STAFF PAPER

September 2021

IFRS® Interpretations Committee meeting

Project	**Lease Liability in a Sale and Leaseback**		
Paper topic	Possible project direction		
CONTACT	Dennis Deysel	ddeysel@ifrs.org	+44 (0)20 7246 6410

Introduction

1. In November 2020, the International Accounting Standards Board (Board) published the Exposure Draft *Lease Liability in a Sale and Leaseback*, which proposed to amend IFRS 16 *Leases*. The comment period ended on 29 March 2021.

2. At its May 2021 meeting, the Board discussed a summary of feedback on the Exposure Draft. The Board did not make any decisions at that meeting, but Board members did provide their initial thoughts on the feedback.

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

Objective and structure

4. To help us develop the project direction and to provide input to the Board, we are asking the IFRS Interpretations Committee (Committee) members for their views on the possible ways forward. This project originated from the Committee's recommendation—and the Board's agreement—to undertake a project to address subsequent measurement of the liability that arises in a sale and leaseback transaction. The Committee discussed and published a related agenda decision—the Agenda Decision *Sale and Leaseback with Variable Payments*—in June 2020. Appendix A to this paper reproduces that Agenda Decision.

5. We note that the possible project direction discussed in the paper outlines our *preliminary* views, which may change or be refined before we ask the Board to make decisions.

6. This paper:

   (a) summarises the proposed amendments in the Exposure Draft (paragraphs 8–11);

   (b) lists the main matters of concern raised by respondents in their comment letters (paragraphs 12–16);

   (c) summarises input after the comment period (paragraphs 17–20);

   (d) explains possible ways forward for the project (paragraphs 21–42); and

   (e) sets out questions for the Committee.

7. There are two appendices to this paper:

   (a) Appendix A—Agenda Decision June 2020.

   (b) Appendix B—The main alternative solutions suggested by respondents.

Summary of the proposed amendments

8. IFRS 16 includes no specific subsequent measurement requirements for sale and leaseback transactions in which the transfer of the asset satisfies the requirements to be accounted for as a sale.[1] Consequently, it is not always clear how to subsequently measure the liability that arises from a sale and leaseback transaction (the leaseback liability), in particular when the leaseback payments include variable payments linked to future performance or use of the underlying asset which are excluded from the measurement of a lease liability.[2]

[1] Throughout this paper, references to sale and leaseback transactions are only to those in which the transfer of the asset satisfies the requirements to be accounted for as a sale. This paper does not discuss sale and leaseback transactions in which the transfer of the asset fails to satisfy the requirements to be accounted for as a sale (to which paragraph 103 of IFRS 16 applies).

[2] This paper uses 'lease liability' to refer to the liability that arises from a lease unrelated to a sale and leaseback transaction.

9. The Exposure Draft proposed:

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

(b) in applying paragraph 100(a) of IFRS 16, to require a seller-lessee to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by comparing the present value of the expected lease payments to the fair value of the asset sold. The seller-lessee would therefore initially measure the leaseback liability at the present value of the expected lease payments.

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

(d) to add subsequent measurement requirements for the leaseback liability (see paragraph 28 of this paper).

10. In paragraphs BC18–BC19 of the Exposure Draft, the Board acknowledged that, for a lease that is unrelated to a sale and leaseback transaction, a lessee excludes from the measurement of the lease liability variable payments that do not depend on an index or rate (and that are not in-substance fixed payments). When developing IFRS 16, the Board had noted concerns about the high level of measurement uncertainty that would result from including such variable payments in the measurement of the lease liability and about the cost associated with such estimates because of the high volume of leases held by some lessees. However, for sale and leaseback transactions, the Board had expected that seller-lessees would be able to reasonably estimate expected lease payments because seller-lessees are in a different position from lessees that enter into leases unrelated to a sale and leaseback transaction. In particular, the Board noted its expectation that any individual seller-lessee would enter into relatively few sale and leaseback transactions with variable payments whereas some lessees routinely enter

into lease contracts with variable payments that are unrelated to a sale and leaseback transaction.

11. Importantly, the Exposure Draft proposed changes only for sale and leaseback transactions and that are consistent with the Board's rationale when developing the sale and leaseback requirements in IFRS 16. The Board concluded that it would be inappropriate to reconsider those sale and leaseback requirements more holistically, in advance of the Post-implementation Review of the Standard. When developing IFRS 16, the Board developed sale and leaseback requirements—that differ from the requirements for leases unrelated to a sale and leaseback transaction—to reflect the economics of sale and leaseback transactions (as explained in paragraph BC266 of IFRS 16). Consequently, the proposed measurement requirements in the Exposure Draft for leaseback liabilities necessarily differed from those for lease liabilities to avoid any change in the sale and leaseback requirements already in paragraph 100(a) of IFRS 16. In particular, we note that the Exposure Draft made no change to the requirement in paragraph 100(a) that a seller-lessee recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

Main matters raised

12. From the 87 responses to the Exposure Draft, a large majority of respondents agreed that there is a need to amend IFRS 16 to enhance the measurement requirements for sale and leaseback transactions. However, only a minority of those respondents agreed with the proposed amendments; a large majority disagreed with, or expressed concerns about, aspects of the proposals.

