STAFF PAPER

June 2020

IFRS® Interpretations Committee meeting

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

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1. This paper reproduces comment letters received on the IFRS Interpretations Committee's tentative agenda decision 'Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)' published in March 2020.

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

DRSC / ASCG • Zimmerstr. 30 • 10969 Berlin

Sue Lloyd
Chair of the IFRS Interpretations Committee
30 Cannon Street
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IFRS Technical Committee
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Berlin, 8 April 2020

Dear Sue,

IFRS IC's tentative agenda decisions in its March 2020 conference call

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the March 2020 *IFRIC Update*.

We agree with the **tentative agenda decision on IAS 12**.

In respect of the **tentative agenda decision on IFRS 16**, we support the IFRS IC's findings that help answering the main questions of (i) how to measure the right-of-use (ROU) asset and (ii) to what extent gains/losses be recognised at the transaction date, while recommending the IASB specify how to (subsequently) measure the lease liability.

We agree with the IFRS IC's observation that IFRS 16.100(a) is the relevant requirement. We appreciate the agenda decision containing an illustrative example that underlines the IFRS IC's conclusions. However, we are not entirely convinced by the conclusions drawn from applying para. 100(a) to the transaction described.

Our main concern is that the way how the retained proportion of PPE (25 %) is determined implicitly determines the (initial) measurement of the lease liability, which appears doubtful to us. We acknowledge that the retained proportion of PPE is derived from the present value of expected lease payments (which equal 25 % of the fair value of the entire PPE). Determining the present value of expected lease payments with the aim of measuring the ROU asset (which equals 25 % of the previous carrying amount of the PPE sold) would, to our understanding, suggest that this present value virtually represents the measurement of the lease liability.

If so, applying para. 100(a) to this specific transaction would lead to (initially) measuring a lease liability (comprising variable payments only that do not depend on an index or rate) different from nil. This seems contradictory to the general principle for measuring a lease liability (paras. 26, and 27, in particular), which would foresee measuring such a lease liability (i.e. with variable payments only that do not depend on an index or rate) at nil.

This said, we suggest the IFRS Interpretations Committee not only reconsider the <u>subsequent</u> measurement of a lease liability arising in a sale and leaseback transaction, but also the <u>initial</u> measurement in the same breath. In particular, we suggest examining whether para. 100(a) would lead to a measurement of the lease liability that conflicts with the general principle in para. 27.

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

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INVESTOR IN PEOPLE

International Financial Reporting Standards Interpretations Committee
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E14 4HD

14 April 2020

Dear IFRS Interpretations Committee members,

Invitation to comment – Tentative Agenda Decision (TAD): Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision of the IFRS Interpretations Committee (the Committee) published in the March 2020 *IFRIC Update*.

The Committee discussed the question "how, in the transaction described in the request, 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."

Paragraph 100(a) of IFRS 16 *Leases* states that "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." We agree with the Committee's observation that the amount of the gain or loss recognised relates only to the rights transferred to the buyer-lessor.

In addition, we welcome the Committee's decision to perform standard setting on the subsequent measurement of the liability recognised as a result of the sale and leaseback transaction.

The TAD provides an illustrative example and journal entries for a sale and leaseback transaction on the commencement date of the lease. However, it is not clear in the TAD why the credit entry of CU 450,000, as shown in the illustrative example, is a lease liability and not in the scope of other standards. We believe that the nature of the liability should be addressed in the narrow-scope standard setting project. Therefore, we recommend that the TAD only addresses the gain recognition at the date of the sale.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152.

Yours faithfully,

Ernst + Young Global Limited

April 27, 2020

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Dear Colleagues,

The Saudi Organization for Certified Public Accountants (SOCPA) appreciates the efforts of the IFRS Interpretations Committee (Committee) and welcomes the opportunity to comment on the *Tentative Agenda Decision—Sale and Leaseback with Variable Payments (IFRS 16).*

We appreciate the extensive work of the staff on this topic and the detailed examples they have provided. However, it seems that in the attempt to apply the principle in paragraph 100 of IFRS 16, the proposal contradicts the requirements of measuring the lease liability, which exclude variable lease payments that do not depend on an index or a rate, such as those linked to future performance or use of an underlying asset. The Basis for Conclusions accompanying IFRS 16 clearly describes why IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. Consequently, any method to calculate the lease liability, directly or indirectly, at initial recognition in any situation using variable lease payments linked to future performance or use of an underlying asset is, in itself, a contradiction of the requirements of the Standard. Therefore, the proposal's conclusion that "*The seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate*" does not have authoritative support. Also, the proposal's conclusion that "*The initial measurement of the lease liability is a consequence of how the right-of-use asset is measured—and the gain or loss on the sale and leaseback transaction determined*" contradicts paragraphs 26-28 without justification. Moreover, it contradicts the definition of liability itself. In fact, and according to paragraph 24, the right of use asset is the one that is a consequence of how lease liability is measured.

To eliminate any contradiction in the Standard, we need to read paragraph 100 in light of paragraph 24 of IFRS 16, which determines the cost components of the right of use asset, one of which is the amount of the initial measurement of the lease liability. Variable lease payments linked to future performance or use of an underlying asset are not part of the amount of the initial measurement of the lease liability. If there is no right of use asset recognised according to paragraph 24, there is no need to apportion the gain on sale between right retained and right transferred. Considering this, we see paragraph 100 as a guidance on how to apportion the gain on sale between the right transferred and the right retained only where there is a right of use asset as measured by paragraph 24. When there is a right of use asset (as measured by paragraph 24), it shall be reduced by the amount of unrecognised gain that relates to the right retained by the seller-lessee. This is supported by paragraph BC266 of the basis for conclusions accompanying IFRS 16, which tells us that paragraph 100 is mainly about recognition of the gain. The right of use asset in a sale and lease back transaction is effectively measured by reducing the right of use asset, as measured according to paragraph 24, by the amount of unrecognised gain. **Otherwise, there is a contradiction in the Standard that needs to be resolved.**

In light of the above, when the lease payments are only in form of variable lease payments linked to future performance or use of an underlying asset, there is no right of use asset to be recognised in the first place. Thus, the first requirement of paragraph 100 of IFRS 16 is not applicable without causing contradiction with other requirements in the Standard. However, to attain the main goal of paragraph 100 of IFRS 16 (i.e., the recognition of gain on sale) in case there is no right of use asset, the Committee may deliberate whether to issue an interpretation or to recommend to the Board (a standard setting activity) to develop an approach similar (in nature) to the one included in IAS 17 to defer, and amortize over the contract term, a proportion of the gain related to the proportion of the remaining asset's useful life retained by the seller-lessee in case that lease payments are only in form of variable lease payments linked to future performance or use of an underlying asset.

Another problem in paragraph 100 is the limit on recognition of loss on sale. This is a contradiction to the general principle throughout IFRSs, where loss is usually recognised immediately.

Therefore, we see this subject as an opportunity to recommend revisiting paragraph 100 to fulfil the objective of the Board stated in paragraph BC 266 of the basis for conclusions of IFRS 16 and to resolve the issue of not recognising loss in full. We suggest amending that paragraph to read:

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:

- **i. determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee and that relates to the right of use transferred to the buyer-lessor. This can be done, for example by comparing the remaining useful life of the underlying assets to the lease term;**
- **ii. recognise in profit or loss only the amount of any gain that relates to the rights transferred to the buyer-lessor;**
- **iii. reduce the right of use asset (as measured according to paragraph 24), if any, by the amount of any gain that relates to the right of use retained by the seller-lessee;**
- **iv. In case there is no right of use asset (as measured according to paragraph 24, for example, where all lease payments are variable lease payments linked to future performance or use of an underlying asset), defer and amortize over the lease term in a systematic basis any gain that relates to the right of use retained by the seller-lessee; and**
- **v. recognise in full any loss resulted from the sale transaction.**

(b) the buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.

We notice the Staff paper (Agenda ref 12A, April 2020), which suggests a limited amendment to IFRS 16 to tackle the problem of subsequent measurement of lease liability that initially measured at the expected amount of lease payment linked to performance or use of the underlying assets. We believe our suggestion to amend paragraph 100 is more in line with the principles of IFRS 16, and the framework in general, simpler and less costly than the approach suggested by the staff in the aforementioned staff paper.

Applying the suggested modification to paragraph 100, and using the example in the draft decision, at the date of the transaction, seller-lessee may account for the transaction as follows (which would comply with paragraph 100 of IFRS 16 in respect of recognising gain in proportion to the useful life transferred assuming that the lease term is for the 25% of the remaining useful life of the asset, while in the same time comply with the Standard in respect of not to include variable lease payments in the lease liability):

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*Nill*	
Cr. PPE		*CU1,000,000*
Cr. Deferred gain on sale of PPE (to be amortized over the life of the lease contract)		*CU200,000*
Cr. Gain on sale of PPE		*CU600,000*

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,

Dr. Ahmad Almeghames
Secretary General

Ms Sue Lloyd
Chair
IFRS Interpretations Committee
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E14 4HD

6 May 2020

Dear Sue,

Tentative agenda decision – IFRS 16 *Leases*: Sale and Leaseback with Variable Payments

We are commenting on the above tentative agenda decision, published in the March 2020 edition of IFRIC Update, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the agenda decision. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee's decision not to add this issue onto its agenda because the principles and requirements in IFRS 16 provide an adequate basis for a seller-lessee to determine the gain at the date of the transaction. We also agree with the Committee's recommendation that the Board consider a narrow scope amendment to specify how the seller-lessee subsequently measures the liability that arises in the sale and leaseback transaction. However, we do not think it is necessarily clear that the liability is a lease liability in the scope of IFRS 16 since the future payments do not meet the standard's definition of lease payments and, if not, which standard should apply. We therefore recommend that the agenda decision remain silent on what type of liability it is at initial recognition and how it is subsequently measured until the Board has considered its narrow scope amendment.

