STAFF PAPER

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IASB® meeting

Project	**Lease Liability in a Sale and Leaseback**
Paper topic	Feedback Summary—Transition and Other Matters

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Purpose and overview

1. As discussed in Agenda Paper 12C for this meeting, this paper summarises feedback on the Exposure Draft *Lease Liability in a Sale and Leaseback* in respect of:

   (a) calculating the proportion of the carrying amount retained using the expected lease payments (paragraphs 2–7);

   (b) remeasurement of the leaseback liability (paragraphs 8–10);

   (c) classification of the leaseback liability (paragraphs 11–12);

   (d) illustrative example (paragraphs 13–15);

   (e) transition requirements (paragraphs 16–20); and

   (f) other comments (paragraphs 21–23).

Calculating the proportion of the carrying amount retained using the expected lease payments

Background

2. The Board proposed requiring seller-lessees to determine the proportion of the carrying amount retained by comparing the present value of the expected lease payments to the fair value of the asset sold.

Respondents' comments

Prescribed method

3. Some respondents support the proposal and say prescribing a single method would bring consistency, clarity, and comparability to the measurement of the right-of-use asset and leaseback liability.

4. As reported in Agenda Paper 12D, many respondents disagree with the use of the expected lease payments because they say it would introduce a high level of measurement uncertainty. One respondent suggests not prescribing a particular method but instead considering the imputed lease payments approach described in paragraph BC24 of the Exposure Draft. It acknowledges this approach could reduce comparability because entities might apply different methods in determining the proportion of the carrying amount of the asset retained. However, it says the measurement uncertainty introduced by the proposals could also limit comparability.

5. A few other respondents also suggest not prescribing a particular method because other methods may be appropriate depending on the circumstances or depending on the information to which the seller-lessee has access. An example of an alternative method may be to compare the leaseback period with the remaining useful life of the asset sold. Similarly:

   (a) one respondent says if the seller-lessee can determine the interest rate implicit in the lease, it should have access to the unguaranteed residual value. Therefore, it suggests allowing entities to calculate the proportion with reference to the unguaranteed residual value and the fair value of the asset.

   (b) another respondent suggests also allowing entities to calculate the proportion with reference to the fair values of both the right-of-use asset and the asset transferred, with both fair values being derived on a comparable basis.

6. Paragraph 15 of IFRS 16 provides a practical expedient whereby a lessee may elect not to separate non-lease components from lease components. A few respondents ask whether the expected lease payments would also include payments for non-lease components if the expedient is elected.

Clarity about the expected lease payments

7. A few respondents ask for clarity about expected lease payments as defined in paragraph 100A of the Exposure Draft:

(a) a few respondents say it is unclear whether the term ‘expected lease payments’ implies the seller-lessee should consider probability-weighted scenarios or only a single best estimate.

(b) a few respondents say the definition of lease term considers only periods covered by extension or termination options if the lessee is reasonably certain to exercise the option and ask whether the word ‘expected’ affects the period over which to estimate payments when the leaseback includes extension or termination options. One respondent suggests including extension options in expected lease payments on a probability-weighted estimate.

(c) a few respondents say paragraph 100(a) in the Exposure Draft refers to paragraph 26 of IFRS 16 to determine the discount rate to use when discounting the expected lease payments. Paragraph 26 in turn refers to the interest rate implicit in the lease and the lessee’s incremental borrowing rate. These respondents ask how these rates should be determined for a sale and leaseback transaction considering their definitions were originally considered within a measurement model for lease liabilities that exclude variable lease payments linked to the performance or use of the asset.

(d) one respondent asks for clarity as to whether foreign exchange rate variations affect the estimate of expected lease payments. They suggest requiring foreign exchange rate variations to be accounted for on the same basis as variable lease payments that depend on an index or rate.