13. Most respondents commented on the differing treatment of variable lease payments when measuring a leaseback liability compared with the measurement of other lease liabilities. Many said including variable lease payments in the measurement of leaseback liabilities raises practical and conceptual challenges.

14. Some respondents said, conceptually, a lessee should measure all liabilities arising from a lease in the same way, regardless of whether the lease is part of a sale and leaseback transaction. Differing measurement reduces comparability and understandability for users of financial statements.

15. In terms of practical challenges, many respondents disagreed with the Board's rationale in paragraphs BC18–BC19 of the Exposure Draft. In particular:

    (a) they said including expected variable payments linked to future performance or use of the underlying asset in the measurement of the leaseback liability would often involve a high level of measurement uncertainty and additional costs. The Board's rationale for excluding such variable payments from the measurement of lease liabilities as explained in paragraph BC169 of IFRS 16 also applies to leaseback liabilities.

    (b) some said estimating future changes in payments resulting from changes in the reference index or rate for variable payments that depend on an index or rate could also involve a high level of measurement uncertainty, particularly when the leaseback term is long and the relevant macroeconomic information is not readily available.

16. Respondents suggested alternative possible ways forward. The two main alternatives – discussed in more detail in Appendix B to the paper – are:

    (a) *Componentised Liability approach*[3]—consistent with paragraph 100(a) of IFRS 16, the seller-lessee would measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains. The seller-lessee would measure the leaseback liability applying the measurement requirements applicable to other lease liabilities, and recognise any residual balance as a liability, amortising it to profit or loss over the term of the leaseback.

    (b) *Deferred Gain approach*[4]—the seller-lessee would measure *both* the right-of-use asset and the leaseback liability applying the measurement requirements applicable to other right-of-use assets and lease liabilities. Consistent with paragraph 100(a) of IFRS 16, a seller-lessee would recognise only the amount of any gain or loss that relates to the rights

[3] Referred to as 'Deferred Income Approach A' when reported to the Board at its May 2021 meeting (see Agenda Paper 12D).
[4] Referred to as 'Deferred Income Approach B' when reported to the Board at its May 2021 meeting (see Agenda Paper 12D).

transferred to the buyer-lessor. The seller-lessee would also recognise as a deferred gain (or loss) the unrecognised amount of the gain (or loss) on sale, amortising it to profit or loss over the term of the leaseback.

Input after the comment period

Meetings with respondents

17. We held follow-up meetings with a number of respondents, in particular to understand better their comments on practical challenges and the alternative solutions suggested (both on initial recognition and subsequently). We met with nine respondents (including preparers, accounting firms, professional bodies and national standard-setters) who provided more detailed observations on their comments in comment letters.

18. We learned that:

    (a) seller-lessees do not enter into high volumes of sale and leaseback transactions, although those transactions are typically highly structured and for large amounts. A seller-lessee would typically enter into, at most, only a few sale and leaseback transactions at any one time. One entity explained that, during one period in its past, management had a policy of improving liquidity by entering into sale and leaseback transactions, and even when it had such a policy, the entity (as the seller-lessee) entered into around 20 sale and leaseback transactions in that period. This contrasts with leases unrelated to a sale and leaseback transaction because lessees can have thousands, or many more (as many as half a million), lease contracts.

    (b) sale and leaseback transactions with variable payments linked to future performance or use of the underlying asset are not common, although some respondents suggested that the frequency may increase in the future.

    (c) respondents' practical concerns about the difficulty in estimating variable payments—in particular, those linked to future performance or use of the underlying asset—are mainly based on their experiences with leases unrelated to a sale and leaseback transaction, rather than with sale and leaseback transactions.

(d) respondents had not developed their alternative solutions beyond what was reported to the Board at the May 2021 meeting. For example, some had not to date considered presentation in the statement of profit or loss or how the solution might work for a change in lease term or a lease modification.

AlphaSense search

19. To obtain further evidence about the volume of material sale and leaseback transactions with variable payments, we used the financial search engine, AlphaSense, to identify these transactions. We performed the search in June 2021. The search considered entities' most recent interim or annual financial statements, circulars, integrated reports, merger and acquisition-related documents, and prospectuses. The search was limited to documents in English. We searched for various forms of 'sale and leaseback' and 'variable payments'.