If you have any questions in relation to this letter please do not hesitate to contact Henry Daubeney, PwC Head of Reporting and Chief Accounting (+447841569635) or Jessica Taurae (+447740166459).

Yours sincerely,

PricewaterhouseCoopers

PricewaterhouseCoopers

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Comment on Tentative Agenda Decision and comment letters: Sale and Leaseback with Variable Payments (IFRS 16)

Dear colleagues ,,

I would like to thank you all , for the bright recognized efforts you performed in the tentative agenda decision of sale and leaseback with variable payments , in addition the example was extremely useful to clearly describe the committee decision .

I found such generous opportunity to provide some suggestions to improve decision reached which might be advantageous in process of further deliberations in considerations with other comments and analysis .

I regret not to agree with the decision of the committee at this time , the justifications and the consequent suggested amendments of such conclusion are accompanied with my letter (Page 2-4).

Kindly , if you need any further explanations in relation to the attached conclusion or suggested amendment , it will be my pleasure to respond in fully to you using below contact.

Thanks

Your sincerely ,,

Shady Mehelba

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CPA- California Board of accountancy

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Basis of conclusion and suggested amendments :

I do not agree with committee's decision , I think the committee's decision ignored IFRS 16 Par.27(b) in which lease liability' composition was determined at initial measurement to include only variable payments linked to rate or index at commencement of lease .

it was indicted in the committee decision "*the seller-lessee also recognizes a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the lease liability is a consequence of how the right-of-use asset is measured— and the gain or loss on the sale and leaseback transaction determined—"*

Applying the previous paragraph Par.100(a) IFRS 16, although achieve its objective of measuring retained right of use of assets and gain to that extent but does not provide clear conclusion about the liability , in my opinion , such paragraph is not aligned with the workings of the example presented . the example's workings has one of its steps determined the right of use of assets using proportionate method based on present value of expected variable payments divided into FMV of PPE , accordingly the present value of expected payment ,which is the major part of composition of any lease liability , would have affected the measurement of right of use of assets and its outcome lease liability . while Par.100(a) focus on measuring of carrying value of right of use of asset which is transferred ,there is no direct criteria for measuring lease liability in such paragraph . in addition , the resulted lease liability is not expected to differ from the PV of expected payment of lease , no other event or condition make it logic that lease liability will be different from criteria stated in Par.27(b)which represent the general rule for measurement of lease liability. In consequence, the inclusion of expected variable payments is indirectly affect the liability ,and if not , then we have to conclude that 450,000 consist of right of use of asset and part of gain unrecognized , while depending on that hypothetical assumption , will need to consider the different accounting behavior of both accounts .

if we consider the present value of expected variable payment of lease in context of determination of right of use of asset(as committee concluded it is a consequence of retained right od use of asset) , this will be a contradiction of unit of account concept as The use of present value of expected variable payments and lease liability as a unit of accounts does have the same characteristics . it is an obligation which assumes time value of money and represent obligation with two types of change interest expense and payment cashflow . although it is in exchange of measured right of use of asset in context of what is retained by seller lessee , it reflects payment considerations for the right of use of asset and interest due to time value of money (i.e same common economic characteristics and pattern of expiration are reflected for both lease liability and the PV of variable payments) . Accordingly treating that liability differently from normal lease liability, taking in considerations assumption of calculation of such liability as a consequence of right of use of asset , will not be aligned with Framework and the associated unit of account concept of this liability (conceptual Framework for financial reporting issued March 2018 , Par 4.51(ii),(iii))

in addition , As a consequence in Subsequent to measurement , in case of asset suspension from operation , no revenues will be generated from the asset and in this case lease liability

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modification which not represent separate lease , it will be accounted for using Par .45-46 , and impairment may be indicated under Par.30 " cost model" . As a result, the effect of capitalizing lease liability and corresponding right of use of asset will not represent the substance of the transaction by recognition of gain when liability extinguished and impairment of asset .Instead ,i suggest that the variable rent payment is recognized as expense when incur since it is not linked to index or rate . This will be aligned with Par. 38 (b) . In addition , Recognition of expense will be faithfully representing the lease substance when asset performance is nill then no expense or revenues are expected to be recognized cause rent expense is linked to usage of asset . rent expense is will be recognized only when performance of related asset generates revenues. From my point of view , this is better achieve matching .

<u>As an alternative</u> *, in conjunction with the framework of financial reporting , Par 4.53 Sometimes, both rights and obligations arise from the same source. For example, some contracts establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability form a single unit of account , accordingly if committee determined liability as consequence of measuring retained asset , another conclusion will have come to minds as a consequence .*

Nevertheless, The related part of unit of account which represent right of use of asset may not relate to the liability as it relates to rights from the asset remaining as a consequence of sale , both accounts still relate to one of source of transaction . In addition , rights and obligations are interdependent of both parties and cannot be separated ,accordingly , suggestion may be concluded that only liability or asset shall be recognized, and accordingly single inseparable asset or liability is presented.

So that , I suggest that the liability is recognized only when satisfy recognition criteria of financial liability(IFRS 9) to extent of right of use of asset retained (not transferred) , if not align with criteria of Par.27. In addition , entity may elect not to defer unrecognized gain (reduce right of use of asset to extent of that amount).

In so far , This will Align partially with (Par 103(a)) ,as liability can be measured to extent of those untransferable rights of use not subject to sale (i.e excess of considerations received over transferable rights and gain either recognized or deferred).

In case of variable payments , degree of uncertainty may impact recognition , so associated asset and liabilities due to uncertainty may depend on same uncertainty and offsetting may be justifiable in such case .

I think committee may consider in further deliberations , other cases which affect whether sale and lease back in substance is a financial liability , especially when we consider ***that IFRS 15 consider only some circumstances that may affect sale and lease back , these cases most likely depend on factors such as repurchase agreement and was not clear regard impacts of other factors of lease back agreement such as lease term in relation to asset useful life or PV's sustainability in subject to FV (i.e instead , if PV of expected variable payment was 1,350,000*** *which would represent 75% of FMV) and lease back is classified as finance lease .*

<u>In accordance to aforementioned criteria of measuring such liability as financial liability , the following is suggested criteria to measure such financial liability and gain</u> *:*

The gain of sale attribute to derecognition of asset which satisfy IFRS 15 criteria subject to IAS 16 Par 68 which refer to IFRS 16 will be appropriately recognized , as in context of IFRS 16 Par.

100 it is required to recognize gain or loss from sale that attribute to rights transferred . The remaining portion which is not satisfying gain recognition criteria (deferred), will be treated as financial liability, by the difference between cash and right of use of asset over the asset 's CV and gain deferred& recognized amounted 450,000(1,800,000-1,350,000)

Accordingly , the amount represent excess of FMV and right od use retained interest over Asset's CV and which cannot be seen as gain or represent deferred gain (not sustained through consideration attribute to part transferred) shall be recognized as financial liability in line with Par 103 (a) . (i.e when part of rights does not satisfy the sale in accordance to IFRS 15 " the seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds " .

(a) *The right of use of assets retained proportionately calculated as apart from CV as the committee's example indicated 250,000 .*
(b) *The gain should be recognized by the difference between the net disposal proceeds and the carrying amount of the item .the attribute proceeds to sale shall be determined proportionately by reference to transferred right /total rights (FMV)1800000* 1350,000/1,800,000 = 1350,000*
(c) *Accordingly ,gain's ceiling is recognized subject to difference between sale's attributable consideration and CV = (1350,000-1000,000 CV) = 350,000.*
(d) *The remaining deferred gain 250,000(600,000-350,000) This reflect prudence rather than using gain over transferred portion of carrying value proportionately*
(e) *The lease liability is recognized to extent of excess of considerations received over asset's CV , recognized, and deferred gain (1800,000+250000 (right of use of asset)-1000,000-250,0000-350000) 450,000.*

The suggested journal entry:

Dr. cash 1800,000

Dr. right of use of asset 250,000

Cr Asset 1000,000

Cr gain 350,000

* *Cr. deferred gain 250,000*

Cr lease liability 450,000

- *Entity may elect to offset such deferred gain to right of use of asset in case of expected variable payment*

Suggested IFRS 16 Par.100 after modification

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 recognize only the amount of any gain or loss that relates to* ***<u>proceeds attribute to disposal</u>*** *of the rights transferred to the buyer-lessor .*

(b) ***The gain in (a) is recognized subject to ceiling in accordance with criteria of IAS 16 Par.71***

(c) ***To extent of gain attribute to transferred asset in (a) in excess of gain's ceiling in (b) , gain should be deferred and amortized over lease term if lease is classified as operating lease or in proportionate to decrease in PV, entity may irrevocably elect to reduce right of use of asset by to extent of such gain .***

(d) ***Remaining proceeds should be recognized as lease liability as required by Par.27 ,otherwise it is considered financial liability to extent to right of use of assets not consider to be transferred in sale .***

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

Our Ref: STA/001

09 May 2020

International Financial Reporting Standards Interpretations Committee
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Canary Wharf
London E14 4HD
United Kingdom

Dear Members of the IFRS Interpretations Committee,

TENTATIVE AGENDA DECISION AND COMMENT LETTERS: SALE AND LEASEBACK WITH VARIABLE PAYMENTS (IFRS 16)

The Institute of Certified Public Accountants of Uganda (ICPAU) appreciates the opportunity to comment on the above tentative agenda decision as published in the March 2020 IFRIC Update.

Enclosed in **Appendix 1** are our comments in detail. We hope that you find them helpful.

In case of any queries relating to this comment letter, please contact the undersigned at clutimba@icpau.co.ug

Yours faithfully,

CPA Charles Lutimba
MANAGER STANDARDS AND TECHNICAL SUPPORT
For: **SECRETARY/CEO**

Encl (ICPAU's Comments on Tentative Agenda Decision: Sale And Leaseback with Variable Payments (IFRS 16))

NNN/…….

