Issue 171 / July 2020

IFRS Developments

Sale and leaseback transactions with variable payments that do not depend on an index or rate

What you need to know

- The IFRS Interpretations Committee issued a final agenda decision on the accounting for sale and leaseback transactions with variable payments that do not depend on an index or rate.
- A seller-lessee must consider how variable payments affect the initial measurement of the right-of-use asset, the amount of gain or loss that relates to the rights transferred to the buyer-lessor and, thus, the related liability.
- Separately, the IASB plans to propose an amendment to IFRS 16 to specify the subsequent accounting by a seller-lessee of the liability that arises in such a transaction.

Highlights

An issue highlighted during the implementation of IFRS 16 *Leases* is how a seller-lessee should account for a sale and leaseback transaction with variable payments that do not depend on an index or rate.

In June 2020, the IFRS Interpretations Committee (the Committee) issued a final agenda decision highlighting that, in measuring the right-of-use asset arising from the leaseback with variable payments that do not depend on an index or rate, the seller-lessee determines the proportion of the underlying asset transferred to the buyer-lessor that relates to the right of use retained. The seller-lessee compares, at the date of the transaction, the right of use it retains via the leaseback, for example, using the present value of expected payments for the lease (including those that are variable), to the rights comprising the entire underlying asset.

The International Accounting Standards Board (IASB or the Board) has also decided to amend IFRS 16 to specify how a seller-lessee should apply the subsequent measurement requirements in IFRS 16 to the lease liability that arises in sale and leaseback transactions that include variable lease payments that do not depend on an index or rate.

Background

The transaction described in the agenda decision is, as follows:

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

Paragraph 100 of IFRS 16 requires 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, the seller-lessee measures 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 recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

While Illustrative Example 24 accompanying IFRS 16 illustrates the application of the requirements of IFRS 16 for a seller-lessee with respect to a sale and leaseback transaction with only fixed lease payments, IFRS 16 does not prescribe a method for initially measuring the right-of-use asset, a related liabilty and the amount of any gain or loss that relates to the rights transferred to the buyer-lessor in a transaction that includes variable payments that do not depend on an index or rate.

IFRS Interpretations Committee observations and conclusions

The Committee was 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 paragraph 100 of IFRS 16 provides the guidance applicable to the transaction described in the fact pattern. Therefore, 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 by the seller-lessee by comparing, at the date of the transaction, the right of use it retains via the leaseback to the rights comprising the entire PPE. However, IFRS 16 does not prescribe a method for determining that proportion. In the transaction described in the agenda decision, the Committee concluded, the seller-lessee could determine the proportion by comparing, for example, (a) the present value of expected payments for the lease (including those that are variable), to (b) the fair value of the PPE at the date of the transaction.

The 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, inclusive of expected variable lease payments. Because the right of use asset the seller-lessee retains 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. It was also observed that the seller-lessee discloses gains or losses arising from sale and leaseback transactions as required by paragraph 53(i) of IFRS 16.

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 determined using the fixed payments in the contract and the guidance in IFRS 16, paragraph 101 (for any below or above-market terms). When the contract includes variable payments that do not depend on an index or rate, the initial measurement of the lease liability also considers, the initial measurement of the right-of-use asset and the gain or loss on the sale and leaseback transaction determined applying paragraph 100(a) of IFRS 16.

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 agenda decision. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Standard-setting project by the IASB

The Committee's discussions highlighted that IFRS 16 is unclear about the subsequent measurement of the liability that arises in a sale and leaseback transaction that includes variable payments that do not depend on an index or rate. The Committee, therefore, recommended that the Board amend IFRS 16 to specify how a seller-lessee applies the subsequent measurement requirements in IFRS 16 to the liability that arises in such a transaction. The Board discussed the Committee's recommendation at its April and May 2020 meetings and has decided to propose an amendment to IFRS 16 in this respect. The Board expects to publish the exposure draft in the third quarter of 2020.

Example on a sale and leaseback with variable payments (as extracted from the agenda decision)

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.

Analysis

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 – CU 450,000) ÷ CU1,800,000.

Applying paragraph 100(a), Seller-lessee:

- Measures the right-of-use asset at CU 250,000, 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).
- 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).

Applying paragraph 100(a), the right-of-use asset would not be measured at zero because zero would not reflect the proportion of the previous carrying amount of the PPE (i.e., CU1,000,000) that relates to the right of use retained by Seller-lessee.

At the date of the transaction, Seller-lessee accounts for the transaction as follows:

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

Next steps

The agenda decision is relevant to sale and leaseback transactions that include variable payments that do not depend on an index or rate. Entities that have entered into such sale and leaseback transactions need to carefully evaluate their accounting policies to determine if any changes in accounting policies are required. The implementation of this agenda decision may require judgement. While the Board expects that an entity would be entitled to sufficient time to make the determination and implement any change, sufficient time is entity-specific and depends on the relevant facts and circumstances. Agenda decisions are expected to be implemented as soon and as quickly as possible. The Board expects this to be months rather than years.

Entities may need to explain their implementation process and, if material, consideration should be given as to whether disclosure related to the accounting policy change is required, taking into account regulatory requirements.

Entities affected by this agenda decision need to monitor the standard-setting process regarding the subsequent measurement of the liability that arises in a sale and leaseback transaction closely and evaluate how this will impact the overall accounting for the transaction.

EYG No 004602-20Gbl

ED None