20. Our search identified one seller-lessee that disclosed two sale and leaseback transactions for which the leaseback payments are based entirely on a percentage of its revenue generated using the underlying asset. Although other entities in the search reported entering into sale and leaseback transactions, there was no reference to variable payments linked to these transactions.

Possible project direction

21. Paragraphs 22–42 of the paper set out possible ways forward for the project:

    (a) paragraphs 22–23 explain the project boundary within which the possible ways forward discussed in this paper have been developed; and

    (b) paragraphs 24–42 describe those possible ways forward.

Project boundary

22. The Board proposed amendments to 'fill a gap' in the subsequent measurement requirements for sale and leaseback transactions in IFRS 16. As mentioned earlier in the paper (see paragraph 11), the Board did not reconsider the initial measurement requirements for sale and leaseback transactions already in IFRS 16 as part of this project and, thus, proposed no change to them. Changing the sale and leaseback requirements already in IFRS 16 would, in our view, require consideration of the accounting for sale and leaseback transactions holistically—an assessment best considered as part of the Post-implementation Review of IFRS 16. The possible ways forward discussed in this paper would therefore not remove existing differences in the initial measurement of right-of-use assets and lease liabilities that arise from a sale and leaseback transaction and the measurement of those assets and liabilities unrelated to such transactions.

23. The Deferred Gain approach (see paragraph 16(b) of this paper) would modify the current requirements in paragraph 100(a) of IFRS 16 related to the initial measurement of the right-of-use asset arising from a leaseback and would, therefore, move the project outside of the Board's intended boundary. We discuss this in more detail in Appendix B.

The possible ways forward

24. Within the project boundary discussed in paragraph 22 of this paper, the possible ways forward discussed in the following paragraphs would be expected to provide an interim solution to 'fill a gap' in the current sale and leaseback requirements. The Board could then seek further input on the accounting for sale and leaseback transactions as part of the Post-implementation Review of IFRS 16.

Subsequent measurement

25. We consider two possible approaches to subsequent measurement:

    (a) *Expected Payments*—this approach would follow the proposals in the Exposure Draft but possibly could be applied to a smaller population of sale and leaseback transactions than proposed (see paragraphs 34-42 of this paper); or

(b) *Imputed Payments*—the Board considered an Imputed Payments approach when developing the Exposure Draft. As explained in paragraph BC26 of the Exposure Draft, the Board decided against that approach as it would complicate the proposals, especially when applied to sale and leaseback transactions with fixed payments. The Imputed Payments approach explained in this paper is simpler than that considered by the Board when developing the proposals, and possibly could be applied to a smaller population of sale and leaseback transactions than proposed—for example, only to such transactions with variable payments or as discussed in paragraphs 34–42 of the paper.

26. Appendix B to this paper sets out the two main alternative solutions suggested by respondents: the Componentised Liability approach and the Deferred Gain approach (see paragraph 16 of the paper).

Illustrative example

27. To compare the Expected Payments approach and Imputed Payments approach, this paper uses the following illustrative example[5]:

Illustrative Example - Sale and leaseback transaction with variable lease payments linked to future performance of the underlying asset

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of CU1,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for five years. The contract requires Seller-lessee to make annual payments calculated as 7% of Seller-lessee's revenue generated using the building during each of the five years, with an annual minimum payment of CU85 in each year (the payments are at market rates). The expected lease payments and the actual lease payments for each of the five years are:

	Expected lease payments	**Actual lease payments**
Year	**CU**	**CU**
1	91	92
2	98	96
3	102	96
4	104	104
5	105	104

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15. Accordingly, Seller-lessee accounts for the transaction as a sale and leaseback.

The interest rate implicit in the lease cannot be readily determined. Seller-lessee's incremental borrowing rate is 3.5% per year. The present value of the expected lease payments (discounted at 3.5% per year) is CU450.

The proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee (calculated using the present value of the expected lease payments or another method) amounts to 25%.

[5] The example is the same as that used in Part 1 to Example 25 *Sale and leaseback transaction with variable lease payments* proposed in the Exposure Draft. The amounts are rounded to the nearest CU'000.

Description

28. This table compares the two approaches by describing the initial and subsequent measurement of the leaseback liability applying each approach:

	Expected Payments	**Imputed Payments**
Initial measurement		
The method to determine the proportion that relates to the right of use retained is…	prescribed as the present value of expected lease payments compared to the fair value of the asset	not prescribed—entities continue to use the method applied in accordance with paragraph 100(a) of IFRS 16
The initial measurement of the leaseback liability is determined as…	the present value of the expected lease payments, discounted using the rate in paragraph 26 of IFRS 16	a consequence of how the right-of-use asset is measured and the gain or loss on sale determined. This amount would represent, or be expected to be similar to, the present value of the expected lease payments
Subsequent measurement		
The leaseback liability is increased by…	interest on the leaseback liability using the discount rate specified in paragraph 37 of IFRS 16	
The leaseback liability is reduced by…	the expected lease payments for the reporting period as determined at the commencement date or, if applicable, a remeasurement date—with any difference compared to the actual lease payments recognised in profit or loss	imputed payments determined as equal periodic payments over the lease term that, when discounted, result in the carrying amount of the leaseback liability at the commencement date or, if applicable, a remeasurement date—with any difference compared to the actual lease payments recognised in profit or loss
The leaseback liability is remeasured…	only when there is a change in lease term or a lease modification	
The leaseback liability is remeasured to…	the present value of the expected payments at the remeasurement date	the present value of the lease payments (as defined in Appendix A to IFRS 16). If the modified liability, when compared to the carrying amount of the leaseback liability at the remeasurement date, is:

		(a) higher, the difference is recognised as an adjustment to the right-of-use asset; or (b) lower, the difference is retained as a liability. The seller-lessee determines new imputed payments as equal periodic payments over the lease term that, when discounted, result in the carrying amount of this liability at the remeasurement date.

Mechanics

29. This table illustrates the two approaches using the illustrative example set out in paragraph 27 of this paper:

Expected Payments	**Imputed Payments**
At the commencement date, Seller-lessee accounts for the transaction as follows:	
Cash CU1,800 Right-of-use asset CU250[a] Building CU1,000 Leaseback liability CU450[b] Gain on sale CU600[c] *Calculations* [a] 1,000 x (450 ÷ 1,800) [b] present value of expected payments, discounted at 3.5% [c] (1,800 - 1,000) x ((1,800 – 450) ÷ 1,800)	Cash CU1,800 Right-of-use asset CU250[a] Building CU1,000 Leaseback liability CU450[b] Gain on sale CU600[c] *Calculations* [a] 1,000 x 25% (this % is assumed for ease of analysis—it may differ if a method other than the present value of expected lease payments is used to estimate the proportion that relates to the right of use retained) [b] a consequence of how the right-of-use asset is measured and the gain or loss on sale determined [c] (1,800 - 1,000) x (100% - 25%)

In year 1, Seller-lessee accounts for the movement in the leaseback liability as follows:	
Interest expense CU16[d] Leaseback liability CU16 Leaseback liability CU91[e] Profit or loss CU1[f] Cash CU92[g] *Calculations* [d] interest on the liability at 3.5% [e] the expected payment for year 1 as determined at the commencement date [f] 92 – 91 [g] the actual lease payment for year 1	Interest expense CU16[d] Leaseback liability CU16 Leaseback liability CU100[e] Profit or loss CU8[f] Cash CU92[g] *Calculations* [d] interest on the liability at 3.5% [e] the equal periodic payment that, when discounted at 3.5%, results in 450 [f] 100 – 92 [g] the actual lease payment for year 1

30. This table shows the effect of the leaseback on Seller-Lessee's profit or loss over the term of the leaseback. The Year 1 effect excludes the gain on sale recognised of CU600 because that gain is the same applying both approaches[6].

[6] The amount of the gain could differ if, applying the Imputed Payments approach, Seller-lessee uses an alternative method to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained when applying paragraph 100(a) of IFRS 16.

	1	2	3	4	5	Total
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual lease payments[1]	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Amount of gain on sale not recognised by Seller-lessee[1]						*200*
Profit or loss						
Expected Payments						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	(1)	2	6	-	1	8
Sub-total	*(51)*	*(48)*	*(44)*	*(50)*	*(49)*	*(242)*
Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Total	**(67)**	**(61)**	**(54)**	**(57)**	**(53)**	**(292)**
Imputed Payments						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	8	4	4	(4)	(4)	8
Sub-total	*(42)*	*(46)*	*(46)*	*(54)*	*(54)*	*(242)*
Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Total	**(58)**	**(59)**	**(56)**	**(61)**	**(58)**	**(292)**

[1] Actual lease payments and the amount of the gain on sale not recognised by Seller-lessee are provided for ease of reference.

[2] The lease expense represents the difference between the actual lease payments and the amount by which the leaseback liability has been reduced for the period.

31. This table shows the 'run-off' of the carrying amounts of the right-of-use asset and leaseback liability in Seller-lessee's statement of financial position over the term of the leaseback.

	1	**2**	**3**	**4**	**5**
	CU	CU	CU	CU	CU
Expected Payments					
Right-of-use	200	150	100	50	-
Leaseback liability	375	290	198	101	-
Imputed Payments					
Right-of-use	200	150	100	50	-
Leaseback liability	366	279	189	96	-

Main benefits of each approach

32. Applying the Expected Payments approach, the proportion of the asset sold that relates to the right of use the seller-lessee retains is calculated in the same way for all applicable sale and leaseback transactions. This results in the gain or loss on sale, and the initial measurement of the right-of-use and leaseback liability arising from the transaction, being measured in the same way, thereby improving understandability and comparability. The leaseback liability (and related interest expense) would reflect the payments the seller-lessee expects to make over the term of the leaseback and, thus, would provide useful information to users of financial statements about expected future cash outflows arising from sale and leaseback transactions. This benefit would reduce if actual lease payments differ significantly from the expected lease payments at the commencement date.