Appendix 1

The IFRS Interpretations Committee (Committee) received a request about a sale and leaseback transaction with variable payments.

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.

Our Comments

Although paragraph 100 of IFRS 16 provides clear guidance on accounting for the transfer of an asset in a sale and leaseback transaction, the Institute of Certified Public Accountants of Uganda (ICPAU) does not consider these adequate in addressing the sale and leaseback transaction with variable payments described in the request. We believe that in addressing the inquiry, the Committee should consider paragraph 24 of IFRS 16 which states that "the cost of the right-of-use asset shall comprise (a) the amount of the initial measurement of the lease liability…"

Further, paragraph 27(b) provides that the lease payments included in the measurement of the lease liability comprise variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date for the right to use the underlying asset during the lease term that are not paid at the commencement date.

In paragraph 28, IFRS 16 gives examples of variable lease payments that depend on an index or a rate described in paragraph 27(b) to include, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. Because these do not include payments calculated as a percentage of the seller-lessee's revenue generated during the lease term, we doubt that this paragraph would be helpful to the transaction described in the request which does not seem to depend on an index or rate. Therefore, any attempt to apply the principle in paragraph 100 of IFRS 16, would make the Committee's proposal contradict the requirements of measuring the lease liability, which exclude variable lease payments that do not depend on an index or a rate, such as those linked to future performance or use of an underlying asset.

Further to this, the Basis for Conclusions accompanying IFRS 16 clearly describe why IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. We thus find it improper for the Committee to conclude that the seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. This does not only contradict with the provisions of the standard but equally lacks authoritative justification.

Additionally, based on paragraph 24 of IFRS 16, initial measurement of the lease liability cannot be as a consequence of how the right-of-use asset is measured because this would contradict the order. The paragraph suggests that a seller-lesser should first measure the lease liability before right-of-use asset is measured, and not the other way round.

To settle any contradictions in the Standard, paragraph 100 needs to be read in light of paragraph 24 of IFRS 16, which determines the cost components of the right of use asset, including as among the components the amount of the initial measurement of the lease liability. Paragraph 27 does not include variable lease payments linked to future performance or use of an underlying asset as part of the amount of the initial measurement of the lease liability.

Therefore, as per paragraph 24, a right of use is a consequence of how a lease liability is measured. In the event that a lease liability cannot be measured, a right of use cannot equally arise; and there would be no need to apportion the gain on sale between right retained and right transferred as guided under paragraph 100 (Paragraph 100 seems to provide guidance on how to apportion the gain on sale between the right transferred and the right retained only where there is a right of use asset).

With the above foregoing, the Committee may request the Board to consider re-introducing an approach similar to the one in paragraph 59 of IAS 17 to defer, and amortize over the lease term, a proportion of the gain related to the proportion of the remaining asset's useful life retained by the seller-lessee in case that lease payments are only in form of variable lease payments linked to future performance or use of an underlying asset.

In conclusion, ICPAU considers this matter may require narrow-scope amendment of IFRS 16 as there are some areas that need clarity such as;

(a) Initial measurement of expected lease liabilities in a sale and lease back transaction where the variable lease payments are linked to future performance or use of an underlying asset;
(b) Subsequent measurement of a lease liability arising in a sale and leaseback transaction; and
(c) Re-assessment of variable lease liabilities in a sale and lease back transaction.

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11th May 2020

Dear IFRS Interpretations Committee members,

Invitation to comment – Tentative Agenda Decision (TAD): Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)

We are pleased to respond to your invitation to comment on the IFRIC's March 2020 Tentative agenda decision on Sale and Leaseback with Variable Payments – Agenda Paper 2 (IFRS 16 Leases). This response summarises our views and comments.

Sale and Leaseback with Variable Payments

We appreciate IFRIC's update to address the issue around measuring the right of use (RoU) retained in a sale and leaseback transaction where the lease payments are variable in nature. We agree that in accordance with paragraph 100 of IFRS 16, 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; 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.

Further, we agree that IFRS 16 provides the principles of measuring the right of use retained. The seller-lessee determines the proportion of the Property, Plant and Equipment (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.

However, IFRS 16 does not provide any specific method of measuring such right of use retained by the seller (lessee). In practice, such right retained is measured by comparing the present value of future lease payments under the leaseback to the fair value of the asset as follows:

Right of use asset retained	<u>Present value of future lease payments (1)</u> * previous carrying amount of the asset Fair value of the asset sold

In this regard, it appears that the interpretation and principal as outlined the tentative agenda paper that all variable payments are to be estimated and included in (1) above to compute RoU retained seems to contradict the general measurement principle in IFRS 16 that variable lease payments are to be excluded unless linked to an index or rate.

Accounting proposed in the Agenda paper

Tentative decision of IFRIC has interpreted, paragraph 100 of IFRS 16 requires an entity to measure the proportion of rights retained by comparing ***the present value of all expected lease payments (including variable payments dependent on future performance of the asset)*** with the fair value of the asset transferred and consequently measure the gain/loss on sale (as envisaged in the illustration in the agenda paper appendix 1).

General measurement principles for right of use asset/ lease liability:

Definition and method of measuring Right-of-use asset and lease liability (IFRS 16)

"*Right-of-use asset: An asset that represents a* ***lessee's right to use an underlying asset*** *for the lease term.*" – (Appendix A of IFRS 16)

"*The cost of the right-of-use asset shall comprise:*

(a) the amount of the initial measurement of the lease liability, as described in paragraph 26;
(b) any lease payments made at or before the commencement date, less any lease incentives received
(c) any initial direct costs incurred by the lessee; and
(d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset….." --- (Para 24 of IFRS 16)

Initial measurement of the lease liability

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. *The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.* – Para 26 of IFRS 16

At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

(a) fixed payments (including in-substance fixed payments as described in paragraph B42), less any lease incentives receivable;
(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 28);
(c) amounts expected to be payable by the lessee under residual value guarantees
(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs B37–B40); and
(e) *payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.* (Para 27 of IFRS 16)

Variable lease payments that depend on an index or a rate described in paragraph 27(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. (Para 28 of IFRS 16)

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Discussion

1. **Variable lease payments consideration while measuring lease liability / future lease payment**

As the variable lease payments based on future performance of the asset should be excluded in lease payments, computation done by applying provisions of para 24 and para 27 of IFRS 16 will result in a near zero lease liability or RoU.

IASB Board is well aware of thought process that went into the deliberation of *2010 exposure draft of Leases standard* to see the possibility of adding variable lease payments to compute lease liabilities, however post comments from various quarters it was decided not to include variable lease payments as:

- Certain board members felt variable lease payments are avoidable in nature or linked to future performance of the asset hence it doesn't meet the definition of liability
- Some board member felt variable lease payments need not be included in computing lease liability as there is the high level of measurement uncertainty

Basis these view board decided to exclude variable lease payments from computation of lease liability.

The whole IFRS 16 standard's lessee accounting is based on the presumption that the asset (RoU) can be reliably measured i.e. present value of future lease payments, excluding variable payments that are dependent on the performance of the asset. Where the definition of the lease payment is not met, the question of computing RoU based on the variable lease payments cannot arise.

In a sale and lease back transaction where lease payments are variable in nature, the cost to acquire the RoU could not be quantified as there is no fixed obligation on the date of acquisition/transfer. This also reflects the economic substance of the transaction because:

- ➢ Seller-lessee has transferred the risk and reward of holding the asset to the buyer-lessor
- ➢ Lessor and lessee have agreed for entire payment to be variable which is dependent on the future performance of the asset. In substance lessee's obligation is not a certain outflow, likewise for lessors also it is not a certain inflow. This is a strong indicator that the buyer-lessor bears the significant risks and rewards relating to the underlying asset.
- ➢ When no amount is attributable to the right held today by the seller-lessee, applying the requirements in para 100 of IFRS 16 does not result in recognition of any asset.

Sale and leasebacks are not any different from an ordinary lease especially when the sale of an asset meets transfer of control criteria under IFRS 15 and the transfer is at a fair market value. In those circumstances we feel entities should draw the principals of para 27 of IFRS 16 to compute lease liability and the consequent computation of right of use asset retained. Thus, when the future variable lease payments do not meet the definition of lease payments are per IFRS 16, it would not be appropriate to consider the same only for sale and leaseback transactions.

2. **Measurement difficulties:**

We wish to highlight to the committee regarding certain practical challenges which lot of entities would face while applying the principles envisaged in Agenda paper 2. We wish to highlight that in case of certain long-term sale and leaseback transactions in various industries where the lease term could be up to 25 to 30 years. The lease rentals are variable and are based on percentage of revenue generated by the asset over the period of lease.

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The sale satisfies the criteria in IFRS 15 and IFRS 16 requires an entity to recognise gain/loss to the extent of rights transferred.

Further, often entities enter into leases with variable lease payments based on performance or use is because of the uncertainty associated with that future performance or use; that is, entities wish to share the risks of the uncertainty about the economic benefits to be derived from using an underlying asset with the lessor.
For such long-term contracts, it would be impracticable to estimate the amount of future lease payments to measure the proportion of rights retained by the entity. Further, measuring such right would also result in fluctuations in subsequent years depending on changes in the actual lease payments.

This is particularly become more impracticable in the agriculture industry since the future revenues and lease payments vary significantly over a long period on account of the following factors:

- Agriculture output depends on many factors such as climate, availability of water, quantum of rain, soil quality, trees quality etc.
- Production volume depends on plant efficiency, consumer demand and behaviour, technological changes.
- Pricing of commodities is market driven which depends upon supply demand curve.

