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Approval by the IASB of *Lease Liability in a Sale and Leaseback* issued in September 2022

Lease Liability in a Sale and Leaseback, which amends IFRS 16 *Leases*, was approved for issue by nine of ten members of the International Accounting Standards Board (IASB). Mr Anderson dissented. His dissenting opinion is set out after the Basis for Conclusions.

Andreas Barckow	Chair
Nick Anderson	
Tadeu Cendon	
Zach Gast	
Jianqiao Lu	
Bruce Mackenzie	
Bertrand Perrin	
Rika Suzuki	
Ann Tarca	
Mary Tokar	

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Amendments to the Illustrative Examples accompanying IFRS 16 *Leases*

Sale and leaseback transactions (paragraphs 98–103)

Illustrative Example 24 has been amended. New text is underlined, and deleted text is struck through. Paragraph IE11 is not amended but is included in grey text for ease of reference. In this Illustrative Example, the headings 'Seller-lessee' and 'Buyer-lessor' are not amended; they are underlined here because that is how they appear in the published illustrative examples.

IE11 Example 24 illustrates the application of the requirements in paragraphs 99–102 of IFRS 16 for a seller-lessee and a buyer-lessor.

Example 24—Sale and leaseback transaction with fixed payments and above-market terms

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of ~~for determining when a performance obligation is satisfied in~~ IFRS 15 Revenue from Contracts with Customers *to be accounted for as a sale of the building. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. ~~This example ignores any initial direct costs.~~*

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. Applying paragraph 101(b) of IFRS 16, the~~The~~ amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) is ~~amounts to~~ CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Buyer-lessor classifies the lease of the building as an operating lease.

Seller-lessee

Applying paragraph 100(a) of IFRS 16, at ~~At~~ the commencement date~~,~~ Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. Seller-lessee calculates this amount ~~This is calculated~~ as: CU1,000,000 (the carrying amount of the building) ~~÷ CU1,800,000 (the fair value of the building)~~ × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset) ÷ CU1,800,000 (the fair value of the building).

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of the building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

(a) CU559,645 (CU800,000 ~~÷ CU1,800,000~~ × CU1,259,200 ÷ CU1,800,000) relates to the right to use the building retained by Seller-lessee; and

(b) CU240,355 (CU800,000 ~~÷ CU1,800,000~~ × (CU1,800,000 – CU1,259,200) ÷ CU1,800,000) relates to the rights transferred to Buyer-lessor.

Example 24—Sale and leaseback transaction with fixed payments and above-market terms

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Lease liability		CU1,259,200
Financial liability		CU200,000 ~~CU1,459,200~~
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

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Paragraph IE12 and Illustrative Example 25 are added. This paragraph and illustrative example have not been underlined for ease of reading.

IE12 Example 25 illustrates the application of the requirements in paragraph 102A and paragraphs 29–46 of IFRS 16 in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate.

Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800,000 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for five years. Lease payments—payable annually—comprise fixed payments and variable payments that do not depend on an index or rate.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IFRS 15 Revenue from Contracts with Customers *to be accounted for as a sale of the building. 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 per cent per annum.

Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use it retains as 25 per cent.[(a)] *Consequently, at the commencement date Seller-lessee accounts for the transaction as follows.*

Cash	*CU1,800,000*	
Right-of-use asset (CU1,000,000 × 25 per cent)	*CU250,000*	
Building		*CU1,000,000*
Lease liability		*CU450,000*
Gain on rights transferred ((CU1,800,000 – CU1,000,000) × 75 per cent)		*CU600,000*

Seller-lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

In measuring the lease liability applying paragraphs 36–46 of IFRS 16, Seller-lessee develops an accounting policy for determining 'lease payments' in a way that it would not recognise any amount of the gain that relates to the right of use it retains. Depending on the circumstances (including the method Seller-lessee used—applying paragraph 100(a) of IFRS 16—for determining the measurement of the right-of-use asset and the gain recognised on the transaction at the commencement date), either Approach 1 or Approach 2 could meet the requirements in paragraph 102A.

Approach 1—Expected lease payments at the commencement date

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect the expected lease payments at the commencement date that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at that date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

	Lease liability				**Right-of-use asset**		
Year	**Beginning balance**	**Lease payments**[(b)]	**3 per cent interest expense**[(c)]	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
	CU	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
1	**450,000**	(95,902)	13,500	**367,598**	**250,000**	(50,000)	**200,000**
2	**367,598**	(98,124)	11,028	**280,502**	**200,000**	(50,000)	**150,000**

Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

3	**280,502**	(99,243)	8,415	**189,674**	**150,000**	(50,000)	**100,000**
4	**189,674**	(100,101)	5,690	**95,263**	**100,000**	(50,000)	**50,000**
5	**95,263**	(98,121)	2,858	**0**	**50,000**	(50,000)	**0**

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,197 (CU99,321 – CU98,124) in profit or loss.

