations in paragraphs 40 and 45 might change the proposals in the Exposure Draft.

Illustrative example

B3. To illustrate and compare the four approaches to subsequent measurement, this appendix uses the following illustrative example[6]:

[6] The example is the same as that used in Part 1 to Example 25 *Sale and leaseback transaction with variable lease payments* proposed in the Exposure Draft. Amounts are rounded to the nearest CU'000.

Illustrative Example - Sale and leaseback transaction with variable payments linked to future performance of the underlying asset

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of CU1,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for five years. The contract requires Seller-lessee to make annual payments calculated as 7% of Seller-lessee's revenue generated using the building during each of the five years, with an annual minimum payment of CU85 in each year (the payments are at market rates). The expected lease payments and the actual lease payments for each of the five years are:

	Expected lease payments	**Actual lease payments**
Year	**CU**	**CU**
1	91	92
2	98	96
3	102	96
4	104	104
5	105	104

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15. Accordingly, Seller-lessee accounts for the transaction as a sale and leaseback.

The interest rate implicit in the lease cannot be readily determined. Seller-lessee's incremental borrowing rate is 3.5% per year. The present value of the expected lease payments (discounted at 3.5% per year) is CU450.

The proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee (calculated using the present value of the expected lease payments or another method) amounts to 25%.

The two approaches permitted within in our recommendations

Description

B4. This table sets out the *Expected Payments approach* and the two variations of the *Imputed Payment approach* by describing the initial and subsequent measurement of the leaseback liability applying each approach. The text in grey blocks indicates how our recommendations in paragraphs 40 and 45 of this paper might change the proposals in the Exposure Draft:

	Expected Payments	**Imputed Payments**
Initial measurement		
The method to determine the proportion that relates to the right of use retained is…	prescribed as the present value of expected lease payments compared to the fair value of the asset not prescribed—entities continue to use the method applied in accordance with paragraph 100(a) of IFRS 16	not prescribed—entities continue to use the method applied in accordance with paragraph 100(a) of IFRS 16
The initial measurement of the leaseback liability is determined as…	the present value of the expected lease payments, discounted using the rate in paragraph 26 of IFRS 16 a consequence of how the right-of-use asset is measured and the gain or loss on sale determined.	a consequence of how the right-of-use asset is measured and the gain or loss on sale determined. This amount would represent, or be expected to be similar to, the present value of the expected lease payments
Subsequent measurement		
The leaseback liability is increased by…	interest on the leaseback liability using the discount rate specified in paragraph 37 of IFRS 16	
The leaseback liability is reduced by…	the expected lease payments for the reporting period as determined at the commencement date or, if applicable, a remeasurement date—with any difference compared to the actual lease payments recognised in profit or loss	imputed payments determined as (i) equal periodic payments or (ii) periodic payments based on the expected profile of the leaseback payments over the lease term that, when discounted, result in the carrying amount of the leaseback liability at the commencement date or, if applicable, a remeasurement date—with any difference

	the payments the seller-lessee determines to apply the term 'lease payments' or 'revised lease payment' in such a manner that it does not recognise any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained—which could be the present value of the expected lease payments at the commencement date	compared to the actual lease payments recognised in profit or loss
The leaseback liability is remeasured…	only when there is a change in lease term or a lease modification when remeasurement is required by paragraphs 36–46 of IFRS 16	Originally this aspect was not developed. Our recommendations would require remeasurement when remeasurement is required by paragraphs 36–46 of IFRS 16.
The leaseback liability is remeasured to…	the present value of the expected payments at the remeasurement date the present value of the payments the seller-lessee determines to apply the term 'lease payments' or 'revised lease payment' in such a manner that it does not recognise any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained—which could be the present value of the expected lease payments at the remeasurement date	Originally this aspect was not developed. Our recommendations would require the seller-lessee to apply the terms 'lease payments' or 'revised lease payment' in such a manner that it does not recognise any amount of the gain or loss that relates to the right of use retained to the extent that the right of use is retained.

