IFRS

STAFF PAPER

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IASB® meeting

Project	**Lease Liability in a Sale and Leaseback**
Paper topic	Feedback Summary—Background and Overview

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Introduction and Purpose

1. In November 2020, the International Accounting Standards Board (Board) published Exposure Draft *Lease Liability in a Sale and Leaseback,* which proposes to amend IFRS 16 *Leases*. The proposals:

   (a) specify the method a seller-lessee uses in initially measuring the right-of-use asset and liability arising in a sale and leaseback transaction in which, applying paragraph 99[1] of IFRS 16, the transfer of the asset satisfies the requirements to be accounted for as a sale of the asset; and

   (b) how the seller-lessee subsequently measures that liability.

2. The purpose of Agenda Papers 12C–12E is to provide the Board with a summary of feedback on the Exposure Draft. We are not asking the Board to make any decisions at this meeting. However, to help us develop papers for future Board meetings, we will ask Board members for their initial thoughts on the feedback and to comment on any feedback that was unclear, that provides new information or that needs further research.

[1] Paragraph 7 of this paper reproduces paragraph 99.

Structure of the Papers

3. This paper includes:

   (a) background (paragraphs 7–16);

   (b) overview of feedback (paragraphs 17–21);

   (c) next steps (paragraph 22); and

   (d) question for the Board.

4. There is one appendix to this paper: Appendix A—Agenda Decision June 2020.

5. Agenda Papers 12D–12E for this meeting provide more information on the feedback:

   (a) Agenda Paper 12D summarises (i) feedback on the treatment of variable lease payments when measuring a liability arising from a sale and leaseback transaction[2] compared with other lease liabilities; and (ii) respondents' suggestions on the possible ways forward; and

   (b) Agenda Paper 12E summarises feedback on other aspects of the proposals, including the proposed transition requirements.

6. The Agenda Papers use the following terms to describe the extent to which feedback was provided by respondents:

Term	*Extent of response among respondents*
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

[2] For simplicity, we use the term 'leaseback liability' within Agenda Papers 12C to 12E to refer to a liability arising from a sale and leaseback transaction.

Background

Requirements in IFRS 16

7. IFRS 16 includes specific requirements for sale and leaseback transactions. Paragraphs 98–100(a) of IFRS 16 state:

> 98 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.
>
> 99 An entity shall apply the requirements for determining when a performance obligation is satisfied in IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset.
>
> 100 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.

8. Paragraph BC266 of IFRS 16 explains that although a 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 transferred all the rights embedded in legal ownership of the asset. The seller-lessee has transferred only its interest in the value of the asset at the end of the leaseback and retained its right to use the asset for the period of the lease. The Board therefore concluded that recognising only the amount of the gain or loss that relates to the rights transferred to the buyer-lessor—and thus not recognising the amount of the gain or loss that relates to the rights retained by the seller-lessee—appropriately reflects the economics of a sale and leaseback transaction.

Agenda decision

9. The IFRS Interpretations Committee (Committee) received a request about a sale and leaseback transaction that includes variable lease payments that depend on the seller-lessee's revenue generated using the underlying asset, and in which applying paragraph 99 of IFRS 16, the transfer of the asset satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale of the asset. The request asked how the seller-lessee measures the right-of-use asset arising from the leaseback and, thus, determines any gain or loss to recognise at the date of the transaction.

10. The Committee concluded that the requirements in paragraph 100 of IFRS 16 provide an adequate basis for a seller-lessee to determine the accounting for the sale and leaseback transaction at the date of the transaction and published an Agenda Decision in June 2020 explaining this conclusion. Appendix A to this paper reproduces the Agenda Decision.

The proposed amendments

11. The Committee's discussions highlighted the improvements that could be made to IFRS 16 by adding subsequent measurement requirements for sale and leaseback transactions. The requirements that apply on initial recognition of a lease that is part of a sale and leaseback transaction differ from those that apply on initial recognition of a lease that is unrelated to such transactions. 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 payments for the lease include variable lease payments that are excluded from the measurement of a lease liability[3].

