Purpose and overview

1. As discussed in Agenda Paper 12C for this meeting, this paper summarises:
   (a) respondents’ comments on the treatment of variable lease payments when measuring a leaseback liability compared with other lease liabilities (paragraphs 9–23); and
   (b) respondents’ suggestions on the possible ways forward, including alternative solutions (paragraphs 24–39).

2. Appendix A to this paper illustrates two of the main alternative solutions suggested by respondents.

Background

Requirements applying to lease liabilities

3. IFRS 16 requires a lessee to:
   (a) include in the measurement of a lease liability, variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date; and
(b) exclude from the measurement of a lease liability, variable lease payments linked to future performance or use of an underlying asset (that are not in-substance fixed payments). Paragraph BC168–BC169 of IFRS 16 explain that the Board decided to exclude these payments because:

(i) some Board members were persuaded by feedback received from stakeholders that the costs of including these payments would outweigh the benefits, particularly because of concerns expressed about the high level of measurement uncertainty that would result from including them and the high volume of leases held by some lessees; and

(ii) other Board members did not think these payments meet the definition of a liability for the lessee until the performance or use occurs.

(c) measure the cost of the right-of-use asset at the amount of the initial measurement of the lease liability (together with other components of cost as specified in paragraph 24 of IFRS 16).

_Requirements applying to leaseback liabilities_

4. Paragraph 100(a) of IFRS 16 requires the seller-lessee to ‘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 due to the sale of the asset that relates to the rights transferred to the buyer-lessor.’ Paragraph BC266 of IFRS 16 (see paragraph 8 of Agenda Paper 12C) explains the Board’s rationale for this requirement.

5. As paragraph BC11 of the Exposure Draft explains, the initial measurement of the leaseback liability is derived from how the right-of-use asset is measured—and the gain or loss determined—applying paragraph 100(a) of IFRS 16. Therefore, the initial measurement of the leaseback liability typically reflects the value of the right of use the seller-lessee retains. This means that, for a sale and leaseback transaction that includes variable lease payments, the initial measurement would typically reflect the expected lease payments at market rates. Those expected payments may include variable lease payments that do not meet the definition of lease payments in IFRS 16.
**Proposed amendments**

6. Paragraph 100(a) does not prescribe a method for determining the proportion of the previous carrying amount of the asset that relates to the right of use that the seller-lessee retains. The Exposure Draft proposes:

   (a) requiring seller-lessees to determine that proportion by comparing the present value of expected lease payments to the fair value of the asset sold.

   (b) specifying the payments that comprise the expected lease payments for sale and leaseback transactions. In particular, expected lease payments would include variable lease payments regardless of whether they depend on an index or rate.

7. As a consequence of these proposed amendments, the initial measurement of the lease liability would include the present value of variable lease payments linked to future performance or use of an underlying asset and future changes in payments resulting from changes in the reference index or rate for variable lease payments that depend on an index or rate.

8. Paragraphs BC18–BC19 of the Exposure Draft state:

   **BC18** In reaching this decision, the Board acknowledged that, for a lease that is unrelated to sale and leaseback transactions, a lessee excludes from the measurement of the lease liability variable lease payments that do not depend on an index or rate (and that are not in-substance fixed payments). When developing IFRS 16, the Board 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.

   **BC19** However, for sale and leaseback transactions, the Board expects that seller-lessees would be able to reasonably estimate the expected lease payments because seller-lessees are in a different position from lessees that enter into a lease that is unrelated to sale and leaseback transactions. In particular:
(a) a seller-lessee owns and controls the underlying asset until the sale and leaseback transaction. Seller-lessees should, therefore, have access to information that would enable them to reasonably estimate the fair value of the underlying asset and the expected lease payments. The Board also observed that seller-lessees would need to have that information to assess whether to enter into the transaction and the price at which to enter into it.

(b) applying the requirements in paragraph 101 of IFRS 16, seller-lessees are already required to consider whether the payments for the lease are at market rates and whether the fair value of the consideration equals the fair value of the underlying asset.

(c) seller-lessees generally do not have high volumes of sale and leaseback transactions that include variable lease payments.

**Respondent’s comments**

9. Almost all respondents comment on the differing treatment of variable lease payments when measuring a leaseback liability compared with other lease liabilities. The main comments relate to:

   (a) practical challenges (paragraphs 11–15);

   (b) conceptual challenges (paragraphs 16–19);

   (c) measurement of the gain or loss on a sale and leaseback transaction (paragraphs 20–21); and

   (d) disagreement with how a leaseback liability is measured applying paragraph 100(a) (paragraphs 22–23).