Approach 2—Equal lease payments over the lease term

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect equal periodic payments over the lease term that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at the commencement date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

	Lease liability				Right-of-use asset		
Year	**Beginning balance**	**Lease payments[d]**	**3 per cent interest expense[c]**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
	CU	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
1	**450,000**	(98,260)	13,500	**365,240**	**250,000**	(50,000)	**200,000**
2	**365,240**	(98,260)	10,957	**277,937**	**200,000**	(50,000)	**150,000**
3	**277,937**	(98,260)	8,338	**188,015**	**150,000**	(50,000)	**100,000**
4	**188,015**	(98,260)	5,640	**95,395**	**100,000**	(50,000)	**50,000**
5	**95,395**	(98,260)	2,865	**0**	**50,000**	(50,000)	**0**

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,061 (CU99,321 – CU98,260) in profit or loss.

(a) Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use retained by comparing, at the commencement date, the right of use it retains via the leaseback to the rights comprising the entire building. Paragraph 100(a) does not prescribe a particular method for determining that proportion.

(b) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date and, when discounted, result in the carrying amount of the lease liability at that date of CU450,000.

(c) Applying paragraph 102A and paragraph 36(a) of IFRS 16, Seller-lessee increases the carrying amount of the lease liability to reflect interest on the lease liability using its incremental borrowing rate.

(d) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect equal periodic payments over the lease term that, when discounted, result in the carrying amount of the lease liability at the commencement date of CU450,000.

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Amendments to the Basis for Conclusions on IFRS 16 *Leases*

Paragraphs BC267ZA–BC267ZF and their heading are added after paragraph BC267. Paragraph BC294A, and paragraphs DO1–DO6, and their headings are added. For ease of reading, these paragraphs and their headings have not been underlined. The heading 'Transition …' after paragraph BC272 is amended (paragraph BC272 is not reproduced). The heading 'Dissenting Opinion' after paragraph BC310 is also amended.

Sale and leaseback transactions (paragraphs 98–103)

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Subsequent measurement

BC267ZA In September 2022 the IASB amended IFRS 16 to add subsequent measurement requirements for sale and leaseback transactions that satisfy the requirements in IFRS 15 to be accounted for as a sale. The amendments require a seller-lessee to subsequently measure lease liabilities arising from a leaseback in a way that it does not recognise any amount of the gain or loss that relates to the right of use it retains. Without these new requirements, a seller-lessee could have recognised a gain on the right of use it retains solely because of a remeasurement (for example, following a lease modification or change in the lease term) if it had applied the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction. This could have been the case, in particular, in a leaseback that includes variable lease payments that do not depend on an index or rate—because these payments are excluded from 'lease payments' as defined in Appendix A. The seller-lessee might therefore have recognised a gain, even though no transaction or event would have occurred to give rise to that gain.

BC267ZB When it exposed its draft amendments, the IASB proposed that a seller-lessee initially measures the right-of-use asset and lease liability arising from a leaseback using the present value of expected lease payments at the commencement date. The IASB had concluded that prescribing initial measurement requirements would be the most effective way to improve comparability while also achieving its objective of prescribing subsequent measurement requirements that would prevent the recognition of any amount of the gain or loss that relates to the right of use the seller-lessee retains. Under the proposals, a seller-lessee would have subsequently measured the lease liability taking into account the expected lease payments at the commencement date.

BC267ZC Respondents raised conceptual and practical concerns about the proposal to require a seller-lessee to estimate expected lease payments (which could include variable payments that depend on an index or rate and variable payments that do not). In response to this feedback, the IASB decided not to prescribe specific measurement requirements for lease liabilities arising from a leaseback. The IASB concluded that it was appropriate for a narrow-scope amendment to focus on the primary matter it sought to address (described in paragraph BC267ZA). Paragraph 102A therefore requires a seller-lessee to apply the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction to lease liabilities arising from a leaseback in a way that it recognises no amount of the gain or loss related to the right of use it retains. But the IASB has not prescribed a particular method for doing that.

BC267ZD The requirements in paragraph 102A could result in a seller-lessee determining 'lease payments' or 'revised lease payments' in a way that would be different from the definition of 'lease payments' in Appendix A. The IASB considered adding requirements that would require a seller-lessee to develop an accounting policy for determining 'lease payments' that provides useful information about the leaseback transaction. The IASB decided not to do so, concluding that the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* are sufficient to require the seller-lessee to develop and apply an accounting policy that results in information that is relevant and reliable.

BC267ZE In developing the amendments, the IASB clarified that the liability that arises from a sale and leaseback transaction—that satisfies the requirements in IFRS 15 to be accounted for as a sale—is a lease liability to which IFRS 16 applies. Such a sale and leaseback transaction gives rise to a right-of-use asset (as specified by paragraph 100(a)). The seller-lessee's obligation to make payments to the buyer-lessor over the lease term for that right of use is therefore a lease liability. Further, the IASB considered the interaction between the requirements in paragraph 102A and other requirements in IFRS 16 and noted that a seller-lessee is not prevented from recognising in profit or loss any gain or loss relating to the partial or full termination of a lease required by paragraph 46(a). In that case, part or all of the right of use the seller-lessee held before the lease modification is terminated. Any gain or loss relating to the partial or full termination of the lease does not, therefore, relate to the right of use retained but to the right of use terminated.