12. The Board was informed that diverse views on how to subsequently measure the leaseback liability could lead to material differences in the financial statements of seller-lessees that enter into such transactions. Sale and leaseback transactions often involve the sale of high-value items of property, plant and equipment with a long

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[3] Agenda Papers 12C–12E use the term 'lease liability' to refer to the liability that arises from a lease unrelated to a sale and leaseback transaction.

economic life. Therefore, the accounting for such transactions can have a long-term material effect on the financial position of seller-lessees. It is therefore important for users of financial statements that seller-lessees apply the requirements in IFRS 16 consistently to sale and leaseback transactions, both on initial recognition and subsequently. Consequently, the Board decided to propose a narrow-scope amendment to IFRS 16.

13. The Exposure Draft proposes:

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

(b) in applying paragraph 100(a) of IFRS 16, 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 therefore initially measure the leaseback liability at the present value of the expected lease payments. (See the illustrative example in the Agenda Decision reproduced in Appendix A to this paper.)

(c) to specify the payments that comprise the expected lease payments. These differ from lease payments as defined in Appendix A to IFRS 16 and included in the measurement of lease liabilities. In particular, expected lease payments would include expectations of (i) variable lease payments linked to the future performance or use of an underlying asset, and (ii) future changes in payments resulting from changes in the reference index or rate for variable lease payments that depend on an index or rate.

(d) to add subsequent measurement requirements for the leaseback liability (see paragraphs 15–16).

(e) that a seller-lessee apply the proposed amendments retrospectively to sale and leaseback transactions entered into after the date of initial application of IFRS 16. However, if retrospective application to a sale and leaseback transaction that includes variable lease payments is possible only with the use of hindsight, the seller-lessee would determine the expected lease payments for that transaction at the beginning of the annual reporting period in which it first applies the amendments.

14. The Exposure Draft also proposes to add an example to the illustrative examples accompanying IFRS 16 to illustrate how a seller-lessee accounts for a sale and leaseback transaction that includes variable lease payments linked to future performance or use of an underlying asset.

Subsequent measurement

15. Consistent with its view of the economics of the transaction (as explained in paragraph 8 of this paper), the Board concluded that seller-lessees should subsequently measure the leaseback liability in a way that would prevent the recognition of a gain or loss on the right of use the seller-lessee retains via the leaseback. The Board therefore decided to propose subsequent measurement requirements for the leaseback liability that are consistent with its initial measurement, and the Board's objective and rationale when it developed the sale and leaseback requirements in IFRS 16.

16. Accordingly, the proposed amendments specify that when subsequently measuring the leaseback liability:

    (a) the seller-lessee would reduce the carrying amount to reflect the expected lease payments for the reporting period as determined at the commencement (or remeasurement) date—that is, the carrying amount would be reduced to reflect both the amount of those payments and when they were expected to be paid as at the commencement (or remeasurement) date.

    (b) the seller-lessee would recognise in profit or loss any difference between those expected lease payments and the actual payments made for the lease. The seller-lessee would recognise any shortfalls in the actual payments made (or recoveries of shortfalls) as an adjustment to the carrying amount of the leaseback liability—as a result, the carrying amount of the leaseback liability would continue to include payments due until those payments are made.

    (c) in remeasuring the leaseback liability to reflect a change in the lease term or a lease modification (that is not accounted for as a separate lease), the revised lease payments (as described in paragraphs 40(a) and 45 of

IFRS 16) would be the revised expected lease payments at the date of remeasurement. This proposal would result in subsequently measuring the leaseback liability on the same basis as its initial measurement in these circumstances. Consistent with the accounting for leases unrelated to sale and leaseback transactions, the seller-lessee would adjust the right-of-use asset for any remeasurement of the leaseback liability.

(d) the seller-lessee would not remeasure the lease liability to reflect a change in future variable lease payments other than as specified for changes in the lease term or lease modifications.

Overview of feedback

17. The Board received 87 comment letters. The chart below groups the responses by type of respondent and geographical region. The response to the proposals and the matters raised by respondents were generally consistent across types of respondents and geographical regions, however we have highlighted trends to the extent any have been identified and are considered relevant.