10. Some respondents also suggest possible ways to address this matter. Paragraphs 24–39 discuss these suggestions.
Practical challenges

11. Many respondents disagree with the Board’s rationale in paragraphs BC18–BC19 of the Exposure Draft. In particular:

(a) many respondents say including expected variable lease payments linked to future performance or use of the underlying asset in the measurement of the leaseback liability would often involve a high level of measurement uncertainty. Respondents say this would arise in particular for long-term leasebacks, and assets for which limited historical information is available. One respondent says a high level of measurement uncertainty could also arise for equipment leases with usage-based payments—a wide range of factors may affect the usage including demand for the lessee’s products or services, technological obsolescence, or mechanical failure. Many respondents say the Board’s rationale for excluding such variable payments from the measurement of lease liabilities as explained in paragraph BC169 of IFRS 16 also applies to leaseback liabilities. A few respondents explicitly agree with paragraph AV4 of the Alternative View of Ms Françoise Flores set out in the Exposure Draft (Alternative View).

(b) some respondents say a high level of measurement uncertainty could also be involved in estimating future changes in payments resulting from changes in the reference index or rate for variable lease payments that depend on an index or rate, particularly when the leaseback term is long (for example 10 to 15 years) and the relevant macroeconomic information is not readily available. Paragraph BC166 of IFRS 16 explains the Board’s rationale for excluding estimates of such future changes from the initial measurement of lease liabilities and respondents say the same concerns also apply to leaseback liabilities. For example, The Hong Kong Institute of Certified Public Accountants says:

Many stakeholders considered that the IASB’s concerns regarding variable lease payments when developing IFRS 16 (as noted in paragraphs BC163-169 of IFRS 16) remain valid with regard to a sale and leaseback transaction. Future changes in indices and rates are outside the control of an entity, and
estimation does not necessarily become more certain under a sale and leaseback transaction. As for performance-based variable lease payments, having owned the asset before does not necessarily make the estimation of future performance more reliable than in a normal lease arrangement, as one would expect the entity to have carried out proper financial due diligence before entering into a normal lease arrangement subject to performance-based variable lease payments.

12. A few respondents also say the use of expected lease payments would:
   (a) require seller-lessees to change their accounting systems and processes and incur significant costs; and
   (b) be difficult to audit.

13. The Association of Chartered Certified Accountants says:
   The measurement uncertainty allows scope for the manipulation of the cost of the lease in subsequent periods by a deliberate under- or over-estimating the variable future lease payments.

14. However, a few respondents agree with the Board’s rationale and say a seller-lessee should have access to the information required to make a reasonable estimate of the expected lease payments at the date of the sale and leaseback transaction.

15. Some respondents suggest requiring seller-lessees to disclose the assumptions and judgements used in estimating the expected lease payments, particularly given the measurement uncertainty that might be involved. However, one respondent says existing disclosure requirements are sufficient in this respect.

**Conceptual challenges**

*Measurement consistency*

16. Many respondents say liabilities arising from a lease, regardless of whether that lease forms part of a sale and leaseback transaction, should be measured consistently. Some of these respondents question the conceptual basis for the difference in the measurement of leaseback and other lease liabilities. For example, the European Financial Reporting Advisory Group (EFRAG) says:
This existing conflict of principles calls for a more fundamental review of the accounting requirements in IFRS 16. In that respect, EFRAG observes that the initial measurement of the lease liability arising from the leaseback is a consequence of how the gain or loss on the sale and leaseback transaction is determined applying paragraph 100(a) of IFRS 16. This initial measurement (and the definition of lease payment that underpins that measurement) differs from the measurement of the liability of a ‘standalone’ lease (that is a lease not entered into as part of a sale and leaseback transaction). EFRAG is concerned that the proposals in this [Exposure Draft] may lead to further inconsistency arising from the use of two different definitions of variable lease payments if they are not accompanied with clear analyses and explanation of the reason for the discrepancy.

17. Many respondents say measuring leaseback liabilities differently from other lease liabilities would reduce comparability and understandability for users of financial statements. For example, Defence Housing Australia (DHA) say:

   … The proposed approach would result in inconsistent treatment of leases due to different measurement techniques being applied to leases obtained either from an SLB arrangement or other means, despite there being the same underlying asset (in DHA’s case, residential property). The divergence in measurement methods would lead to confusion for users of the financial statements, as DHA currently bases values for all leases – SLB leases and other direct leases – to movements in the residential property market.