Mechanics

B5. This table illustrates the two approaches using the illustrative example set out in paragraph B3 above:

Expected Payments	**Imputed Payments**
At the commencement date, Seller-lessee accounts for the transaction as follows:	
Cash CU1,800 Right-of-use asset CU250[a] Building CU1,000 Leaseback liability CU450[b] Gain on sale CU600[c] *Calculations* [a] 1,000 x (450 ÷ 1,800) [b] present value of expected payments, discounted at 3.5% [c] (1,800 - 1,000) x ((1,800 – 450) ÷ 1,800)	Cash CU1,800 Right-of-use asset CU250[a] Building CU1,000 Leaseback liability CU450[b] Gain on sale CU600[c] *Calculations* [a] 1,000 x 25% (this % is assumed for ease of analysis—it may differ if a method other than the present value of expected lease payments is used to estimate the proportion that relates to the right of use retained) [b] a consequence of how the right-of-use asset is measured and the gain or loss on sale determined [c] (1,800 - 1,000) x (100% - 25%)
In year 1, Seller-lessee accounts for the movement in the leaseback liability as follows:	
Interest expense CU16[d] Leaseback liability CU16 Leaseback liability CU91[e] Profit or loss CU1[f] Cash CU92[g] *Calculations* [d] interest on the liability at 3.5% [e] the expected payment for year 1 as determined at the commencement date [f] 92 – 91 [g] the actual lease payment for year 1	Interest expense CU16[d] Leaseback liability CU16 Leaseback liability CU100[e] Profit or loss CU8[f] Cash CU92[g] *Calculations* [d] interest on the liability at 3.5% [e] assume variation (i): the equal periodic payment that, when discounted at 3.5%, results in 450 [f] 100 – 92 [g] the actual lease payment for year 1

B6. This table shows the effect of the leaseback on Seller-Lessee's profit or loss over the term of the leaseback. The Year 1 effect excludes the gain on sale recognised of CU600 because that gain is the same applying both approaches[7].

	1	**2**	**3**	**4**	**5**	**Total**
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual payments[1]	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Amount of gain not recognised[1]						*200*
Profit or loss						
Expected Payments						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	(1)	2	6	-	1	8
Sub-total	*(51)*	*(48)*	*(44)*	*(50)*	*(49)*	*(242)*
Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Total	**(67)**	**(61)**	**(54)**	**(57)**	**(53)**	**(292)**
Imputed Payments						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	8	4	4	(4)	(4)	8
Sub-total	*(42)*	*(46)*	*(46)*	*(54)*	*(54)*	*(242)*
Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Total	**(58)**	**(59)**	**(56)**	**(61)**	**(58)**	**(292)**

[1] Actual lease payments and the amount of the gain on sale not recognised by Seller-lessee are provided for ease of reference.

[2] The lease expense represents the difference between the actual lease payments and the amount by which the leaseback liability has been reduced for the period.

[7] The amount of the gain could differ if, applying the *Imputed Payments approach*, Seller-lessee uses an alternative method to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained when applying paragraph 100(a) of IFRS 16.

B7. This table shows the 'run-off' of the carrying amounts of the right-of-use asset and leaseback liability in Seller-lessee's statement of financial position over the term of the leaseback.

	1	**2**	**3**	**4**	**5**
	CU	CU	CU	CU	CU
Expected Payments					
Right-of-use	200	150	100	50	-
Leaseback liability	375	290	198	101	-
Imputed Payments					
Right-of-use	200	150	100	50	-
Leaseback liability	366	279	189	96	-

The two approaches not permitted within our recommendations

Description

B8. This table describes the initial and subsequent measurement of the leaseback liability, as well as the initial measurement of the right-of-use asset, applying the *Componentised Liability approach* and the *Deferred Gain approach*:

	Componentised Liability	**Deferred Gain**
Initial measurement		
The method to determine the proportion that relates to the right of use retained is…	not prescribed—entities continue to use the method applied in accordance with paragraph 100(a) of IFRS 16	
The initial measurement of the right-of-use asset is determined as…	consistent with paragraph 100(a) of IFRS 16, the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains	the amount of the initial measurement of the lease liability and an estimate of decommissioning costs to be incurred by the lessee (similar to right-of-use assets arising from leases unrelated to a sale and leaseback transaction)