33. Applying the Imputed Payments approach, the seller-lessee is not required to estimate the expected lease payments (even though the seller-lessee could—and perhaps often would—determine the proportion of the asset sold that relates to the right of use it retains using the expected lease payments). The approach would therefore address one of the main practical concerns raised by respondents in comment letters. As a practical expedient, the measurement of the leaseback liability would assume equal payments

in each period during the leaseback, which may not reflect the expected or actual lease payments.

Applicable transactions

34. The proposals in the Exposure Draft would apply to all sale and leaseback transactions but be expected to affect only sale and leaseback transactions with variable payments. Although the proposals originated from a submission to the Committee on sale and leaseback transactions with variable payments linked to future performance or use of the underlying asset, the Board proposed amendments that would affect transactions with any form of variable payments, including those that depend on an index or rate. This is because the same subsequent measurement question that arose for transactions with variable payments linked to future performance or use—namely, how to subsequently measure the liability that arises at the date of the transaction when the amount of that liability on initial recognition differs from the initial measurement of other lease liabilities—could also arise for transactions with variable payments that depend on an index or rate.

35. Considering the feedback on the proposals and to alleviate some of the practical concerns of implementing any new requirements, the Board could consider narrowing the scope of their application to a smaller population of sale and leaseback transactions than proposed in the Exposure Draft.

36. We have initially identified two ways that the Board could narrow the scope of application of any new requirements:

    (a) the new requirements could apply only to sale and leaseback transactions with variable payments linked to future performance or use of the underlying asset; or

    (b) the new requirements could apply only to sale and leaseback transactions for which the initial measurement of the leaseback liability recognised and measured as a result of applying paragraph 100(a) of IFRS 16 differs materially from the initial measurement of that liability applying paragraphs 26-28 of IFRS 16. If considered in the context of the Expected Payments approach (which would amend paragraph 100(a)), a seller-lessee could make this materiality assessment based on its reasonable expectations (similar to paragraph B1 of IFRS 16) at the commencement date.

Sale and leaseback transactions with variable payments linked to performance or use

37. The proposals in the Exposure Draft originated from a submission to the Committee on sale and leaseback transactions with variable payments linked to future performance or use of the underlying asset. Because a lessee excludes such payments from the measurement of lease liabilities, IFRS 16 includes no subsequent measurement requirements for liabilities recognised when payments are variable and linked to future performance or use. For this reason, the Committee recommended, and the Board agreed, to 'fill the gap' in the sale and leaseback requirements for these transactions, in particular because sale and leaseback transactions are often highly structured and involve large amounts. Consistent with its view of the economics of the transaction, the Board concluded (see paragraph BC13 of the Exposure Draft) that seller-lessees should subsequently measure the leaseback liability in a way that would prevent the recognition of an additional gain or loss associated with the sale of the asset when no transaction or event has occurred to give rise to such a gain or loss. Respondents to the Exposure Draft agreed that there is a need to add to the sale and leaseback requirements in IFRS 16.

38. That need for additional requirements is not the same for sale and leaseback transactions with variable payments based on an index or rate. IFRS 16 requires a lessee to include in the measurement of lease liabilities variable payments based on an index or rate; the Standard therefore already has subsequent measurement requirements for liabilities recognised when lease payments are variable depending on an index or rate. Although application of the sale and leaseback requirements in paragraph 100(a) of IFRS 16 could result in the initial recognition and measurement of a liability at an amount that differs from the initial measurement of a lease liability unrelated to a sale and leaseback transaction, feedback did not indicate that this is a significant practical concern.

39. This alternative could, therefore, alleviate the practical concerns for sale and leaseback transactions with variable payments that depend on an index or rate but still address the need for subsequent measurement requirements where they are needed

most (ie for sale and leaseback transactions with payments linked to future performance or use of the underlying asset).

Sale and leaseback transactions with a materially different leaseback liability on initial recognition

40. The population of sale and leaseback transactions within the scope of any new requirements could be reduced by excluding transactions with leaseback liabilities (initially measured applying paragraph 100(a) of IFRS 16) that do not differ materially from their initial measurement applying paragraphs 26-28 of IFRS 16. For those transactions, the seller-lessee could apply the subsequent measurement requirements in paragraphs 36-46 of IFRS 16, without the need for additional subsequent measurement requirements within the sale and leaseback requirements.