18. A few respondents say consistent measurement of the liability arising from a lease is more important to the quality of financial information than limiting the amount of the gain or loss of the sale in a sale and leaseback transaction. For example, the Footnotes Analyst says:

   …We do not think the circumstances by which leases came about justifies the different recognition and measurement of otherwise identical leases. Having two approaches for leases
with variable payments will confuse investors. Perhaps investors will understand the difference at the time of the sale and leaseback, but the sale transaction will likely be forgotten in subsequent periods when there will still be a perplexing difference in accounting.

**Existence of a liability**

19. Many respondents say it is unclear whether variable payments linked to future performance or use of an underlying asset meet the definition of a liability in the *Conceptual Framework for Financial Reporting*. Some respondents agree with the view of some Board members expressed in paragraph BC169 of IFRS 16, or cite paragraph AV4 of the Alternative View, regarding why no liability exists at the commencement date. Some respondents say the fact that, when developing IFRS 16, some Board members questioned whether a liability exists raises sufficient concern to not have a measurement basis under which a liability is recognised for these payments. One respondent says variable lease payments based on future revenue does not represent a present obligation but reflects a joint arrangement akin to a profit share arrangement.

**Measurement of gain or loss on sale and leaseback transactions**

20. Although raising concerns about the measurement requirements (see paragraphs 11–15 above), many respondents support 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-lessee. The most common reason provided is that this treatment reflects the economics of a sale and leaseback transaction.

21. However, some respondents share the view expressed in AV3 of the Alternate View and say a seller-lessee should recognise the gain to the extent the leaseback payments include variable payments that do not meet the definition of lease payments in IFRS 16. A few respondents say because the sale met the requirements in IFRS 15 to be accounted for as a sale, a seller-lessee should recognise the entire amount of the gain or loss on sale.
Disagreement with how a leaseback liability is measured applying paragraph 100(a)

22. A few respondents disagree with paragraph BC11 of the Exposure Draft which explains how a seller-lessee measures the leaseback liability at the date of the transaction applying paragraph 100(a) of IFRS 16 (see paragraph 5 of this paper). They say although paragraph 100(a) addresses the measurement of the right-of-use asset and the gain or loss on the sale and leaseback transaction, it does not require the initial measurement of the leaseback liability to be derived from how the right-of-use asset (and the gain or loss) is measured. For example, the Institute of Singapore Chartered Accountants (ISCA) says:

Under the current IFRS 16 Leases, we note that paragraph 100(a) requires the seller-lessee to measure the right-of-use asset arising from the leaseback...However, IFRS 16 is silent with regards to the measurement of the liability arising from the leaseback...As such, entities would typically look to Illustrative Example 24 for guidance on the measurement of the right-of-use asset and the liability (termed as ‘financial liability’ in the illustrative example) arising from the sale and leaseback transaction. However, Illustrative Example 24 only addresses the scenario of a sale and leaseback transaction with fixed payments...Hence, the illustrative example may be construed to mean that such variable payments are to be excluded from the measurement of the proportion of the previous carrying amount that relates to the right of use retained by the seller-lessee and the liability, which is in line with the existing measurement requirement of ‘lease liability’ under paragraph 27 of IFRS 16.

23. Similarly, the Autorité des Normes Comptables (ANC) says:

ANC first observes that, from a practical perspective, and consistent with the computations described in Examples 24 and 25 as amended in the [Exposure Draft], the seller-lessee first determines the lease liability, measures the right of use, and then, derives the gain (or loss) on rights transferred—in other words, from a computational perspective, (i) the lease liability is the starting point for the accounting and (ii) the gain (or loss) on
the rights transferred is the balancing credit journal entry. This perspective—which does not entirely tally with the Board’s view in paragraph BC11 of the ED—explains why some stakeholders would focus on how to measure the lease liability and would intuitively apply the general measurement requirements for a lease liability in IFRS 16.

Possible ways forward

24. Most respondents say there is the need to amend IFRS 16 to enhance the measurement requirements for sale and leaseback transactions. The paragraphs below discuss respondents’ suggestions on possible ways to do so.