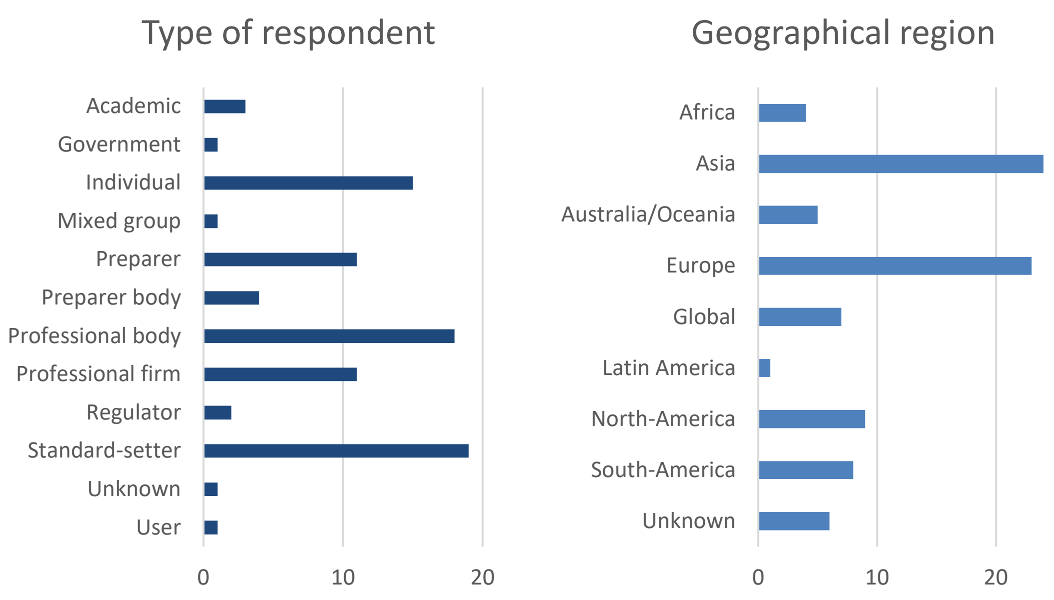

Chart 1— Response to proposals by type of respondent and geographical region

18. While a few respondents agree with the proposed amendments, most respondents disagree with, or express concerns about, aspects of the proposals.

19. Almost all respondents comment on the differing treatment of variable lease payments when measuring a leaseback liability compared with other lease liabilities. Many respondents say including variable lease payments in leaseback liabilities raises several practical and conceptual challenges. A few respondents disagree with paragraph BC11 of the Exposure Draft (and the Committee's conclusion in the agenda decision set out in Appendix A) which explains how a seller-lessee—applying paragraph 100(a) of IFRS 16—measures the leaseback liability at the date of the transaction. Most respondents nonetheless agree that there is a need to amend IFRS 16 and enhance the measurement requirements for sale and leaseback transactions. Many respondents suggest possible ways forward, including alternative solutions to account for sale and leaseback transactions. Agenda Paper 12D provides more detail on these matters.

20. In addition:

(a) some respondents support the use of expected lease payments in determining the proportion of the carrying amount retained in paragraph 100(a) of IFRS 16, while others say it might not always be appropriate and could result in a high level of measurement uncertainty.

(b) some respondents disagree with limiting the remeasurement of the leaseback liability to only changes in lease term and lease modifications.

(c) some respondents suggest further clarifications in respect of some aspects of the proposals.

(d) most respondents agree with the proposed transition requirements. However, some respondents disagree and suggest permitting or requiring prospective application of the amendments.

21. Agenda Paper 12E provides more detail on the matters in paragraph 20.

Next steps

22. We plan to bring a paper to a future Board meeting analysing the feedback and providing recommendations on the project direction.

Question for the Board
Does the Board have any questions on the feedback as summarised in Agenda Papers 12C–12E and are there any topics that Board members would like more details on in future meetings?

Appendix A—Agenda Decision June 2020

A1. This appendix reproduces the Agenda Decision *Sale and Leaseback with Variable Payments (IFRS 16 Leases)* 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.