41. We would expect this alternative to exclude from the scope of any new requirements sale and leaseback transactions with leaseback payments that:

    (a) are fixed; or

    (b) depend on an index or rate for which the lease term is not long or the expected change in the index or rate is low (eg transactions entered into in a jurisdiction with low inflation).

42. This alternative would have the benefit of removing any doubt about how to account for sale and leaseback transactions with any form of variable payments but still reduce the population of transactions to which any new requirements would apply.

Questions for the Committee

What are Committee members' views on the possible project direction? Please explain the reasons for your views.

For example, do you:

(a) support either the Expected Payments approach or the Imputed Payments approach explained in paragraphs 25–33 of the paper?

  (i) If 'yes', which one would you prefer and why?

  (ii) If 'no', do you support either of the approaches described in Appendix B to the paper, or another approach (please specify)?

(b) support reducing the population of applicable sale and leaseback transactions as set out in paragraphs 34–42 of the paper?

  (i) If 'yes', do you support either of the alternatives set out in these paragraphs, or another alternative (please specify)?

Appendix A—Agenda Decision June 2020

A1. This appendix reproduces the Agenda Decision *Sale and Leaseback with Variable Payments* published in June 2020.

Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)

The Committee received a request about a sale and leaseback transaction with variable payments. In the transaction described in the request:

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

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

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

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

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

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

The gain or loss the seller-lessee recognises at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the PPE's previous carrying amount), the amount of the gain or loss recognised relates only to the rights transferred to the buyer-lessor. Applying paragraph 53(i) of IFRS 16, the seller-lessee discloses gains or losses arising from sale and leaseback transactions.

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

Illustrative example

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

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

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

Applying paragraph 100(a), Seller-lessee:

(a) measures the right-of-use asset at CU250,000, calculated as CU1,000,000 (previous carrying amount of the PPE) × 25% (proportion of the PPE that relates to the right of use it retains).

(b) recognises a gain of CU600,000 at the date of the transaction, which is the gain that relates to the rights transferred to Buyer-lessor. This gain is calculated as CU800,000 (total gain on sale of the PPE (CU1,800,000 – CU1,000,000)) × 75% (proportion of the PPE that relates to rights transferred to Buyer-lessor).

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*CU250,000*	
Cr. PPE		*CU1,000,000*
Cr. Liability		*CU450,000*
Cr. Gain on rights transferred		*CU600,000*

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction described in the request. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Appendix B—The main alternative solutions suggested by respondents

B1. This appendix explains the two main alternative solutions suggested by respondents and reported to the Board at its meeting in May 2021: the Componentised Liability approach and the Deferred Gain approach. This appendix, therefore:

(a) describes the two approaches (paragraphs B2);

(b) illustrates their mechanics (paragraphs B3–B4);

(c) provides our preliminary view and reasons not to recommend either approach to the Board (paragraphs B5–B12); and

(d) presents them together with the two approaches discussed in the main body of the paper—the Expected Payments approach and Imputed Payments approach (paragraph B13).

Description

B2. This table describes the initial and subsequent measurement of the leaseback liability, as well as the initial measurement of the right-of-use asset, applying each of the alternative solutions:

	Componentised Liability	**Deferred Gain**
Initial measurement		
The method to determine the proportion that relates to the right of use retained is…	not prescribed—entities continue to use the method applied in accordance with paragraph 100(a) of IFRS 16	
The initial measurement of the right-of-use asset is determined as…	consistent with paragraph 100(a) of IFRS 16, the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains	the amount of the initial measurement of the lease liability and an estimate of decommissioning costs to be incurred by the lessee (similar to right-of-use assets arising from leases unrelated to a sale and leaseback transaction)
The gain or loss on sale recognised is determined as…	consistent with paragraph 100(a), the amount of any gain or loss that relates to the rights transferred to the buyer-lessor	

The initial measurement of the lease liability is determined as…	consistent with paragraph 26 of IFRS 16, the present value of the lease payments (as defined in Appendix A to IFRS 16), eg no liability is recognised for variable payments linked to future performance or use of the underlying asset	
The balancing figure is recognised as a…	liability in the statement of financial position. This amount would represent, or be expected to be similar to, the present value of the leaseback payments not included in the measurement of the lease liability.	deferred gain in the statement of financial position. This amount would represent the amount of the overall gain or loss on sale not recognised at the commencement date.
Subsequent measurement		
The lease liability is…	measured as specified in paragraphs 36–46 of IFRS 16	
The balancing item is…	amortised to profit or loss over the lease term. Different amortisation methods may be appropriate. Some suggested a straight-line basis, unless another method better reflects the economics of the transaction. As noted in paragraph 18(d) of this paper, respondents had not developed their alternative solutions to consider, for example, presentation of the amortisation amount in the statement of profit or loss.	