Considering the requirements more holistically

25. Many respondents suggest considering the accounting for variable lease payments more holistically as part of either the Post-implementation Review (PIR) of IFRS 16 or a project on variable and contingent consideration\(^1\). Some respondents suggest delaying the proposed amendments until the PIR of IFRS 16. For example, the Australian Accounting Standards Board says:

> …that the amendments proposed in ED/2020/4, though addressing an existing gap in IFRS 16, maybe premature given the post-implementation review of IFRS 16 is yet to occur. Whilst we acknowledge that there is a need to address the gap in the subsequent measurement requirements for sale and leaseback transactions, we have not seen evidence to suggest that the scenario which lead to the initial IFRIC submission is widespread. This suggests there may be merit in delaying any proposed amendments until such time as a scenario in which all lease payments in a sale and leaseback arrangement are variable becomes prevalent enough to warrant such

\(^1\) The Board’s [Third Agenda Consultation](#) lists variable and contingent consideration as a possible research project.
modifications. This approach would also avoid unnecessarily increasing the complexity for all in-scope sale and leaseback transactions (i.e., sale and leaseback transactions with a mix of fixed and variable lease payments). Additionally, by waiting for the post-implementation review, other potentially more prevalent IFRS 16 implementation issues may be identified and addressed concurrently.

26. However, one respondent says the Board is already aware of the inconsistency in the treatment of variable lease payments and should accordingly not wait until the PIR of IFRS 16 to holistically address this particular issue.

27. One respondent says the proposals go beyond the scope of a narrow-scope standard-setting project and create a dual measurement model for lease liabilities. It then suggests an alternative way forward (see paragraph 29 below).

28. Many respondents, including many of those who say the Board should address the accounting for variable lease payments holistically, suggest alternative solutions the Board could consider. The following paragraphs discuss these suggestions.

**Deferred income approach**

29. Some respondents suggest an approach in which a seller-lessee measures the gain or loss relating to the right of use retained in accordance with paragraph 100(a) of IFRS 16 and recognises a deferred income liability.

30. Although some of these respondents did not specify how the seller-lessee would measure the right-of-use asset and lease liability, a few provided more specificity. Based on the descriptions provided, we have identified two variations of this approach which we describe below.

31. Many of these respondents acknowledge the solution might be imperfect or have conceptual flaws but could, nonetheless, be a useful temporary solution that would in their view:

(a) be simpler to apply than the proposals; and

(b) not result in inconsistencies in the measurement of leaseback liabilities and lease liabilities.
32. One respondent suggests considering such an approach only for sale and leaseback transactions with variable payments and doing so only if the Board concludes that the existing gain or loss requirements for sale and leaseback transactions are appropriate (see paragraph 39(b) below).

**Deferred Income Approach A**

33. Some respondents suggest an approach in which:

(a) 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. Accordingly, the seller-lessee would recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

(b) the seller-lessee would measure the leaseback liability applying the measurement requirements applicable to other lease liabilities (ie in accordance with paragraphs 26–28 of IFRS 16).

(c) the seller-lessee would recognise any residual balance as a deferred income liability\(^2\) and amortise this balance to profit or loss on a straight-line basis over the term of the leaseback (unless another systematic basis would be more representative of the pattern in which the seller-lessee receives benefit). One respondent suggests presenting the amortisation as a reduction of the lease expense recognised in profit or loss.

34. Appendix A to this paper illustrates the application of this approach.

**Deferred Income Approach B**

35. Similar to Deferred Income Approach A, and consistent with paragraph 100(a) of IFRS 16, applying this approach a seller-lessee would recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessee.

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\(^2\) Different respondents suggest different terms to describe the liability (for example, ‘contract liability’, ‘deferred income’ or ‘deferred gain’). In order to distinguish this approach from the one that follows, we call the first approach, Approach A.
36. However, applying this approach 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 leaseback liabilities (ie applying paragraphs 23–28 of IFRS 16).

37. The seller-lessee would recognise any residual balance as a deferred income liability, which would be amortised to profit or loss on a straight-line basis over the term of the leaseback (unless another systematic basis is more representative of the pattern in which the seller-lessee receives benefit).

38. Appendix A to this paper illustrates the application of this approach.

**Other suggestions**

39. Respondents also suggest the following approaches:

   (a) some respondents suggest measuring the right-of-use asset arising in a sale and leaseback transaction and the leaseback liability consistently with other right-of-use assets and lease liabilities, with any residual amount being recognised as the gain or loss on the sale and leaseback transaction. This suggestion would result in the seller-lessee recognising the full gain or loss on sale at the date of the sale and leaseback transaction.

   (b) consistent with the Alternative View, some respondents say a full discussion is needed of what principle should prevail at initial recognition of a sale and leaseback transaction that includes variable payments (see paragraphs AV1–AV4 of the Exposure Draft).