As outlined above, when lease rental is dependent on future performance of the asset, there are multiple factors which are highly variable in nature and it is extremely difficult and impracticable to estimate the amount of future lease payments, this become more complex and impracticable if lease is for longer period. For example, recent COVID 19 outbreak has been adversely impacting many economic activities around the world and this may substantially impact the revenue or cash flows performance for current year and this may substantially change future estimates as well. In the current circumstances with lockdown and no revenue to the seller-lessee, the lessor's lease payment might be zero.

Further, currently there is no clarity in guidance available in terms of method to be used to estimate the future lease payment when lease payments are dependent on the performance of the asset. We feel in the absence of additional guidance, trying to estimate future lease payment for long periods (25 – 30 years) may be a futile exercise.

IFRS does not generally encourage takings in estimates for such long term where there are multiple variables (specially not within the control of an entity), case and point is impairment testing. Such long-term estimates will invariably have significant deviation and will not represent the pattern of economic benefits that will flow into the entity.

3. The question of subsequent accounting:

We would like to highlight that a question related to variable payments for purchase of Property, plant and equipment and intangible assets were raised in 2011, in July 2013 IFRIC agreed that this is a large question and it needs to be addressed by way of a separate project and will be taken up when the project related to framework is complete. It also agreed that the project has to comment on both initial and subsequent recognition of at the same time.

In the case of sale and leaseback with variable lease payments, IFRIC itself has agreed that there is little guidance on how to account for subsequent variation from estimate and actuals payments and subsequent accounting will

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be taken up as a narrow scope amendment. When the variability is dependent on future performance of the asset there are bound to huge variation from the initial estimate. In such a scenario without addressing subsequent accounting only commenting on initial accounting could put preparers at a disadvantage as no-one is clear on the entire flow of accounting for the transaction.

IASB updates July 2013 is attached in Appendix 2 for quick reference.

4. Current guidance – Accounting for variable lease payments in various non-current assets:

Below table illustrates the current guidance for treatment of variable payments linked to future performance of the assets for various nature of non-current assets:

Item	Treatment
Property, Plant and equipment	No specific guidance in the standards, entities need to develop an accounting policy. There are varied practices in industry, which is outlined below: Alternative 1: the fair value of all variable payments should be included in the initial measurement of the liability on the date of purchase of the asset (provided that the asset has been received); or Alternative 2: variable payments that are dependent on the purchaser's future activity should be excluded from the initial measurement of the liability until the activity is performed. (refer Appendix - 3)
Intangible assets	
Right of Use asset (RoU)	Excluded.
RoU out of sale and leaseback	As per committee's tentative decision variable payments will be included

Concluding remarks:

IFRS is driven by economics and substance of the transaction, if in substance of the transaction where there is no lease liability required, then even under a sale and lease back scenario a liability and RoU need not be recognised. In our opinion para 100 of IFRS 16 provides adequate basis for measuring RoU retained and in the instant example if the RoU retained is zero, this not necessarily wrong as there is no fixed obligation to obtain the right.

IFRS is a principal-based standard except for the obvious quote of para 100 of IFRS 16, the agenda paper does not provide a rationale for considering variable lease payments as a part of expected lease payments.

We feel there will be significant cost required to identity variable lease payments and even if identified there could be significant deviation from the estimated lease payments, committee itself has agreed the subsequent accounting is not clear. Further, excluding variable lease payments is also consistent with IASB's conclusion of measurement of lease liability on a cost-benefit aspect as well.

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As we see there are lot of challenges in applying the guidance outlined above and guidance itself is not complete where it is not addressing the subsequent measurement there could deviations in the practice when it is applied. If IFRIC in its wisdom concludes additional guidance is required we suggest committee to issue a comprehensive guidance on initial accounting and subsequent accounting of variable lease payments in sale and leaseback transactions, else this agenda decision could lead to divergent practices without achieving any tangible benefit of improving the financial reporting across industries.

If you have any questions in relation to this letter please do not hesitate to contact Neelamani Muthukumar, MD and Group CFO (muthu@olamnet.com), or Bikash Prasad, Global head – Corporate Finance (bikash.prasad@olamnet.com).

Yours sincerely,

Olam International Limited

Managing Director & Group CFO

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Appendix 1

Agenda Paper 2 – Sale and leaseback transactions – Variable payments
The Committee received a request about a sale and leaseback transaction with variable payments. In the transaction described in the request:

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

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

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

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

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

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

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

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

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

Seller-lessee determines that it is appropriate to calculate the proportion of the PPE that relates to the right of use retained using the present value of expected payments for the lease. On this basis, the proportion of the PPE that relates to the right of use retained is 25%, calculated as CU450,000 (present value of expected payments for the lease) ÷ CU1,800,000 (fair value of the PPE). Consequently, the proportion of the PPE that relates to the rights transferred to Buyer-lessor is 75%, calculated as (CU1,800,000 - U450,000) ÷ 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).*

At the date of the transaction, Seller-lessee accounts for the transaction as follows:
Dr. Cash CU1,800,000
Dr. Right-of-use asset CU250,000
Cr. PPE CU1,000,000
Cr. Lease 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 2

IAS 16 / IAS 38 — Contingent Pricing of PPE and Intangible Assets:
IAS 16 *Property, Plant and Equipment* / IAS 38 *Intangible Assets*: Variable payments for the separate acquisition of PPE and intangible assets

The IFRS Interpretations Committee received a request to address an issue that is related to the accounting for variable payments for the acquisition of property, plant and equipment or intangible assets outside of a business combination. It observed that there are currently divergent interpretations of the current requirements in IFRS regarding the timing of recognition of the liability to make variable payments for the acquisition of a tangible or intangible asset. The Interpretations Committee could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be excluded from the initial measurement of the liability until that activity is performed. In all other cases (i.e. where the variable payments do not depend on the purchaser's future activity), it tentatively agreed that the fair value of those variable payments should be included in the initial measurement of the liability on the date of purchase of the asset (provided that the asset has been received).

With regard to the subsequent accounting for a financial liability to make variable payments, the Interpretations Committee decided to recommend that the IASB should amend current Standards. It recommended that if the financial liability is not a floating rate instrument then, in specified circumstances, the cost of the corresponding asset should be adjusted when the carrying amount of that financial liability is remeasured.

At its July 2013 meeting, the IASB noted that the initial accounting for variable payments affects their subsequent accounting. Some IASB members expressed the view that the initial and subsequent accounting for variable payments for the purchase of assets are linked and should be addressed comprehensively. The IASB also noted that accounting for variable payments is a topic that was discussed as part of the Leases and Conceptual Framework projects. The IASB decided that it would reconsider the accounting for variable payments for the acquisition of tangible or intangible assets after the proposals in the Exposure Draft Leases (published in May 2013) have been redeliberated. All IASB members agreed.

Next steps

The staff will bring a paper to a future IASB meeting after the proposals in the Exposure Draft Leases (published in May 2013) have been redeliberated.

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Stockholm 12 May 2020

Tentative Agenda Decision – Sale and Leaseback with Variable Payments (IFRS 16)

FAR, the Institute for the Accountancy Profession in Sweden, is responding to your invitation to comment on the above Tentative Agenda Decision, that was published in the March 2020 edition of IFRIC Update.

FAR does not agree with the decision not to add this issue onto its standard-setting agenda. The principles and requirements in IFRS 16 with regard to variable lease payments that do not depend on an index or rate is clear and excludes variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. BC 169 states the reasons for this decision by the IASB. For some Board members, this decision was made solely for cost-benefit reasons. Those Board members were of the view that all variable lease payments meet the definition of a liability for the lessee. However, they were persuaded by the feedback received from stakeholders that the costs of including variable lease payments linked to future performance or use would outweigh the benefits, particularly because of the concerns expressed about the high level of measurement uncertainty that would result from including them. Other Board members did not think that variable lease payments linked to future performance or use meet the definition of a liability for the lessee until the performance or use occurs. They regarded those payments to be avoidable by the lessee and, accordingly, concluded that the lessee does not have a present obligation to make those payments at the commencement date.

The tentative agenda decision explains that the seller-lessee recognises a lease liability at the date of the sale and leaseback transaction, even if all the payments for the lease are variable and do not depend on an index or rate. FAR questions whether this apparent contradiction to the definition of a lease liability in IFRS 16 can be solved by means of an agenda decision, with all the limitations that pertain to such an agenda decision. When an issue is of importance principally, FAR thinks it would be better to amend a standard, either through a separate process or through the annual improvement process. Such a process would involve proper due process.

FAR has noted the IFRS Interpretations Committee's (Committee) recommendation that the Board consider a narrow scope amendment to specify how the seller-lessee subsequently measures the liability that arises in the sale and leaseback transaction. Since the Committee itself has concluded that standard setting with regard to sale and leaseback transactions involving variable lease payments is needed, FAR is of the opinion that also the matter covered by the tentative agenda decision should be part of such future standard setting activities, given the conflicting guidance included in the tentative agenda decision compared to principles and requirements in IFRS 16. By doing so, the feedback received from stakeholders with regard to the high level of measurement uncertainty that would result from including variable payments in the lease liability can be addressed, as well as views expressed in BC 169 that lessees do not have a present obligation to make those variable payments at the date of the transaction.

Yours sincerely,

Pernilla Lundqvist
Chairman Accounting Practices Committee

Accounting Standards Board of Japan (ASBJ)
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13 May 2020

Ms. Sue Lloyd
Chair of the IFRS Interpretations Committee
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Comments on the Tentative Agenda Decision Relating to
IFRS 16 *Leases* — Sale and Leaseback with Variable Payments

1. The Accounting Standards Board of Japan ("the ASBJ" or "we") welcome the opportunity to comment on the IFRS Interpretation Committee ("the Committee")'s tentative agenda decision relating to IFRS 16 *Leases* — Sale and Leaseback with Variable Payments, proposed in the March 2020 IFRIC Update.

