IFRS

STAFF PAPER

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IASB Meeting

Project	**Lease Liability in a Sale and Leaseback**
Paper topic	Transition, Early Application and Due Process

CONTACT(S)	Aishat Akinwale	aakinwale@ifrs.org	+44 (0)20 7246 6910
	Jawaid Dossani	jdossani@ifrs.org	+44 (0)20 7332 2742

Introduction

1. At its April 2020 meeting, the International Accounting Standards Board (Board) tentatively decided to propose a narrow-scope amendment to IFRS 16 *Leases*. The proposed amendment would specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the lease liability that arises in a sale and leaseback transaction.

2. The objective of this paper is to:

   (a) ask the Board whether it agrees with our recommendations on transition and early application of the proposed amendment;

   (b) set out the steps in the IFRS Foundation *Due Process Handbook* (*Due Process Handbook*) that the Board has taken in developing the proposed amendment;

   (c) ask the Board to confirm it is satisfied that it has complied with the applicable due process requirements; and

   (d) ask whether any Board member intends to dissent from the publication of the proposed amendment.

Structure of the paper

3. This paper is structured as follows:
   (a) Background and summary of the proposed amendment (paragraphs 5-9);
   (b) Transition (paragraphs 10-13);
   (c) Early application (paragraph 14);
   (d) Due Process steps and permission for balloting (paragraphs 15-19):
      (i) comment period (paragraphs 15-16);
      (ii) intention to dissent (paragraph 17);
      (iii) proposed timetable for balloting and publication (paragraph 18); and
      (iv) confirmation of due process steps (paragraph 19).
4. Appendix A summarises the due process steps taken by the Board in developing the proposed amendment.

Background and summary of the proposed amendment

5. At its March 2020 meeting, the IFRS Interpretations Committee (Committee) discussed a submission about a sale and leaseback transaction with variable leaseback payments. The submitter asked how, applying IFRS 16, the seller-lessee measures the right-of-use asset arising from the leaseback and, thus determines any gain or loss recognised at the date of the transaction. The Committee concluded that IFRS 16 provides an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction submitted.
6. However, the Committee's discussions highlighted that IFRS 16 is not as complete as it might be regarding subsequent measurement of the lease liability that arises in such a sale and leaseback transaction. The Committee recommended an amendment to IFRS 16 to specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the lease liability that arises in such a transaction. At its April 2020 meeting, the Board agreed with the Committee's recommendation and tentatively decided to propose a narrow-scope amendment.

7. This proposed amendment would improve the sale and leaseback requirements in IFRS 16 by adding to those that already exist on initial measurement at the date of the transaction. In other words, the proposed amendment would change none of the underlying principles or existing requirements in IFRS 16, but would add to those requirements in the context of sale and leaseback transactions. Importantly, therefore the proposed amendment would result in no change to the accounting for a ‘standalone’ lease (a lease entered into outside of a sale and leaseback transaction).

8. The proposed amendment would specify that:

   (a) in applying paragraphs 36-38 of IFRS 16 to a sale and leaseback transaction with variable leaseback payments, a seller-lessee is required:

      (i) to determine the lease payments made (as described in paragraph 36(b)) as the payments included in the measurement of the lease liability. The payments included in that measurement are those that, when discounted using the discount rate described in paragraph 37, result in an amount equal to the carrying amount of the lease liability.

      (ii) not to remeasure the lease liability to reflect any reassessment of future variable lease payments; and

      (iii) to apply paragraph 38 in accounting for any difference between the payments made for the lease and those included in the measurement of the lease liability.

   (b) in applying paragraphs 40 and 45 of IFRS 16 to lease modifications and changes in the lease term related to a sale and leaseback transaction, a seller-lessee is required to determine the revised lease payments as the revised expected payments for the lease.

9. The Board also tentatively decided to develop an additional example that would illustrate how a seller-lessee accounts for a sale and leaseback transaction with variable leaseback payments, both at the date of the transaction and subsequently throughout the lease term.

Transition

10. We recommend requiring seller-lessees to apply the proposed amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as discussed in paragraphs 11-13. In our view, the expected benefits of retrospective application would outweigh the expected costs—specifically:

    (a) the proposed amendment is expected to affect only sale and leaseback transactions with variable leaseback payments and, for those transactions, affect only the subsequent measurement of the lease liability that arises from the transaction (it will propose no change to the accounting for a sale and leaseback transaction at the date of the transaction). In addition, the proposed amendment would (i) *clarify* subsequent measurement (a seller-lessee could already apply the accounting proposed in applying IFRS 16); and (ii) generally require a seller-lessee to determine no new information in doing so, ie the proposed amendment would in effect specify how to do the debits and credits in subsequently measuring the lease liability, which would require no new calculations or assessments. We also note that the transition requirements in IFRS 16 mean that a seller-lessee applies the sale and leaseback requirements in IFRS 16 only to sale and leaseback transactions that occur after its date of initial application of IFRS 16[1]. As a consequence, for most entities, retrospective application of the proposed amendment could affect only sale and leaseback transactions with variable leaseback payments occurring from 2019. Therefore, we conclude that the cost of applying the proposed amendment retrospectively would not be excessive.

    (b) when sale and leaseback transactions occur, they often relate to high-value items of property, plant and equipment with a long economic life. For this reason, the accounting for such transactions can have a long-term material effect on a seller-lessee's financial position. We therefore see considerable

[1] For first-time adopters, the requirements in IFRS 1 *First-time Adoption of International Financial Reporting Standards* on leases mean that a seller-lessee applies the sale and leaseback requirements in IFRS 16 only to sale and leaseback transactions after its date of transition to IFRSs.

benefit in requiring retrospective application of the proposed amendment. Such application would facilitate consistent accounting for sale and leaseback transactions, thereby improving understandability and comparability of the financial statements.