   (c) a few respondents suggest changing the measurement requirements of other lease liabilities to include all variable lease payments (regardless of whether they depend on an index or rate).

   (d) one respondent suggests, for the leaseback liability, to initially measure variable lease payments that depend on an index or rate using the index or rate at the commencement date (ie to account for such variable lease payments consistently when measuring both leaseback liabilities and other lease liabilities).
(e) one respondent says a sale and leaseback transaction is always a financing transaction and consequently suggests an alternative model to account for all sale and leaseback transactions.
Appendix A—Alternative solutions

Purpose

A1. As discussed in paragraph 29, some respondents suggest an approach in which a seller-lessee measures the gain or loss that relates to the right of use retained in accordance with paragraph 100(a) of IFRS 16 and recognises a deferred income liability. This appendix illustrates and compares the proposals in the Exposure Draft to the Deferred Income Approach A (paragraph 33) and Deferred Income Approach B (paragraphs 35–37).

Illustrative example

A2. The following illustrative example is adapted from Example 25 included in the Exposure Draft.³

Fact pattern

A3. 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.

A4. At the same time, Seller-Lessee enters into a contract with Buyer-Lessor for the right to use the building for three 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 three years. The leaseback does not include any annual minimum payments. The leaseback payments are at market rates.

A5. At the commencement date of the leaseback, the estimated revenue and expected lease payments for each of the three years are:

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³ For simplicity, we have rounded all amounts to 000’s.
Year | Estimated revenue (CU) | Expected lease payments (CU)
--- | --- | ---
1  | 1,300 | 91
2  | 1,400 | 98
3  | 1,450 | 100

Assumptions

A6. We have made the following assumptions:

(a) the terms and conditions of the transaction are such that the transfer of the building meets the requirements to be accounted for as a sale. Accordingly, Seller-Lessee accounts for the transaction as a sale and leaseback.

(b) 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 CU270.

(c) Seller-Lessee measures the right-of-use asset at cost and depreciates it on a straight-line basis over the term of the leaseback.

(d) actual lease payments equal the expected lease payments as at the commencement date.
**Analysis**

**Commencement Date**

A7. At the commencement date, applying the Exposure Draft approach, the Deferred Income Approach A and the Deferred Income Approach B, Seller-Lessee would account for the transaction as follows:

<table>
<thead>
<tr>
<th>DR / (CR)</th>
<th>Exposure Draft</th>
<th>Approach A</th>
<th>Approach B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>CU1,800</td>
<td>CU1,800</td>
<td>CU1,800</td>
</tr>
<tr>
<td>Right-of-use asset</td>
<td>CU150(a)</td>
<td>CU150(a)</td>
<td>-</td>
</tr>
<tr>
<td>Building</td>
<td>(CU1,000)</td>
<td>(CU1,000)</td>
<td>(CU1,000)</td>
</tr>
<tr>
<td>Lease liability</td>
<td>(CU270)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Deferred income</td>
<td>-</td>
<td>(CU270)(c)</td>
<td>(CU120)(d)</td>
</tr>
<tr>
<td>Gain on transfer</td>
<td>(CU680)(b)</td>
<td>(CU680)(b)</td>
<td>(CU680)(b)</td>
</tr>
</tbody>
</table>

(a) Applying the Exposure Draft approach and the Deferred Income Approach A, Seller-Lessee measures the right-of-use asset by comparing the present value of the expected lease payments (CU270) to the fair value of the building. Seller-Lessee measures the right-of-use asset at CU150 (CU1,000 × CU270 (present value of lease payments) ÷ CU1,800 (fair value of building)). Applying the Deferred Income Approach B, Seller-Lessee measures the leaseback liability at nil because all payments for the leaseback are variable and do not depend on an index or rate. Therefore, Seller-Lessee measures the right-of-use asset at nil.

(b) The gain on sale of the building is CU800 (CU1,800 – CU1,000). Applying each of the three approaches, Seller-Lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-Lessor of CU680 calculated as follows: (i) CU120 (CU800 × CU270 (present value of lease payments) ÷ CU1,800 (fair value of building)) relates to the right to use the building retained by seller-lessee; and (ii) CU680 (CU800 - CU120) relates to the rights transferred to Buyer-Lessor.

(c) Applying the Deferred Income Approach A, Seller-Lessee measures the leaseback liability at nil because all payments are variable lease payments linked to the future performance of the asset. The deferred income liability, as the balancing figure in the journal entry, reflects the present value of the expected lease payments.