The gain or loss on sale recognised is determined as…	consistent with paragraph 100(a), the amount of any gain or loss that relates to the rights transferred to the buyer-lessor	
The initial measurement of the lease liability is determined as…	consistent with paragraph 26 of IFRS 16, the present value of the lease payments (as defined in Appendix A to IFRS 16), eg no liability is recognised for variable payments linked to future performance or use of the underlying asset	
The balancing figure is recognised as a…	liability in the statement of financial position. This amount would represent, or be expected to be similar to, the present value of the leaseback payments not included in the measurement of the lease liability.	deferred gain in the statement of financial position. This amount would represent the amount of the overall gain or loss on sale not recognised at the commencement date.
Subsequent measurement		
The lease liability is…	measured as specified in paragraphs 36–46 of IFRS 16	
The balancing item is…	amortised to profit or loss over the lease term. Different amortisation methods may be appropriate. Some suggested a straight-line basis, unless another method better reflects the economics of the transaction. As noted in paragraph 26(d) of this paper, respondents had not developed their alternative solutions to consider, for example, presentation of the amortisation amount in the statement of profit or loss.	

Mechanics

B9. This table illustrates the two approaches using the illustrative example set out in paragraph B3 above:

Componentised Liability			**Deferred gain**		
At the commencement date, Seller-lessee accounts for the transaction as follows:					
Cash	CU1,800		Cash	CU1,800	
Right-of-use asset	CU250[a]		Right-of-use asset	CU385[a]	
Building		CU1,000	Building		CU1,000
Leaseback liability			Lease liability		CU385[b]
- lease liability		CU385[b]	Gain on sale		CU600[c]
- other component		CU65	Deferred gain		CU200[d]
Gain on sale		CU600[c]			

Calculations [a] 1,000 x 25% (this % is assumed for ease of analysis) [b] present value of annual minimum lease payments of CU85, discounted at 3.5% [c] (1,800 - 1,000) x ((1,800 – 450) ÷ 1,800)	*Calculations* [a] the amount of the initial measurement of the lease liability [b] present value of annual minimum lease payments of CU85, discounted at 3.5% [c] (1,800 - 1,000) x (100% - 25%) [d] 800 – 600
In year 1, Seller-lessee accounts for the movement in the items as follows:	
Interest expense CU13[d] Leaseback liability – lease liability CU13 Leaseback liability – other component CU13[e] Profit or loss CU13 Leaseback liability – lease liability CU85 Profit or loss CU7[f] Cash CU92[g] Depreciation CU50[h] Right-of-use asset CU50	Interest expense CU13[d] Lease liability CU13 Deferred gain CU40[e] Profit or loss CU40 Lease liability CU85 Profit or loss CU7[f] Cash CU92[g] Depreciation CU77[h] Right-of-use asset CU77
Calculations [d] interest on the lease liability at 3.5% [e] 65 ÷ 5 [f] the payment not included in the measurement of the lease liability [g] the actual lease payments for year 1 [h] 250 ÷ 5	*Calculations* [d] interest on the lease liability at 3.5% [e] 200 ÷ 5 [f] the payment not included in the measurement of the lease liability [g] the actual lease payments for year 1 [h] 385 ÷ 5

B10. This table shows the effect of the leaseback on Seller-Lessee's profit or loss over the term of the leaseback. The Year 1 effect excludes the gain on sale of CU600 because this amount is the same applying both approaches. The balancing item under both approaches is amortised on a straight-line basis over the term of the leaseback.

	1	2	3	4	5	Total
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual payments[1]	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Profit or loss						
Componentised Liability						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	(7)	(11)	(11)	(19)	(19)	(67)
Amortisation	13	13	13	13	13	65
Sub-total	*(44)*	*(48)*	*(48)*	*(56)*	*(56)*	*(252)*
Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Total	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
Deferred Gain						
Depreciation	(77)	(77)	(77)	(77)	(77)	(385)
Lease expense[2]	(7)	(11)	(11)	(19)	(19)	(67)
Amortisation	40	40	40	40	40	200
Sub-total	*(44)*	*(48)*	*(48)*	*(56)*	*(56)*	*(252)*
Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Total	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**

[1] Actual lease payments are provided for ease of reference.

[2] The lease expense represents the payments not included in the measurement of the lease liability.