BC267ZF The IASB also considered alternative ways suggested by respondents to achieve its objective (described in paragraph BC267ZA):

(a) an approach that would change the existing sale and leaseback requirements to initially measure the right-of-use asset and lease liability arising from a leaseback similarly to right-of-use assets and lease liabilities unrelated to a sale and leaseback transaction. Applying this approach, a seller-lessee would recognise a deferred gain for the amount of any gain that relates to the right of use it retains. However, such an approach would require the reconsideration of the sale and leaseback requirements in IFRS 16. And as explained in paragraph BC266, when developing IFRS 16 the IASB's view was that recognising only the amount of the gain or loss that relates to the rights transferred to the buyer-lessor appropriately reflects the economics of a sale and leaseback transaction because, from an economic standpoint, the seller-lessee has sold only its interest in the value of the underlying asset at the end of the leaseback. The IASB concluded that it would be inappropriate to reconsider those sale and leaseback requirements.

(b) an approach that would split the lease liability arising from a leaseback into two components—one component measured similarly to lease liabilities unrelated to a sale and leaseback transaction and one component that would include any residual liability recognised applying paragraph 100(a). The IASB decided not to permit or require such an approach, which could have resulted in the seller-lessee recognising gains greater than the full gain on the sale and leaseback transaction. Also, splitting the lease liability into two components, potentially measured differently, would create complexity in the requirements and be confusing for users of financial statements. In particular, amounts recognised in profit or loss might be misunderstood as the release of a deferred gain or some other form of income for the seller-lessee.

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Transition (paragraphs C2–C20E)

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Lease liability in a sale and leaseback (paragraph C20E)

BC294A The IASB decided to require a seller-lessee to apply the amendments retrospectively in accordance with IAS 8. The IASB expects the benefits of retrospective application to outweigh the expected costs because:

(a) sale and leaseback transactions often involve the sale of high-value items of property, plant and equipment with long economic lives. The accounting for such transactions could have a long-term material effect on the financial position of a seller-lessee. It is therefore important for users of financial statements that seller-lessees apply IFRS 16 consistently to those transactions.

(b) the amendments are expected to affect only the subsequent measurement of lease liabilities arising from a sale and leaseback transaction:

(i) with variable lease payments;

(ii) occurring from the date of initial application of IFRS 16 (1 January 2019 for most seller-lessees); and

(iii) for which the seller-lessee's accounting policy differs from the requirements specified in these amendments.

(c) the amendments do not require the seller-lessee to estimate expected lease payments. The seller-lessee could use the carrying amount of the lease liability at the commencement date—determined applying paragraph 100(a)—to develop its accounting policy for determining 'lease payments' as required by paragraph 102A.

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Dissenting Opinions

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Dissent of Nick Anderson from *Lease Liability in a Sale and Leaseback*

DO1 Mr Anderson voted against the publication of *Lease Liability in a Sale and Leaseback*.

DO2 Mr Anderson's preferred approach to accounting for a sale and leaseback transaction would be for the seller-lessee to recognise the full gain or loss on the transaction immediately—a view shared by some respondents to the draft amendments. He believes this accounting approach would:

(a) better reflect the economics of the transaction;

(b) be more transparent to users of financial statements, providing a more reliable basis for forecasting future cash flows than the accounting required by paragraph 100(a); and

(c) be less costly for preparers to implement and simpler for users of financial statements to understand.

DO3 Mr Anderson acknowledges that his preferred accounting approach would require the IASB to reconsider the sale and leaseback requirements in IFRS 16, which the IASB decided against doing when it developed the amendments. However, he is concerned that the amendments will further embed those sale and leaseback requirements.

DO4 Mr Anderson views the IFRS 16 treatment of the amount of the gain or loss that relates to the right of use the seller-lessee retains as economically equivalent to a deferred disposal gain. In his experience, users of financial statements seek to differentiate between gains on disposal and other profits an entity generates. Generally, users of financial statements place a lower valuation on disposal gains than on other profits. Mr Anderson is concerned that the subsequent measurement requirements developed in these amendments effectively embed what users of financial statements would view as disposal gains in the interplay between lease payments, interest and the depreciation charge on the leaseback.

DO5 Further, although the draft amendments aimed to reduce the potential for diversity in accounting for sale and leaseback transactions after initial recognition, Mr Anderson is concerned that the amendments issued include an accounting policy choice, albeit within defined boundaries.

DO6 Mr Anderson believes that the sale and leaseback requirements in IFRS 16 result in accounting that lacks transparency. In his view, users of financial statements will be unable to track the effect of what he regards as economically equivalent to a deferred gain over the term of the leaseback. He is concerned this lack of transparency will hinder users of financial statements in forecasting a seller-lessee's future cash flows and in assessing its long-term prospects.