Mechanics

B3. This table illustrates the alternative solutions using the illustrative example set out in paragraph 27 of this paper:

<table>
<tr><th>Componentised Liability</th><th>Deferred gain</th></tr>
<tr><td colspan="2">At the commencement date, Seller-lessee accounts for the transaction as follows:</td></tr>
<tr><td>Cash CU1,800
Right-of-use asset CU250[a]
Building CU1,000
Leaseback liability
- lease liability CU385[b]
- other component CU65
Gain on sale CU600[c]

Calculations
[a] 1,000 x 25% (this % is assumed for ease of analysis)
[b] present value of annual minimum lease payments of CU85, discounted at 3.5%
[c] (1,800 - 1,000) x ((1,800 – 450) ÷ 1,800)</td><td>Cash CU1,800
Right-of-use asset CU385[a]
Building CU1,000
Lease liability CU385[b]
Gain on sale CU600[c]
Deferred gain CU200[d]

Calculations
[a] the amount of the initial measurement of the lease liability
[b] present value of annual minimum lease payments of CU85, discounted at 3.5%
[c] (1,800 - 1,000) x (100% - 25%)
[d] 800 – 600</td></tr>
<tr><td colspan="2">In year 1, Seller-lessee accounts for the movement in the items as follows:</td></tr>
<tr><td>Interest expense CU13[d]
Leaseback liability – lease liability CU13

Leaseback liability – other component CU13[e]
Profit or loss CU13

Leaseback liability – lease liability CU85
Profit or loss CU7[f]
Cash CU92[g]

Depreciation CU50[h]
Right-of-use asset CU50</td><td>Interest expense CU13[d]
Lease liability CU13

Deferred gain CU40[e]
Profit or loss CU40

Lease liability CU85
Profit or loss CU7[f]
Cash CU92[g]

Depreciation CU77[h]
Right-of-use asset CU77</td></tr>
</table>

Calculations [d] interest on the lease liability at 3.5% [e] 65 ÷ 5 [f] the payment not included in the measurement of the lease liability [g] the actual lease payments for year 1 [h] 250 ÷ 5	*Calculations* [d] interest on the lease liability at 3.5% [e] 200 ÷ 5 [f] the payment not included in the measurement of the lease liability [g] the actual lease payments for year 1 [h] 385 ÷ 5

B4. This table shows the effect of the leaseback on Seller-Lessee's profit or loss over the term of the leaseback. The Year 1 effect excludes the gain on sale of CU600 because this amount is the same applying both approaches. The balancing item under both approaches is amortised on a straight-line basis over the term of the leaseback.

	1	2	3	4	5	Total
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual lease payments[1]	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Profit or loss						
Componentised Liability						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense[2]	(7)	(11)	(11)	(19)	(19)	(67)
Amortisation	13	13	13	13	13	65
Sub-total	*(44)*	*(48)*	*(48)*	*(56)*	*(56)*	*(252)*
Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Total	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
Deferred Gain						
Depreciation	(77)	(77)	(77)	(77)	(77)	(385)
Lease expense[2]	(7)	(11)	(11)	(19)	(19)	(67)
Amortisation	40	40	40	40	40	200
Sub-total	*(44)*	*(48)*	*(48)*	*(56)*	*(56)*	*(252)*
Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Total	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**

[1] Actual lease payments are provided for ease of reference.

[2] The lease expense represents the payments not included in the measurement of the lease liability.

Staff preliminary views: reasons not to recommend either approach to the Board

B5. Our preliminary view is that we would not recommend that the Board amend IFRS 16 to reflect either the Componentised Liability approach or the Deferred Gain approach. The following paragraphs explain the reasons for our preliminary view.

Componentised Liability approach

B6. The Componentised Liability approach retains the measurement of the right-of-use asset as specified in paragraph 100(a) of IFRS 16. Because the approach would retain those initial measurement requirements (and, in effect, would not remeasure the right-of-use asset at the commencement date), the liability recognised by the seller-lessee at the commencement date would not include any amount of deferred gain. Instead, that overall leaseback liability would represent, or be expected to be similar to, the present value of expected payments to be made by the seller-lessee over the term of the leaseback. Consequently, the ‘other component’ of the leaseback liability would represent, or be expected to be similar to, the present value of expected payments that are not included in the measurement of the lease liability.

B7. For this reason, in our view it would be inappropriate to amortise the ‘other component’ of the leaseback liability on a straight-line basis or any other basis that does not result in the recognition of interest on that liability. IFRS 16 treats lease liabilities as ‘debt-like’ liabilities—a sale and leaseback transaction similarly gives rise to a ‘debt-like’ liability. Consequently, an approach to subsequent measurement that recognises interest on the leaseback liability separately from depreciation of the right-of-use asset would, in our view, best reflect that the liability that arises from a sale and leaseback transaction is a ‘debt-like’ liability.