(d) Applying the Deferred Income Approach B, Seller-Lessee measures both the right-of-use asset and the leaseback liability, applying the measurement requirements applicable to leases that do not form part of a sale and leaseback transaction, at nil because all payments are variable lease payments linked to the future performance of the asset. The deferred income liability represents the part of the CU800 gain that relates to the rights retained by Seller-Lessee.
Balance Sheet

A8. The following table shows the measurement of the right-of-use asset, the leaseback liability, and the deferred income liability over the term of the leaseback:

<table>
<thead>
<tr>
<th></th>
<th>Exposure Draft</th>
<th>Approach A</th>
<th>Approach B</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Right-of-use asset</td>
<td>Leaseback liability</td>
<td>Right-of-use asset</td>
</tr>
<tr>
<td>Initial recognition</td>
<td>150</td>
<td>270</td>
<td>150</td>
</tr>
<tr>
<td>Depreciation/amortisation(^{(a)})</td>
<td>(50)</td>
<td>(50)</td>
<td>(50)</td>
</tr>
<tr>
<td>Interest(^{(b)})</td>
<td>9</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>Cash payment</td>
<td>(91)</td>
<td>(91)</td>
<td>(98)</td>
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<tr>
<td>Balance Yr. 1</td>
<td>100</td>
<td>188</td>
<td>100</td>
</tr>
<tr>
<td>Depreciation/amortisation(^{(a)})</td>
<td>(50)</td>
<td>(50)</td>
<td>(50)</td>
</tr>
<tr>
<td>Interest(^{(b)})</td>
<td>7</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Cash payment</td>
<td>(98)</td>
<td>(98)</td>
<td>(100)</td>
</tr>
<tr>
<td>Balance Yr. 2</td>
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<td>97</td>
<td>50</td>
</tr>
<tr>
<td>Depreciation/amortisation(^{(a)})</td>
<td>(50)</td>
<td>(50)</td>
<td>(50)</td>
</tr>
<tr>
<td>Interest(^{(b)})</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Cash payment</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Balance Yr. 3</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

\(^{(a)}\) Seller-Lessee depreciates the right-of-use asset and amortises the deferred income on a straight-line basis over the three-year term of the leaseback. For example, the annual amount of depreciation for the right-of-use asset is CU50 (CU150 ÷ 3).

\(^{(b)}\) Seller-Lessee calculates the interest expense by applying its incremental borrowing rate of 3.5% to the carrying amount of the leaseback liability. For example, the interest expense for Year 2 of CU7 was calculated as follows: CU188 × 3.5%.
### Income Statement

A9. The following 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 CU680 because this amount is the same applying all three approaches.

<table>
<thead>
<tr>
<th>Income / (expense)</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CU</td>
<td>CU</td>
<td>CU</td>
<td>CU</td>
</tr>
<tr>
<td><strong>Exposure Draft</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>(50)</td>
<td>(50)</td>
<td>(50)</td>
<td>(150)</td>
</tr>
<tr>
<td>Interest</td>
<td>(9)</td>
<td>(7)</td>
<td>(3)</td>
<td>(19)</td>
</tr>
<tr>
<td></td>
<td>(59)</td>
<td>(57)</td>
<td>(53)</td>
<td>(169)</td>
</tr>
<tr>
<td><strong>Approach A</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>(50)</td>
<td>(50)</td>
<td>(50)</td>
<td>(150)</td>
</tr>
<tr>
<td>Amortisation of deferred amount</td>
<td>90</td>
<td>90</td>
<td>90</td>
<td>270</td>
</tr>
<tr>
<td>Variable lease payment(^{(a)})</td>
<td>(91)</td>
<td>(98)</td>
<td>(100)</td>
<td>(289)</td>
</tr>
<tr>
<td></td>
<td>(51)</td>
<td>(58)</td>
<td>(60)</td>
<td>(169)</td>
</tr>
<tr>
<td><strong>Approach B</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortisation of deferred amount</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>120</td>
</tr>
<tr>
<td>Variable lease payment(^{(a)})</td>
<td>(91)</td>
<td>(98)</td>
<td>(100)</td>
<td>(289)</td>
</tr>
<tr>
<td></td>
<td>(51)</td>
<td>(58)</td>
<td>(60)</td>
<td>(169)</td>
</tr>
</tbody>
</table>

\(^{(a)}\) Applying Approaches A and B, we assume Seller-Lessee recognises variable lease payments not included in the measurement of the leaseback liability in the period in which the event or condition that triggers those payments occurs (paragraph 38(b) of IFRS 16).