(e) another respondent asks whether expected lease payments include 'variable end of lease return provisions, which are typical in aircraft leases'—they say such provisions are currently accounted for applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Remeasurement of the leaseback liability

Background

8. The Exposure Draft proposed that a seller-lessee would not remeasure the leaseback liability to reflect a change in future variable lease payments related to a sale and leaseback transaction, other than as specified for changes in the lease term or lease modifications. In the Board's view there would be no significant benefit in requiring seller-lessees to remeasure the leaseback liability if the seller-lessee's expectations of future variable lease payments were to change. IFRS 16 already includes various simplifications to the measurement of lease liabilities for variable lease payments arising from a lease unrelated to sale and leaseback transactions.

Respondents' comments

9. Some respondents express concern that a seller-lessee would not remeasure the leaseback liability to reflect a change in future variable lease payments other than for changes in the lease term or lease modifications for the following reasons:

    (a) the leaseback could extend over many years. After initial recognition, the carrying amount of the leaseback liability could become less relevant if it continues to be based on estimates at the commencement date.

    (b) management's estimates at the commencement date (or a later remeasurement date) could significantly affect profit or loss for several reporting periods. A few respondents express particular concerns about the profit or loss effect in the context of variable lease payments that depend on an index or rate and significant changes in macroeconomic factors occurring after the measurement date. Paragraph 42(b) of IFRS 16 requires the remeasurement of lease liabilities when there is a change in future lease payments resulting from a change in an index or rate used to determine those payments. A few respondents suggest requiring similar remeasurement for variable payments in a sale and leaseback transaction that depend on an index or rate.

(c) when leaseback payments include variable lease payments linked to the performance or use of the asset and the seller-lessee's expected performance or use declines—for example due to unexpected economic conditions as experienced during the covid-19 pandemic—the leaseback liability would be overstated.

(d) tracking the expected lease payments and actual lease payments may require significant cost and effort and not necessarily align with the configuration of existing lease accounting systems.

10. One respondent acknowledges the cost efficiency of this proposal but says seller-lessees would often have the information required to remeasure the liability and remeasurement would provide useful information for users of financial statements. Another respondent suggests requiring entities to apply the principles in IFRS 9 *Financial Instruments* to account for changes in estimates of the liability.

Classification of the leaseback liability

Background

11. The Exposure Draft proposes to clarify that the leaseback liability is a liability to which IFRS 16 applies. Paragraph BC4 of the Exposure Draft explains the Board's rationale for this proposal.

Respondent's comments

12. Although not disagreeing with the Board's rationale and conclusion, a few respondents say it could be confusing to classify leaseback liabilities in the same manner as other lease liabilities because the measurement requirements for a leaseback liability would differ from those applying to other lease liabilities. They suggest requiring entities to separately present and/or disclose leaseback liabilities. A few respondents also suggest clarifying how a seller-lessee would present changes in leaseback liabilities in the statement of cash flows.

Illustrative example

Background

13. The Board concluded that developing an example with journal entries would enhance the understandability of the proposed amendment. The Exposure Draft therefore proposed 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.

Respondents' comments

14. In addition to the Illustrative Example included in the proposals, a few respondents suggest also illustrating (or otherwise clarifying) situations in which:

    (a) actual payments made include shortfalls or recoveries of shortfalls;

    (b) leaseback payments include variable lease payments that depend on an index or rate; and

    (c) the transaction includes off-market rates (paragraphs 101–102 of IFRS 16).

15. A few respondents also suggest updating proposed Illustrative Example 25 to:

    (a) disaggregate the journal entries to better explain the accounting for the transaction; and

    (b) reflect changes in estimated future revenue (the example notes that Seller-Lessee's estimated revenue for Year 3 to Year 5 at the date of the lease modification remains unchanged from that estimated as at the commencement date).

Transition requirements

Background

16. The Exposure Draft proposes that a seller-lessee apply the amendment retrospectively to sale and leaseback transactions entered 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 (hindsight expedient). Paragraphs BC32–BC34 of the Exposure Draft explain the Board's rationale for the proposed transition requirements.