Lease modifications or changes in the lease term related to a sale and leaseback transaction

11. For a lease modification or change in the lease term, the proposed amendment would require the seller-lessee to determine the revised expected payments for the lease at the date of the modification or change in the lease term. Even if the date of the modification were before the amendment is issued, we would expect seller-lessees to have that information in deciding whether to agree to the modification. Nonetheless, it is possible that, for modifications or changes in the lease term before the amendment is issued, retrospective application may require the use of hindsight.

12. We would expect the occurrence of such situations to be rare—it would be the case only for sale and leaseback transactions with variable leaseback payments (a) that occurred after the seller-lessee's date of initial application of IFRS 16 and that subsequently have been modified or for which the lease term has changed; (b) for which the seller-lessee has not already applied the accounting in the proposed amendment; and (c) for which the seller-lessee is unable to determine what the expected payments for the lease would have been at the date of the modification or change in the lease term. That said, if such a situation were to arise, then we would propose that the seller-lessee determine the expected payments for the lease at the date it first applies the proposed amendment. Specifying what to do in this situation would provide clarity for seller-lessees. It would also avoid the possibility of interpreting the proposed amendment to not require expected payments to be included in the measurement of the lease liability in this situation.

13. We therefore recommend that, if applying the proposed amendment retrospectively to lease modifications or changes in the lease term is possible only with the use of hindsight, the seller-lessee should determine the revised expected payments for the lease at the date it first applies the proposed amendment.

Early application

14. We recommend that the Board permit a seller-lessee to apply the proposed amendment earlier than the effective date. We will discuss the effective date at the time of finalising the amendment, should the Board decide to do so. As explained in Agenda Paper 12A of the Board's April 2020 meeting, seller-lessees can already apply the accounting specified by the proposed amendment. Accordingly, we see no reason to prohibit a seller-lessee from applying the proposed amendment earlier than the effective date.

Due process steps and permission for balloting

Comment period

15. Paragraph 6.7 of the *Due Process Handbook* states that the Board 'normally allows a minimum period of 120 days for comment on an Exposure Draft'. However, if the matter is narrow in scope and urgent, the Board may consider a shorter comment period.

16. The proposed amendment to IFRS 16 is narrow in scope and, given the structured nature of many sale and leaseback transactions, could be viewed by some as urgent. That said, in our view the proposed amendment is not so urgent that it would warrant a comment period of less than 120 days, particularly in the light of challenges stakeholders are facing during the covid-19 pandemic. We therefore recommend a comment period of no less than 120 days for the Exposure Draft on the proposed amendment to IFRS 16 (Exposure Draft).

Intention to dissent

17. In accordance with paragraph 6.9 of the *Due Process Handbook*, we are asking whether any Board member intends to dissent from the publication of the Exposure Draft.

Proposed timetable for balloting and publication

18. We plan to begin the balloting process in the near future and expect the Exposure Draft to be published in the third quarter of 2020.

Confirmation of the due process steps

19. Appendix A sets out the required due process steps in developing and publishing the Exposure Draft together with the current status of, and any planned action for, these steps. We note that the applicable due process steps to date for balloting of the Exposure Draft have been completed.

Questions for the Board

1. **Transition**—does the Board agree with our recommendation to require seller-lessees to apply the proposed amendment to IFRS 16 retrospectively in accordance with IAS 8, except when that application to lease modifications and changes in the lease term is possible only with the use of hindsight? In that case, the seller-lessee should determine the expected payments for the lease at the date it first applies the proposed amendment.

2. **Early application**—does the Board agree with our recommendation to permit a seller-lessee to apply the proposed amendment earlier than the effective date?

3. **Comment period**—does the Board agree with our recommendation to allow a comment period of no less than 120 days for the Exposure Draft?

4. **Dissent**—does any Board member intend to dissent from publication of the Exposure Draft?

5. **Permission to ballot**—is the Board satisfied that it has complied with the applicable due process steps and that it should begin the balloting process for the Exposure Draft?

Appendix A—Due process steps taken in developing the proposed amendment

A1. The following table summarises the required due process steps taken in developing the proposed amendment to IFRS 16. The table omits the optional steps.

Step	Actions
Board meetings are held in public, with papers available for observers. All decisions are made in public sessions	The Board discussed the matter at its meetings in April 2020 (see Agenda Paper 12A) and May 2020 (see this Agenda Paper). The IFRS Interpretations Committee (Committee) discussed this matter at its meetings in November 2019 (see Agenda Paper 5) and March 2020 (see Agenda Paper 2).
Consultation with the Trustees and the Advisory Council	The Trustees and Advisory Council will be updated on the project as part of their discussions of the Board's technical activities.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs	The proposed amendment is narrow in scope and would supplement but not change the underlying principles or existing requirements for sale and leaseback transactions. Consequently, we do not see a need to have a separate effects analysis. The main effect is expected to be more consistent application of the requirements in IFRS 16 for sale and leaseback transactions. The proposed amendment would have no effect on the accounting for leases, other than those that arise from sale and leaseback transactions.
Finalisation	
Due process steps reviewed by the IASB	This paper asks the Board to review the due process steps for the project.
The Exposure Draft has an appropriate comment period	This paper seeks the Board's approval for a comment period of no less than 120 days. The proposed comment period is in line with the minimum period specified in paragraph 6.7 of the IFRS Foundation *Due Process Handbook* and, therefore, no special approval is required from the Due Process Oversight Committee.
Drafting	
Drafting quality assurance steps are adequate	The translations and editorial teams will review drafts during the balloting process.
Publication	
Exposure Draft published	The Exposure Draft will be made available on the project website when published.
Press release to announce publication of the Exposure Draft	A press release will be published on our website with the Exposure Draft.