2. There are various perspectives regarding whether a gain or loss should be recognised on the sale of an underlying asset in a sale-and-leaseback transaction, ranging from immediate recognition of the entire gain on the sale of the asset when control is transferred to recognition over the leaseback term to reflect the way in which the significant risks and rewards are transferred. IFRS 16 states that, because the seller-lessee has partly retained rights inherent in the asset subject to the leaseback, recognising the gain that relates to the rights transferred to the buyer-lessor appropriately reflects the economics of the transaction (paragraph BC266). We agree with this approach in IFRS 16 to recognise the gain that relates to the rights transferred to the buyer-lessor.

3. On the other hand, IFRS 16 prescribes that, if the consideration for a lease is a variable payment linked to future performance or use of an underlying asset (hereinafter called the "performance-based variable lease payments"), such payments are excluded from the measurement of lease liabilities. IFRS 16 explains that some think that a lessee's liability to make variable lease payments does not exist until the

future event requiring the payment occurs and others think that a lessee's obligation to make variable lease payments exists at the commencement date by virtue of the lease contract and receipt of the right-of-use asset (paragraph BC168). However, the Board decided to exclude performance-based variable lease payments from the measurement of lease liabilities, noting that, for some Board members, this decision was made solely for cost-benefit reasons (paragraph BC169).

4. The tentative agenda decision states, without adding any clear explanation:

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

   However, as illustrated in the discussion in the previous paragraph regarding performance-based variable lease payments, some hold the view that a lessee's liability to make variable lease payments does not exist until the future event requiring the payment occurs. Accordingly, we note that it is not necessarily obvious that "the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee" set out in the paragraph 100(a) exists.

5. Although we agree with the conclusions in the tentative agenda decision, we do not think those conclusions can be derived directly from IFRS 16. Accordingly, we are of the view that IFRS 16 should be amended in this respect. Specifically, we propose that the following amendments be made to IFRS 16:

   (a) the seller-lessee shall take into account the lease payments, even if they are variable lease payments that do not depend on an index or a rate, when it determines "the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee" set out in the paragraph 100(a) of IFRS 16; and
   (b) accordingly, the seller-lessee shall recognise a lease liability on the transaction date, even if the payments for the lease are variable payments that do not depend on an index or a rate.
   (c) IFRS 16 should include application guidance regarding how to measure lease liabilities for leases with variable lease payments that do not depend on an index or a rate.

(d) IFRS 16 should include disclosure requirements regarding lease liabilities for leases with variable lease payments that do not depend on an index or a rate. This is because, while such liabilities would be included in the maturity analysis, it is unclear what to disclose given that their nature is unclear.

6. We hope that our comments are helpful for the Committee's and the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Atsushi Kogasaka
Chair
Accounting Standards Board of Japan

13 May 2020

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
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London E14 4HD
United Kingdom

Dear Ms. Lloyd,

IFRS Interpretations Committee Tentative Agenda Decisions

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the following Tentative Agenda Decisions:

- Deferred Tax Related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)
- Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)

We agree with the Interpretations Committee's reasons set out in the respective Tentative Agenda Decisions for not adding these items onto its agenda.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,

TAN BEE LENG
Executive Director

Córdoba (SPAIN) May, 13th 2020

Dear members of the International Accounting Standards Board,

We appreciate the opportunity to comment on *Tentative Agenda Decision and comment letters: Sale and Leaseback with Variable Payments (IFRS 16).* We are faculty members of the Department of Financial Economics and Accounting at Universidad Loyola Andalucía (Spain). We have been studying IFRS 16 *Leases* for a long time, and we would like to share with you our comments. We hope you find them helpful.

We consider that IFRS 15 and IFRS 16 accounting standards are useful for addressing this issue. However, we think that the lease liability that is recognized on the commencement date does not meet the criteria to be classified as a liability. A present obligation does not exist as the seller-lessee has the practical ability to avoid the expected lease payments.

In our opinion, this sale-leaseback operation is equivalent to a sale in which the rights are transferred at the end of the lease term. For this reason, the gain (or loss) that the seller-lessee recognizes is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor. In the illustrative example, a performance-based variable consideration is included in the transaction price. On the commencement date of the agreement, the seller-lessee receives payment of the selling price, but he/she must satisfy future payments that are normally fixed but, in this case, must be estimated. In our opinion, the transaction could be analysed by applying IFRS 15 as regards to variable considerations in the transaction price. Thus, the liability that would arise on the commencement would be classified as a contract liability.

The accounting entry would be as follows:

At the date of the transaction:

Items	Db.	Cr.
Cash	1,800	
Property, plant & equipment		1,000
Contract liability		200
Profits on disposal of PPE		600

The contract liability would represent, in this case, a deferred gain, corresponding to the gain on the rights that were not transferred to the buyer-lessor. The entity should not re-measured the rights transferred retrospectively due to changes in actual lease payments based on actual usage. The contract liability should, therefore, be recognized in the income statement on a straight-line basis. Then, it would be treated as an adjustment to the future lease payment rather than the reassessment of the deferred gain.

The accounting entry would be as follows:

Items	Db.	Cr.
Contract liability	40	
Lease expenses		40
Lease expenses	150	
Cash		150

A most common situation would be a leaseback contract with fixed and variable payments and the accounting treatment should be consistent with that of the discussed example.

Please do not hesitate to contact us for any clarification or further information.

Sincerely,

PhD Horacio Molina-Sánchez **PhD Marta de Vicente-Lama** **Mar Ortiz-Gómez**

Universidad Loyola Andalucía

Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2020:02

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Dear Committee members,

Re: Tentative agenda decisions Sale and Leaseback with Variable Payments (IFRS 16 *Leases*) and Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)

The Swedish Financial Reporting Board (SFRB) is responding to your invitation to comment on the tentative agenda decisions regarding Sale and Leaseback with Variable Payments (IFRS 16 *Leases*) and Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*).

We have analyzed the committee's decision not to add the two issues to the standard setting agenda. As we understand the committee's due process, not adding an issue to the standard setting agenda means that the answers to the questions posed to the committee can be derived from reading current IFRS without having to add any new principles or rules and, in effect, ruling out alternative interpretations of the standards. Adding the issues to the agenda would have meant that the committee must suggest formal interpretations, i.e. IFRICs, or suggest changes to the standards to clarify the accounting because the standards are not sufficiently clear.

The committee has however in this case also reached the conclusion that answers to the questions shall be issued as so-called agenda decisions and published in the committee's newsletter. This means that guidance is given, even though not as formal interpretations, about how to apply IFRS as a response to the questions. However, these are not formal interpretations which create uncertainties among prepares, auditors and other stakeholders if the agenda decisions are the only acceptable way to interpret the principles in IFRS, or if there could be other equally possible interpretations.

For one of the issues addressed, the sale and leaseback issue, the committee has also reached the conclusion that even though no interpretation is needed, an annual improvement of IFRS 16 is needed because of the conclusion drawn by the committee in the agenda decision.

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The SFRB has some concerns related to these decisions. Our concerns follow below under separate headings.

Sale and leaseback with variable payments

The SFRB has two concerns related to this tentative agenda decision. The first concern is that we don't agree that the answer to the question addressed by the committee follows from a reading of the standard. In our opinion the committee has interpreted the standard and added new principles regarding measurement that cannot be found in the standard. The tentative agenda decision suggests a possible way to measure the sale and the lease back that changes the definition of lease liabilities by including variable lease payments, thus actually setting some form of preferred measurement standard, but at the same time leaving the area open for uncertainty and judgement. A change in the definition of what payments to include in the lease liability shall not be dealt with in a tentative agenda decision. Such a change should be made via an amendment of the standard.

Secondly, we find it hard to understand why the consequence of the suggested measurement of the liability results in a need to amend IFRS 16 through an annual improvement. The committee has reached the conclusion that the suggested measurement approach for the lease back liability in the tentative agenda decision effects the accounting treatment of the leased back right-of-use asset. For some reason the committee believes the accounting treatment of the right-of-use asset should be addressed through an annual improvement of IFRS 16. If there was no need to address the question posed to the committee through a change of the standard or through an IFRIC, then why is it necessary to update the standard for a conclusion drawn in an agenda decision? An agenda decision and an annual improvement does not have the same standing in the "GAAP-hierarchy" and the due processes are not similar. For an annual improvement, a formal comment period is required, and the outcome changes the actual standard. That is not the case with an agenda decision. We would have expected that an interpretation of the standard and a suggested change or clarification to measurement principles for a linked transaction (sale and lease back), was treated in one coherent way for both the sale and the leased back right-of-use asset.

Deferred tax related to an investment in a subsidiary

We cannot see that the conclusion made by the committee in this case follows from a simple reading of the standard.

The committee has reached its conclusion after taking into its analysis (refer to committee staff paper ap03):

- what the standard said in paragraph 3 before an amendment in 2000,
- what the purpose of the amendments in 2000 were,
- Agenda Paper 7 for the International Accounting Standards Committee's October 2000 meeting

This shows in our opinion that the conclusion in the tentative agenda decision cannot be made without interpreting IAS 12 to such a degree that it means a change in the standard is needed in order to reach the conclusion. Thus, we believe that this conclusion is above the level of dismissing it from the standard setting agenda. We don't agree to the approach that guidance as to how the standard is supposed to be read should be given through an agenda decision if the standard is unclear and can be read in more than one way. In such a situation, the standard should be adjusted, and a formal due process applied.

If you have any questions concerning our letter, please address our Executive member Mikael Scheja by e-mail to: mikael.scheja@radetforfinansiellrapportering.se.