Respondents' comments

17. Some respondents agree with the proposed transition requirements for the reasons explained by the Board. However, a few respondents disagree. In particular:

    (a) a few respondents say the cost of applying the proposals retrospectively would not outweigh the expected benefits. For example, one respondent says:

    > The proposed change adds unnecessary complexity and would require significant investment in systems and an administrative burden to restate prior financial year statements with little benefit for users of the financial statements.

    (b) a few respondents say it would be difficult to avoid the use of hindsight when estimating variable lease payments retrospectively. Determining whether hindsight is being used would also be difficult.

    (c) one respondent says information to apply the amendments retrospectively may either be unavailable or, where available, not reliable. They also raise concerns about the auditability of such information.

18. A few respondents who disagree suggest requiring or permitting prospective application to sale and leaseback transactions occurring after the date of initial application of the amendments (or from the beginning of the annual reporting period immediately preceding the date of initial application). In addition:

    (a) one respondent suggests a modified retrospective approach in which a seller-lessee would not restate comparative information.

    (b) one respondent suggests requiring entities to use the proposed hindsight expedient in all situations but permitting entities to apply the amendment retrospectively only if they had made an explicit estimate of variable payments at the date of the transaction. Similarly, another respondent suggests requiring entities to apply the amendment retrospectively only for sale and leaseback transactions without variable lease payments.

19. In addition, a few respondents suggest:

(a) requiring entities to disclose the use of the hindsight expedient; and

(b) providing an exemption for first-time adopters of IFRS Standards. For example, the Japanese Institute of Certified Public Accountants (JICPA) says:

> …IFRS 1 does not specify any exemptions for sale and leaseback transactions. Moreover, it is quite uncertain as to how such transactions fit into the existing exemption requirements for revenue (paragraphs D34 and D34 of IFRS 1) and leases (paragraphs D9-D9E of IFRS 1). If the [Board] plans to reconsider the accounting for sale and leaseback transactions, introducing an accounting treatment completely different from that for general lease transactions, then we suggest that an exemption should be set out for first-time adopters.

20. We note that some respondents who comment on other aspects of the proposals do not comment on the proposed transition requirements.

Other comments

21. A few respondents raise the following questions:

(a) one respondent says it is unclear whether any dismantling costs related to the underlying asset would be allocated to the transferred asset or to the right-of-use asset.

(b) paragraph 5 of IFRS 16 provides an exemption for short-term leases and leases for which the underlying asset is of low value. A few respondents ask whether these exemptions also apply to sale and leaseback transactions.

(c) paragraph 101(b) of IFRS 16 requires the seller-lessee to account for any above-market terms as additional financing provided by the buyer-lessor to the seller-lessee. One respondent says it is only by referring to the proposed

Illustrative Example 24 that one can understand that the amount represents a financial liability separate from the leaseback liability. It suggests clarifying this in the main body of the Standard, together with the requirements applicable to this separate financial liability and how to allocate contractual payments between the leaseback liability and the separate financial liability. Another respondent asks whether, in a situation in which leaseback payments include fixed and variable payments, it would be permissible to allocate any fixed payments to the above-market element. This is because it is more likely that the variable payments relate to the leaseback liability than the financial liability.

22. A few respondents suggest the following:

(a) one respondent suggests defining the term 'sale and leaseback'.

(b) one respondent suggests specifying that a loss on sale of the underlying asset is an indication that the right-of-use asset may be impaired.

(c) one respondent says a strict application of the proposals would require a seller-lessee to exclude initial direct costs incurred on the leaseback from the initial measurement of the right-of-use asset and, therefore, recognise those costs in profit or loss as incurred. However, in its view, the seller-lessee should include such costs in the cost of the right-of-use asset (as is required for other right-of-use assets).

23. Some respondents suggest editorial changes and clarifications to the text of the Exposure Draft.