B8. We think amortising the ‘other component’ of the leaseback liability—as illustrated in the tables above—could be misleading for users of financial statements, in particular if that amortisation were mistakenly viewed as the release of a deferred gain or some other form of income for the seller-lessee.

B9. Our concern in this respect is best illustrated using an example in which the leaseback payments are fully variable linked to future performance or use of the underlying asset. So, to illustrate, the following table sets out the amounts recognised in profit or loss applying the Componentised Liability approach using the illustrative example set out in paragraph 27 of this paper, but with one change to the facts—assume there are no minimum annual payments. The leaseback payments are fully variable, calculated as 7% of Seller-lessee’s revenue generated using the building for each of the five years of the leaseback. In that case, the lease liability would be CU0 and the ‘other component’ of the leaseback liability would be CU450 at the commencement date.

	1	**2**	**3**	**4**	**5**	**Total**
Income / (expense)	CU	CU	CU	CU	CU	CU
Actual lease payments	*(92)*	*(96)*	*(96)*	*(104)*	*(104)*	*(492)*
Profit or loss						
Componentised Liability						
Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Lease expense	(92)	(96)	(96)	(104)	(104)	(492)
Amortisation	90	90	90	90	90	450
Sub-total	*(52)*	*(56)*	*(56)*	*(64)*	*(64)*	*(292)*
Interest expense	(0)	(0)	(0)	(0)	(0)	(0)
Total	**(52)**	**(56)**	**(56)**	**(64)**	**(64)**	**(292)**

B10. In this example, the amortisation of the ‘other component’ of the leaseback liability would total CU450 over the term of the leaseback. Considered together with the gain on sale recognised at the commencement date of CU600, the total credit amount recognised in profit or loss over the term of the leaseback is CU1,050 (CU450 + CU600)—this would be CU250 (CU1,050 – CU800) more than the overall gain on sale of the building of CU800. In our view, it would be difficult for users of financial statements to understand what the amortisation of CU90 in each year represents.

Deferred Gain approach

B11. The Deferred Gain approach goes beyond the boundary of the project (see paragraph 22 of the paper). It would be a more significant change to the sale and leaseback requirements in IFRS 16 than proposed in the Exposure Draft and, for this reason, we think any consideration of this approach would be appropriate as part of the Post-implementation Review of IFRS 16 but not before.

B12. The Deferred Gain approach does not go as far as a holistic review of the accounting for sale and leaseback transactions because it would continue to require a seller-lessee to recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. Compared to the sale and leaseback requirements in IFRS 16, it would, however, change the measurement of the right-of-use asset arising from a sale and leaseback transaction and, consequently, change the measurement of the liability arising from that transaction. Because the seller-lessee would measure the right-of-use asset and lease liability on a similar basis to a lease unrelated to a sale and leaseback transaction, the amount of the overall gain on sale deferred would be truly that—a deferred gain. It would not represent future payments to be made by the seller-lessee.

Presentation of all four approaches discussed in this paper

B13. This table sets out, side by side, all four approaches discussed in this paper. All of the numbers illustrate application of the approaches to the illustrative example in paragraph 27 of this paper.

Journal entry at the commencement date			*Profit or loss*	**1**	**2**	**3**	**4**	**5**	**Tot.**
Expected Payment approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	(1)	2	6	-	1	8
Building		CU1,000	Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Leaseback liability		CU450	**Total**	**(67)**	**(61)**	**(54)**	**(57)**	**(53)**	**(292)**
Gain on sale		CU600							
Imputed Payment approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	8	4	4	(4)	(4)	8
Building		CU1,000	Interest expense	(16)	(13)	(10)	(7)	(4)	(50)
Leaseback liability		CU450	**Total**	**(58)**	**(59)**	**(56)**	**(61)**	**(58)**	**(292)**
Gain on sale		CU600							
Componentised Liability approach									
Cash	CU1,800		Depreciation	(50)	(50)	(50)	(50)	(50)	(250)
Right-of-use asset	CU250		Lease expense	(7)	(11)	(11)	(19)	(19)	(67)
Building		CU1,000	Amortisation	13	13	13	13	13	65
Leaseback liability			Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
- lease liability		CU385	**Total**	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
- other component		CU65							
Gain on sale		CU600							
Deferred Gain approach									
Cash	CU1,800		Depreciation	(77)	(77)	(77)	(77)	(77)	(385)
Right-of-use asset	CU385		Lease expense	(7)	(11)	(11)	(19)	(19)	(67)
Building		CU1,000	Amortisation	40	40	40	40	40	200
Lease liability		CU385	Interest expense	(13)	(11)	(8)	(6)	(2)	(40)
Gain on sale		CU600	**Total**	**(57)**	**(59)**	**(56)**	**(62)**	**(58)**	**(292)**
Deferred gain		CU200							