Stockholm, 12 May 2020

Yours sincerely

Anders Ullberg
Chairman

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Ms. Sue Lloyd
Chairperson
IFRS Interpretations Committee

Date: May 13, 2020
New Delhi, India

Dear Ms. Lloyd

Sub: Comments of the Institute of Chartered Accountants of India (the ICAI) on Tentative Agenda Decision issued by IFRS Interpretations Committee on 'Sale and leaseback with variable payments (IFRS 16)'

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (the ICAI) acknowledges the opportunity to comment on the Tentative Agenda Decision (TAD) on 'Sale and leaseback with variable payments (IFRS 16)' issued by IFRS Interpretations Committee.

Our comments are given in Annexure A.

Our comments are based on deliberations at the ASB on the TAD.

With kind regards,

CA. M.P Vijay Kumar
Chairman
Accounting Standards Board
Institute of Chartered Accountants of India

Annexure A

Comments on Tentative Agenda Decision on 'Sale and leaseback with variable payments (IFRS 16)'

We appreciate the guidance provided by IFRS Interpretations Committee on the measurement of right-of-use asset and resultant gain or loss (if any) arising from the sale and leaseback transaction where lease back payments are variable and not based on index or rate. We agree that IFRS 16 provisions do not explicitly deal with the instant situation and there is a need for clarity in this regard. We have following comments on the TAD:

Initial Measurement of lease liability and right-of-use asset arising from sale and lease back transaction

Lease payments in the instant case are variable that do not depend on index or rate, therefore, such future payments do not meet the general requirements of paragraph 26 to 28 of IFRS 16 for inclusion in the initial measurement of a lease liability and right-of-use asset of the lessee. Rather, after the commencement date of lease, such variable lease payments are recognized in profit or loss, unless the costs are included in the carrying amount of another asset applying other applicable Standards (paragraph 38 of IFRS 16). However, in view of special requirements for initial measurement of right-of-use of asset of a seller-lessee and gain or loss on such a sale transaction as contained in paragraph 100(a) of IFRS 16, right-of-use asset of a seller-lessee is initially measured at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, gain or loss is recognised only to the extent it relates to the rights transferred to the buyer-lessor. As per the TAD, in the books of the lessee, liability is also to be recognized for the obligation to make lease payments even if the lease payments are variable and not based on index or rate. In this regard we would like to highlight the following issues:

- As mentioned in the Staff paper, there are two views possible here. With regard to the view that paragraph 100(a) should be applied and right-of-use asset of a seller-lessee is initially measured at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee and initial measurement of the lease liability is a consequence of the measurement of the ROU asset, the primary issue is that since the obligation of the seller lessee to pay variable lease rentals does not meet the provisions of paragraph 26 to 28 of IFRS 16 regarding initial measurement of a lease liability of lessee, the same cannot be treated as lease liability.
- If, as stated in the TAD, such liability is classified as lease liability of a lessee, the accounting treatment prescribed in the TAD is inconsistent with the general principles of the initial measurement of a lease liability that it should not include variable lease payments, other than those that depend upon an index or rate. It may also be noted that according to paragraph 24, one of the elements that comprise the right-of-use asset is the initial measurement of lease liability measured as per paragraph 26. In the given case, since all the lease payments are variable and are not based on an index or rate, these therefore, do not qualify to be included in the initial measurement of a lease liability. Accordingly, the lease liability should be initially measured and recognised at zero and as a consequence the right-of-use asset should also be recognized at zero. Accordingly, the entire amount of gain gets recognized at the time of sale and leaseback transaction. This view is not consistent with the IASB's intended rationale for measuring the gain or loss on sale and lease back transaction as stated in paragraph BC266 of IFRS 16. However, recognition of right-of-use asset at zero in the given case will contradict the requirements of paragraph 100(a) of IFRS 16, which needs to be addressed, may be by creating an exception to paragraph 100(a).

- It is not appropriate to address this inconsistency by way of a position in the agenda decision. In this regard, it is important to note that paragraph 36 of the staff paper provides that "As discussed earlier in the paper, paragraph 100(a) of IFRS 16 specifies how the seller-lessee measures the ROU asset arising from a leaseback and the amount of gain or loss it recognises at the date of the transaction. This means that the seller-lessee does not apply the measurement requirements in paragraphs 23–24 of IFRS 16, which would otherwise apply when initially measuring a ROU asset. Similarly, a consequence of the requirements in paragraph 100(a) is that the initial measurement of the lease liability is determined by the measurement of the ROU asset and the gain or loss on the transaction recognised applying paragraph 100(a). This in turn means that the seller-lessee does not apply the measurement requirements in paragraphs 26-27 of IFRS 16, which would otherwise apply when initially measuring a lease liability." We do not agree that the Standard has sufficient guidance and, therefore, the issue of initial recognition, as proposed in TAD, cannot be addressed through Agenda Decision. We recommend to deal with the matter through a standard setting activity.

Subsequent Measurement of lease liability arising from sale and lease back transaction

- As mentioned in the earlier section, since the obligation of seller-lessee to pay variable lease rentals that are not based on an index or rate does not qualify to be lease liability as per provisions of IFRS 16, the subsequent measurement provisions of the Standard cannot be applied in the instant case without resolving the inconsistency as mentioned above. In our view, the liability cannot be classified as lease liability until IFRS 16 is amended.

Proposal to address the issue by narrow scope through amendment through an Annual Improvement

- It is proposed to address the issue by making narrow scope amendment through an Annual Improvement that would specify how the seller-lessee applies IFRS 16's subsequent measurement requirements to the lease liability that arises in a sale and leaseback transaction. In this regard, paragraph 58 of the Staff Paper states that "In our view, such an amendment would meet the criteria for annual improvements in paragraph 6.11-6.14 of the Due Process Handbook. To meet these criteria, the amendment should not propose a new principle or change an existing principle, and would need to be limited to:

  (a) clarifying the wording in a Standard; or

  (b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements."

  We are of the view that the treatment proposed in TAD in the instant case is creating an exception to general principles of the Standard particularly with regard to initial and subsequent measurement of lease liability, and attempting to address the consequent inconsistency with regard to recognition of the right-of-use asset. The proposals are not merely clarifying the wording of the Standard or correcting the minor conflicts, therefore, the same do not meet the criteria as mentioned in paragraph 58 of the Staff Paper in order to qualify for narrow scope amendment. Accordingly, the issue needs to be addressed by taking up a Standard-setting activity other than narrow scope amendment.

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Ms Sue Lloyd
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Our ref BOD/288

13 May 2020

Dear Ms Lloyd

Tentative agenda decision: *Sale and Leaseback with Variable Payments (IFRS 16 Leases)*

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee) tentative agenda decision *Sale and Leaseback with Variable Payments (IFRS 16 Leases)* (IFRIC Update March 2020). We have consulted with, and this letter represents the views of, the KPMG network.

We support the Committee's tentative conclusion that the seller-lessee initially measures the right-of-use asset as a proportion of the previous carrying amount of the underlying asset. However, we disagree that the seller-lessee recognises a lease liability when all payments for the lease are variable. We believe that this conclusion is inconsistent with the measurement requirements of IFRS 16. See the Appendix to this letter for our detailed analysis of this question.

Therefore, we recommend that:

— the Committee finalise the agenda decision confirming that the seller-lessee initially measures the right-of-use asset as a proportion of the previous carrying amount of the underlying asset; and

— the International Accounting Standards Board (the Board) consider both the initial and subsequent accounting for the liability that arises in such transactions in its proposed narrow-scope standard-setting project.

Please contact Reinhard Dotzlaw or Kimber Bascom at +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Appendix – Detailed comments

The seller-lessee's liability

We disagree with the Committee's tentative conclusion that the liability recognised by the seller-lessee is a lease liability for the following reasons:

- IFRS 16 contains specific guidance on the initial measurement of a lease liability, which should be applied to all lease liabilities;
- that guidance excludes variable lease payments that do not depend on an index or rate from the measurement of the lease liability;
- it is unclear whether the discount rate to be used by the seller-lessee complies with IFRS 16;
- the tentative conclusion raises questions over accounting for more complex sale and leaseback transactions; and
- specifying that the liability is a lease liability impacts subsequent accounting.

For these reasons, we recommend that the Board consider both the initial and subsequent accounting for the liability that arises in such transactions in its proposed narrow-scope standard-setting project.

* * *

IFRS 16 contains specific guidance on the initial measurement of a lease liability

IFRS 16 contains guidance on initial measurement of a lease liability in paragraphs 26-28. It does not contain alternative guidance that applies when a lease liability arises in the context of a sale and leaseback transaction. We therefore believe that the lease liability should be measured initially in accordance with paragraphs 26-28.

We note that the question in the submission to the Committee arose because IFRS 16 includes guidance on initial measurement of a right-of-use asset in paragraphs 23-25, and also in paragraph 100. The Committee concluded that the guidance in paragraph 100 applies. However, there is no equivalent question regarding initial measurement of lease liabilities, as IFRS 16 sets out a single approach.

IFRS 16 excludes variable payments that do not depend on an index or rate from measurement of a lease liability

IFRS 16 lists the lease payments that are included in the initial measurement of a lease liability in paragraph 27. This list does not include variable lease payments that do not depend on an index or a rate.

We note that the Committee agenda paper argues that the seller-lessee's obligation to make variable payments to the buyer-lessor arises in consideration for the right to use the underlying asset during the term of the leaseback. This observation applies equally to every other lease that includes variable lease payments. It does not in itself justify a departure from the requirements of paragraph 27 of IFRS 16.

We note that the Board decided to exclude most variable payments from the measurement of a lease liability on practical grounds. This exclusion is a requirement, not a choice. There are many situations in which this exclusion may result in counterintuitive accounting – notably when all lease payments are variable.

If a Committee agenda decision promotes departure from such a clear requirement of IFRS 16 in one case, this will raise practice questions as to what other situations justify such a departure.

It is unclear whether the discount rate to be used by the seller-lessee complies with IFRS 16

The Committee did not discuss the discount rate to be used by the seller-lessee to discount the variable lease payments. The Committee agenda paper implied this would be a market rate.

