

IFRS Developments

IASB issues ED on measuring the lease liability arising in a sale and leaseback transaction

What you need to know

- ▶ The IASB proposes amending IFRS 16 to specify the method a seller-lessee uses in initially measuring the right-of-use asset and lease liability in a sale and leaseback transaction.
- ▶ The proposed amendment also addresses how the seller-lessee subsequently measures the liability in a sale and leaseback transaction.
- ▶ Comments are due by 29 March 2021.

Highlights

On 27 November 2020, the International Accounting Standards Board (the IASB or Board) issued an Exposure Draft *Lease Liability in a Sale and Leaseback* (*Proposed amendment to IFRS 16*) (the ED). The Board is proposing an amendment to IFRS 16 *Leases* to specify the method a seller-lessee uses in initially measuring the right-of-use asset and lease liability arising in a sale and leaseback transaction and how the seller-lessee subsequently measures that liability.

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee.

The proposal in the ED is intended to improve the requirements for sale and leaseback transactions in IFRS 16. It does not change the principles for the sale and leaseback requirements in IFRS 16 and does not result in any change to the accounting for leases unrelated to sale and leaseback transactions.

The ED is open for public comments until 29 March 2021.

Proposed amendment to IFRS 16

Initial measurement

For sale and leaseback transactions in which a transfer of the asset satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale, paragraph 100 (a) of IFRS 16 requires the seller-lessee to 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.

The proposed amendment clarifies that the seller-lessee determines the proportion described above by comparing the present value of the expected lease payments to the fair value of the asset sold.

The expected lease payments comprise the following relating to the right to use the asset during the lease term at market rates:

- ▶ Fixed payments (including in-substance fixed payments), less any lease incentives
- ▶ Variable lease payments (regardless of whether they depend on an index or rate). This represents a departure from the general leases model under IFRS 16
- ▶ Amounts expected to be payable by the seller-lessee under residual value guarantees
- ▶ Payments of penalties for terminating the lease, if the lease term reflects the seller-lessee exercising an option to terminate the lease

The present value of the expected lease payments is determined by discounting the expected lease payments using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee uses its incremental borrowing rate.

The proposed amendment also clarifies that the seller-lessee recognises a lease liability arising from the leaseback. The seller-lessee initially measures the lease liability at the present value of the expected lease payments (as described above) that are not paid at the commencement date as determined above.

Subsequent measurement

The proposed amendment clarifies that the seller-lessee subsequently measures the right-of-use asset arising from the leaseback in accordance with the existing requirements in IFRS 16.

Applying the proposed amendment, the seller-lessee will subsequently measure the lease liability arising from the leaseback by:

- ▶ Increasing the carrying amount to reflect interest on the lease liability
- ▶ Reducing the carrying amount to reflect the expected lease payments for the reporting period as determined at the commencement date (or the revised expected lease payments for the reporting period if applicable)
- ▶ Remeasuring the carrying amount to reflect any reassessments or lease modifications, or to reflect revised in-substance fixed lease payments, other than a change in future lease payments resulting from a change in an index or a rate (including a change to reflect changes in market rental rates following a market rent review). Where there is a lease modification or a change in the lease term, the revised lease payments are the revised expected lease payments at the date of remeasurement. Except for a change in the lease term or a lease modification, the seller-lessee will not remeasure the lease liability to reflect a change in future variable lease payments

- ▶ Recognising any excess of the actual payments made for the lease (excluding any above-market terms) over the expected lease payments for the reporting period in profit or loss. If there are shortfalls in the actual payments made or recoveries of shortfalls, the seller-lessee also adjusts the carrying amount of the lease liability and makes a corresponding adjustment through profit or loss

Transition and effective date

The ED proposes that a seller-lessee would apply the amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to sale and leaseback transactions entered into after the date of initial application, except when retrospective application to a lease modification or change in the lease term is possible only with the use of hindsight. In that circumstance, the seller-lessee would determine the revised expected payments for the lease at the beginning of the annual reporting period in which it first applies the amendment.

A lessee will apply the amendment for annual reporting periods beginning on or after a date yet to be determined. Earlier application will be permitted.

Illustrative examples to IFRS 16

The ED proposes to amend the Illustrative Examples to IFRS 16. Example 24 will be amended to illustrate a sale and leaseback transaction with fixed payments and above-market terms. The ED also proposes a new Example 25 that will illustrate a sale and leaseback transaction with variable lease payments.

Next steps

Comments are due by 29 March 2021. We encourage stakeholders to provide feedback to the IASB on the proposed amendment.

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ED None

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How we see it

The proposed amendment to IFRS 16 will provide clarification of the initial and subsequent measurement of the right-of-use asset and lease liability arising in a sale and leaseback transaction. Such a lease liability includes the present value of variable lease payments regardless of whether they depend on an index or rate. This represents a departure from the general leases model which requires variable lease payments that do not depend on an index or rate to be recognised in profit or loss in the period in which the event or condition that triggers those payments occurs.