Would the Componentised Liability approach *provide useful information?*

B11. The *Componentised Liability approach* retains the measurement of the right-of-use asset as specified in paragraph 100(a) of IFRS 16. Because the approach would retain those initial measurement requirements (and, in effect, would not remeasure the right-of-use asset at the commencement date), the liability recognised by the seller-lessee at the commencement date would *not* include any amount of deferred gain or loss. Instead, that overall leaseback liability would represent—or be expected to be similar to—the present value of expected payments to be made by the seller-lessee over the term of the leaseback. Consequently, the 'other component' of the leaseback liability would represent—or be expected to be similar to—the present value of expected payments not included in the measurement of the lease liability.

B12. For this reason, in our view it would be inappropriate to amortise the 'other component' of the leaseback liability on a straight-line basis or any other basis that does not result in the recognition of interest on that part of the liability. IFRS 16 treats lease liabilities as 'debt-like' liabilities—a sale and leaseback transaction similarly gives rise to a 'debt-like' liability. Consequently, an approach to subsequent measurement that recognises interest on the leaseback liability separately from depreciation of the right-of-use asset would, in our view, best reflect that the liability that arises from a sale and leaseback transaction is a 'debt-like' liability.

B13. We also think amortising the 'other component' of the leaseback liability could be misleading for users of financial statements, in particular if that amortisation were mistakenly viewed as the release of a deferred gain or some other form of income for the seller-lessee.

B14. Our concern in this respect is best illustrated using an example in which the leaseback payments are fully variable linked to future performance or use of the underlying asset. So, to illustrate, the following table sets out the amounts recognised in profit or loss applying the *Componentised Liability approach* using the illustrative example set out in paragraph B3, but with one change to the facts—assume there are no minimum annual payments. The leaseback payments are fully variable, calculated as 7% of Seller-lessee's revenue generated using the building for each of the five years of the leaseback. In that case, the lease liability would be CU0 and the 'other component' of the leaseback liability would be CU450 at the commencement date.

	1	2	3	4	5	Total
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual lease payments	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Profit or loss						
Componentised Liability						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense	(92)	(96)	(96)	(104)	(104)	(492)
Amortisation	90	90	90	90	90	450
Sub-total	*(52)*	*(56)*	*(56)*	*(64)*	*(64)*	*(292)*
Interest expense	(0)	(0)	(0)	(0)	(0)	(0)
Total	**(52)**	**(56)**	**(56)**	**(64)**	**(64)**	**(292)**

B15. In this example, the amortisation of the ‘other component’ of the leaseback liability would total CU450 over the term of the leaseback. Considered together with the gain on sale recognised at the commencement date of CU600, the total credit recognised in profit or loss over the term of the leaseback is CU1,050 (CU450 + CU600)—this would be CU250 (CU1,050 – CU800) more than the overall gain on sale of the building of CU800. In our view, it would be difficult for users of financial statements to understand what the amortisation of CU90 in each year represents.

Presentation of all four approaches discussed in this paper

B16. This table sets out, side by side, all four approaches discussed in this paper. All of the numbers illustrate application of the approaches to the illustrative example in paragraph B3 above.

Journal entry at the commencement date			*Profit or loss*	**1**	**2**	**3**	**4**	**5**	**Tot.**
Expected Payment approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	(1)	2	6	-	1	8
Building		CU1,000	Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Leaseback liability		CU450	**Total**	**(67)**	**(61)**	**(54)**	**(57)**	**(53)**	**(292)**
Gain on sale		CU600							
Imputed Payment approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	8	4	4	(4)	(4)	8
Building		CU1,000	Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Leaseback liability		CU450	**Total**	**(58)**	**(59)**	**(56)**	**(61)**	**(58)**	**(292)**
Gain on sale		CU600							
Componentised Liability approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	(7)	(11)	(11)	(19)	(19)	(67)
Building		CU1,000	Amortisation	13	13	13	13	13	65
Leaseback liability			Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
- lease liability		CU385	**Total**	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
- other component		CU65							
Gain on sale		CU600							
Deferred Gain approach									
Cash	CU1,800		Depreciation	(77)	(77)	(77)	(77)	(77)	(385)
Right-of-use asset	CU385		Lease expense	(7)	(11)	(11)	(19)	(19)	(67)
Building		CU1,000	Amortisation	40	40	40	40	40	200
Lease liability		CU385	Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Gain on sale		CU600	**Total**	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
Deferred gain		CU200							