Under paragraph 26 of IFRS 16, a lessee measures a lease liability by discounting the lease payments using either the rate implicit in the lease or the lessee's incremental borrowing rate. It is not clear how the seller-lessee can comply with that requirement given the methodology used in the agenda paper to calculate the initial carrying amount of the liability.

The tentative conclusion raises questions over accounting for more complex sale and leaseback transactions

The fact pattern considered by the Committee is relatively simple: the transaction is on market terms and all payments are variable. Additional issues will arise with the application of the Committee's conclusions to more complex fact patterns.

For example, in the fact pattern considered by the Committee, the transaction is assumed to be at market. IFRS 16 provides guidance on accounting for sale and leaseback transactions that are not at market in paragraphs 101-102 and in Illustrative Example 24. Paragraph 101(b) states that above-market terms shall be accounted for as “additional financing”, and Illustrative Example 24 specifies that the liability arising is a “financial liability”.

It is unclear whether the Committee’s tentative conclusion also applies to the liability recognised by a seller-lessee under paragraph 101(b).

Further, in the fact pattern considered by the Committee, all payments are variable. If some of the payments were fixed – for example, if there were a minimum guaranteed payment under the leaseback – then many of the issues already noted would be exacerbated. For example, would the lessee be required to use its incremental borrowing rate to discount the fixed lease payments and some other “market-based” rate to discount the variable payments?

Specifying that the liability is a lease liability impacts subsequent accounting

We note that the Board has already discussed a narrow-scope standard-setting project on subsequent accounting for the liability. However, until any changes to IFRS 16 arising from that project become effective, the seller-lessee would have to apply the currently effective requirements of IFRS 16 to the liability if the Committee specifies that it is a lease liability.

One complexity already noted is that it is not clear whether the seller-lessee can comply with the requirements of IFRS 16 regarding the discount rate. This impacts both the initial and subsequent accounting for the liability.

In addition, if the liability is a lease liability, then it is subject to the guidance in IFRS 16 on reassessments and modifications. We are concerned that a reassessment or insubstantial modification could result in remeasurement of the right-of-use asset and liability to nil. This would frustrate the intention of the Committee in specifying the measurement of the right-of-use asset.

Other comments on the tentative agenda decision

We recommend that the Committee should make the following clarifications to the agenda decision.

— Include within the agenda decision the statement in the Committee agenda paper that an entity would not comply with IFRS 16 if it were to measure the right-of-use asset at zero. We believe that this would be helpful given that the approach illustrated in the tentative agenda decision is a departure from the approach illustrated in Example 24.

- Clarify that all payments for the lease are variable payments to avoid any implication that the payments may include a mix of fixed and variable payments.

- Refer more broadly to paragraphs 99-102 of IFRS 16 as being applicable to sale and leaseback transactions where the transfer of the asset is a sale rather than just paragraph 100.

- Note that paragraphs 101-102 of IFRS 16 do not apply to the transaction described in the request because the lease payments are at market rates.

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13 May 2020

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Chair IFRS Interpretations Committee
International Accounting Standards Board
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Canary Wharf
London E14 4HD
United Kingdom

Online submission: https://www.ifrs.org/projects/work-plan/sale-and-leaseback-with-variable-payments/

Dear Sue

Tentative agenda decision - Sale and Leaseback with Variable Payments (IFRS 16)

I am pleased to make this submission on the above Tentative Agenda Decision (TAD) relating to Sale and Leaseback with Variable Payments (IFRS 16).

I have extensive experience in accounting advice on International Financial Reporting Standards across a wide range of clients, industries and issues in the for-profit, not-for-profit, private and public sectors.

My clients have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, federal, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises). I also have some commercial, standard setting and academic experience.

Overall

While I agree with the overall reasoning of the TAD, I believe that the TAD should not be issued due to:

- the conflict with IFRS 16 Illustrative Example 24
- the lack of suitable accounting guidance for the resultant lease liability (i.e. no day 2 accounting guidance).

The clarification by the IASB of what the liability is should be part of the proposed standard setting.

Specifically, I agree with the reasoning on the recognition of a lease liability, and how the gain is calculated.

Conflict with IFRS 16 Illustrative Example 24

IFRS 16 Illustrative Example 24 classifies the resultant liability on a sale and leaseback as a financial liability. While the example is slightly different, because it includes an above fair value component, a substantial portion of the liability ($1,259,200 out of $1,459,200) relates to the TAD lease liability.

While it is not clear whether Example 24 was an error not picked up during drafting, or a deliberate decision, the Example does state that the liability is a financial liability. Preparers may already have an existing accounting policy that is based on the liability being a financial liability.

While staff identified some examples of sale and leasebacks that classified the liability as a lease liability, the extracts of the financial statements were not provided for analysis. I am very surprised that all examples were classified as a lease liability, given the description in Example 24. I can envisage that preparers may have labelled the liability as a lease liability but used financial liability accounting from day 2, given the lack of guidance on how to account for the liability under IFRS 16.

Consequences of mandatory application of IFRIC Agenda Decisions

I believe there will be undesirable consequences of issuing the TAD without having sorted out the day 2 accounting.

If a preparer is using financial liability accounting, as per Example 24, then the accounting makes sense, as there is already a mechanism for dealing with differences between estimated and actual payments, and the reassessment of future expected payments.

If a preparer is currently using lease liability accounting, then I have no idea as to what they are doing for CPI changes, variable payments and term changes.

Under the agreed changes to the IFRS Foundation Due Process Handbook (wording yet to be issued) IFRIC Agenda Decisions will become mandatory, changing from being “helpful, informative and persuasive”.

The consequence of issuing the TAD, without sorting out the day 2 accounting, is that preparers using the common sense financial liability accounting will need to move to some other method, to be determined.

I believe that both the nature of the liability and the subsequent accounting should be sorted out before mandatory requirements are issued.

The desire of the Interpretations Committee to issue something

I do not believe that issuing an agenda decision answering a narrowly interpreted scope is helpful, because of the consequences noted above.

I believe the underlying issue of the submission is both day 1 and day 2 accounting and both need to be resolved at the same time.

Further guidance

If the IFRS Interpretations Committee decides to pursue issuing an Agenda Decision on just day 1 accounting, there should be a further explanation on the accounting for the gain on sale. The accounting can be confusing as there is reference to proceeds on sale, a sale and transfer of control under IFRS 15, but only a portion of the gain recognised. Some people seem to interpret the lease liability as including a deferred gain.

I suggest the following guidance be included for the calculation of the gain on sale:

CU 1,350,000	Proceeds applicable to the portion of the asset sold (CU 1,800,000 for the entire asset less CU 450,000 for the retained portion that has to be 'repaid'):
CU 750,000	Carrying value of portion of asset sold (CU 1,000,000 entire carrying value less CU 250,000 portion retained)

CU 600,000	

While I believe that the liability from a sale and leaseback is a lease liability, the above illustrates that the initial measurement of the sale and leaseback liability looks and feels like a financial liability – the fair value of the proceeds attributed to the portion of the asset retained that has to be repaid.

This is another reason why I believe that there is not an urgent problem if preparers use financial liability accounting, per Example 24, until the conflict with Example 24 is resolved.

Componentising the journal entries

The single journal entry can cause confusion. I suggest including guidance on the individual component entries:

Dr Right-of-use asset	CU 250,000	
Cr PPE		CU 250,000

Transfer of rights retained from PPE to leased assets

Dr Cash	CU 1,350,000	
Cr PPE		CU 750,000
Cr Gain on rights transferred		CU 600,000

Recognition of disposal of rights transferred

Dr Cash	CU 450,000	
Cr (Lease) Liability		CU 450,000

Secured 'borrowing' for the rights transferred

Not a new problem

This is not a new problem. Similar issues arose under IAS 17 with variable payments (defined as contingent consideration), and how contingent consideration was evaluated in the finance / operating classification, and determination of finance lease liability (if applicable).

Other issues

I believe other non-foxed payments, that are not variable payments under IFSR 16, need to be dealt with. This includes "fixed" payments subject to index adjustments such as:

- CPI
- others, for example average room rentals (for hotels)
- market resets.

Yours sincerely,

David Hardidge
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Deloitte.

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13 May 2020

Sue Lloyd
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Dear Ms Lloyd

Tentative agenda decision – Sale and Leaseback with Variable Payments (IFRS 16 *Leases)*

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March 2020 IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on how to measure a right-of-use asset (RoU asset) arising from a sale and leaseback and thus how to determine the amount of any gain or loss on the transaction.

We agree with the IFRS Interpretations Committee's conclusions regarding the measurement of the RoU asset and the resulting gain or loss for the reasons stated in the tentative agenda decision. Further, we welcome the tentative decision of the IASB, at its 22 April 2020 meeting, to propose limited amendments to IFRS 16 to address the subsequent accounting of the lease liability recognised in a sale and leaseback transaction with variable payments. As part of this project, it would be useful for the Board to consider addressing what appears to be a conflict between IFRS 16 paragraphs BC262 and BC266. Paragraph BC262 conveys the notion that the RoU asset is a different asset from the underlying asset transferred to the buyer-lessor, hence supporting derecognition. However, in measuring the transfer and resulting gain or loss, paragraph BC266 views the RoU asset as a portion of the underlying asset retained. This might be the root cause of the issue of the issue submitted. In addition, we would suggest that the Board considers broadly the scope of this project on subsequent measurement of the liability to encompass, for example, the impact of contract modifications.

Until this project is completed, we would suggest that the Committee does not describe the resulting liability as being a 'lease liability' in its agenda decision. This liability is comprised of variable payments not dependent on an index or rate; such variable payments are excluded from the definition of lease payments in Appendix A of IFRS 16. Accordingly, the liability recognised by the seller-lessee does not appear to meet the definition of a lease liability. Because the subsequent accounting for this liability is not currently addressed in IFRS 16, entities entering into such transactions will need to develop an appropriate accounting policy applying IAS 8 to implement the conclusion reached by the Committee. Describing as a *lease liability* an amount that is not accounted for subsequently applying the *leasing* Standard may create unnecessary confusion. In addition, we note that Example 24 of the Illustrative Examples accompanying IFRS 16 describes the liability recognised by the seller-lessee as a 'financial liability'. We would encourage the Board to consider whether changes are required to Example 24 as part of its project.

We note that the example proposed in the tentative agenda decision addresses a relatively simplistic situation. In order for the decision to be implemented successfully, it would be useful if the Committee provided guidance on the factors that could be used to determine a reasonable approach to calculate the relative proportions of the asset transferred and retained. It would also be useful if the Committee clarified whether variable payments the lessee pays on behalf of the lessor for real estate taxes and insurance premiums in a triple net lease should be included as part of the present value of expected payments for the lease in determining the proportion of the asset retained in the sale and leaseback transaction. As these payments are for future costs, their inclusion may result in the value attributed to the proportion of the asset retained exceeding the fair value of the underlying asset.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

MAZARS

Mrs Sue Lloyd

IFRS Interpretations Committee Chair

Columbus Building,
7 Westferry Circus, Canary Wharf

London E14 4HD
United Kingdom

Paris, 13 May 2020

Tentative Agenda Decisions – IFRIC Update March 2020

Dear Sue,

MAZARS is pleased to comment on the IFRS Interpretations Committee Tentative Agenda Decisions published in the March 2020 IFRIC Update.

We have gathered our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

Should you have any questions regarding our comments on the tentative agenda decisions, please do not hesitate to contact Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Edouard Fossat

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Appendix 1

Sale and Leaseback with Variable Payments (IFRS 16 Leases)

We agree with the analysis performed by the Interpretations Committee and with its decision not to add the matter to its standard-setting agenda. The clear rationale and the illustrative example provide useful guidance on how to account for such transactions.

We also support the Committee's recommendation that the Board amend IFRS 16 to deal with the subsequent measurement of the lease liability, as IFRS 16 is silent on that issue.

AcSB
Accounting Standards Board

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May 13, 2020

(By e-mail to ifric@ifrs.org)

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Dear Sirs,

Re: Tentative agenda decision on IFRS 16 *Leases* – Sale and Leaseback with Variable Payments

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's (Committee) tentative agenda decision on sale and leaseback transactions with variable payments. This tentative agenda decision was published in the March 2020 IFRIC® Update.

The views expressed in this letter take into account discussions with individual members of the AcSB staff.

We agree with the Committee's conclusion that IFRS 16 only addresses the accounting for a sale and leaseback transaction at the date of the transaction. Therefore, we support the Committee's recommendation to the International Accounting Standards Board (IASB) to amend IFRS 16 by specifying how the seller-lessee would apply IFRS 16's subsequent measurement requirements to the lease liability that arises in the sale and leaseback transaction.

The AcSB's IFRS® Discussion Group discussed a similar sale and leaseback issue and observed a growing trend in leases structured with variable lease payments.[1] Therefore, clarifying the initial and subsequent measurement requirements applicable to sale and leaseback transactions could help to

[1] IFRS® Discussion Group, September 2019 meeting – IFRS 16: Sale-leaseback Transaction with Variable Payments

reduce the potential diversity in practice. To enable stakeholders to better understand the analysis in the tentative agenda decision, we suggest including two additional points from the Committee's discussions regarding scope and the definition of lease payments as described in the next two paragraphs.

Our understanding is that there are mixed views in practice on whether the liability in the transaction is within the scope of IFRS 16 or another IFRS Standard, such as IFRS 9 *Financial Instruments*. Since the tentative agenda decision concludes that the liability is within the scope of IFRS 16, we suggest adding an explanation of how the Committee has determined that the transaction contains a lease and should be excluded from IFRS 9 based on paragraph 2.1(b) of IFRS 9.

We also think that the agenda decision should explain why the Committee is recommending to the IASB to amend IFRS 16's subsequent measurement requirements in a sale and leaseback transaction. We suggest explaining in the agenda decision that the situation involves variable payments that do not meet the definition of lease payments. Therefore, the Committee observed that IFRS 16's subsequent measurement requirements do not contemplate such a situation and would need to be amended to address the gap in the requirements.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me at +1 416-204-3453 (e-mail kkhalilieh@acsbcanada.ca), or, alternatively, Davina Tam, Principal, Accounting Standards at +1 416 204-3514 (e-mail dtam@acsbcanada.ca).

Yours truly,

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Chief Accounting Officer & Head of Group Control

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13 May 2020

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Dear Ms Lloyd,

IFRS Interpretations Committee tentative agenda decision on Sale and Leaseback with Variable Payments (IFRS 16)

We welcome the opportunity to comment on the tentative agenda decision made by the IFRS Interpretations Committee (the Committee) at its March meeting in relation to Sale and Leaseback with Variable Payments (IFRS 16).

In summary, we disagree with the conclusion reached by the Committee not to add the matter to its standard-setting agenda. We believe that, in reaching its conclusions, the Committee has made significant interpretations of the Standard.

The tentative agenda decision states that "the seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate." We have the following concerns regarding that statement:

1. This approach is inconsistent with the measurement basis for other lease liabilities with variable payments that do not depend on an index or a rate. Applying paragraph 27 of IFRS 16, those payments are not included in the measurement of the liability. In our view, resolution of such an inconsistency should not be achieved through an agenda decision.

2. Recognising a liability with fully variable lease payments contradicts paragraph BC169 in Basis for Conclusions, which states:

> *The IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. For some Board members, this decision was made solely for cost-benefit reasons. Those Board members were of the view that all variable lease payments meet the definition of a liability for the lessee. However, they were persuaded by the feedback received from stakeholders that the costs of including variable lease payments linked to future performance or use would outweigh the benefits, particularly because of the 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. Other Board members did not think that variable lease payments linked to future performance or use meet the definition of a liability for the lessee until the performance or use occurs. They regarded those payments to be avoidable by the lessee and, accordingly, concluded that the lessee does not have a present obligation to make those payments at the commencement date. In addition, variable lease payments linked to future performance or use could be viewed as a means by which the lessee and lessor can share future economic benefits to be derived from use of the asset.*

In our view, the concerns expressed by Board members in paragraph BC169, are equally applicable to the liability recognised as a result of sale and leaseback transactions.

Consequently, we believe that the committee should not finalise its tentative agenda decision. We note that the Committee recommended the Board amend IFRS 16 to specify how the seller-lessee applies IFRS 16's subsequent measurement requirements to the lease liability that arises in the sale and leaseback transaction. We believe that, in addition, standard setting should be initiated for the initial recognition of the liability in the sale and leaseback transaction.

If you wish to discuss any of the comments in this letter, we would be happy to do so.

Yours sincerely,

/s/ Jayne Hodgson

May 13, 2020

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Dear IFRS Interpretation Committee Members,

Re: Tentative Agenda Decisions –
Sale and Leaseback with Variable Payments

We welcome the opportunity to provide our comments on the Tentative Agenda Decision - Sale and Leaseback with Variable Payments.

1. We disagree with a sentence in the tentative agenda decision which is stipulated as follows.

   The seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate.

2. We believe that the present value of expected payments for the lease (including those that are variable) in this fact pattern is not lease liabilities in IFRS16. The reasons of it consist of the followings.

   Contradiction to the Definition of Lease Payments

3. We believe that the variable lease payments other than that depend on an index or a rate is not included in the definition of lease payments. Appendix in IFRS16 defines the lease payments as follows.

   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; and*

(d) *payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.*

4. Moreover paragraphs 27 and 28 of IFRS16 specify clearly that variable lease payments other than that depend on an index or a rate do not comprise in the measurement of the lease liability as initial measurement of it.

5. Therefore we believe that IFRS16 has the fundamental principle that variable lease payments other than that depend on an index or a rate is not the consideration of a lease. And we believe that it is not logical and is inconsistent that IFRS Interpretation Committee tentatively decided going against the fundamental principle underlying in IFRS16 for sale and leaseback transaction which is the applied type of a lease.

Role of IFRS Interpretation Committee

6. We also believe that it goes beyond the role of IFRS Interpretation Committee to interpret the present value of expected payments for the lease (including those that are variable) in this fact pattern as if lease liability. Paragraph 5.20 of Due Process Handbook of IFRS Foundation stipulates as follows.

> *The Interpretations Committee applies a principle-based approach founded on the Conceptual Framework. It considers the principles established in the relevant IFRSs to develop its interpretative guidance and to determine that the proposed guidance does not conflict with IFRSs.*

7. This agenda decision conflicts with the principle in IFRS16. The IFRS Interpretation Committee should not interpret the variable lease payments other than that depend on an index or a rate as if lease liability in IFRS16 unless the IASB amends the fundamental principal with respects to the variable lease payments of IFRS16.

8. We also believe this issue is not addressed within short-term by the IFRS Interpretation Committee because of no meeting with agenda condition in paragraph 5.16(c) of Due Process Handbook of IFRS Foundation, which is "*that can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework for Financial Reporting*".

Another Issue

9. We recommend the IFRS Interpretation Committee to address the issue with respects to applying IAS12 to right-of-use assets and liabilities at the initial recognition for leaseback transaction in sale and leaseback transaction regardless of its liabilities is either lease liabilities or other liabilities, when tax deductions relate to the payments of liabilities.

We hope our comments will contribute to the forthcoming deliberations in the meeting of IFRS Interpretation Committee. Please feel free to contact us if you have any questions with respect to this letter.

Yours sincerely,

Masahiro Hoshino
Certified Public Accountant of Japan