



<b>Project:</b>	<b>Exposure Draft on Sale and Leaseback</b>	<b>Meeting:</b>	AASB February 2021 (M179)
<b>Topic:</b>	<b>ED 305 <i>Lease Liability in a Sale and Leaseback</i></b>	<b>Agenda Item:</b>	12.1.1
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		<b>Project Priority:</b>	Low
		<b>Decision-Making:</b>	Medium
		<b>Project Status:</b>	Decide whether to comment to the IASB

## Objective of this agenda item

- The objective of this agenda item is:
  - to **inform** the Board about [AASB Exposure Draft ED 305 \*Lease Liability in a Sale and Leaseback\*](#) including a summary of feedback received to date; and
  - for the Board to **decide** whether or not to submit a comment letter to the IASB on the Exposure Draft.

## Attachments

Agenda Paper 12.1.2 For noting: AASB Exposure Draft ED 305 *Lease Liability in a Sale and Leaseback* [[supporting documents folder](#)]

## Background

- The IFRS Interpretations Committee (IFRIC) received a request about a sale and leaseback transaction that includes variable lease payments. The request asked how the seller-lessee measures the right-of-use asset arising from the leaseback and thus determines any gain or loss to recognise at the transaction date.
- The IFRIC initially concluded that IFRS 16 *Leases* provides an adequate basis for a seller-lessee to account for a sale and leaseback transaction at the date of the transaction. However, the request highlighted the absence of specific subsequent measurement requirements for sale and leaseback transactions. The IFRIC recommended the IASB consider amending IFRS 16 to address subsequent accounting for sale and leaseback transactions, which would address divergent practices that could lead to material differences in the financial statements.
- In November 2020, the IASB issued Exposure Draft ED/2020/4 [Lease Liability in a Sale and Leaseback](#), which proposes amendments to IFRS 16 to require a seller-lessee to estimate the variable lease payments it expects to make over the lease term. The seller-lessee would then use this estimate to measure the right-of-use asset and lease liability. In December 2020, the AASB issued an equivalent Exposure Draft, ED 305.

- 5 Specifically, the proposed amendments would require the seller-lessee to:
- (a) initially measure the right-of-use asset by comparing the present value of expected lease payments, even if they are variable, to the fair value of the asset sold; and
  - (b) include expected lease payments in the lease liability, even if they are variable. Over the lease term, the seller-lessee would reduce the lease liability as if the expected lease payments had been paid and recognise the difference between expected and actual payments in the profit or loss.
- 6 The proposed amendments would apply retrospectively except when hindsight would be required. In this case, the expected payments would be determined when the proposed amendments are first applied.
- 7 The IASB considered several alternative approaches. However, it concluded that the proposed amendments ensure that the requirements of IFRS 16 are reflective of the economics of a sale and leaseback transaction.
- 8 In December 2020, the AASB issued an equivalent Exposure Draft to gauge Australian stakeholders' feedback on the proposals, with comments closing on 21 February.

*Alternative view in the ED*

- 9 Staff note that one IASB Member disagrees with the proposals. They have provided an alternative view that accompanies the IASB ED.
- 10 While they agreed that an amendment to IFRS 16 was needed, they disagree with the proposed changes for several reasons. For example, in their view:
- (a) there is an implicit conflict between the sale and leaseback requirements and lease payment definition and lease liability. Including variable lease payments (not based on an index or rate) in lease payments for sale and leaseback transactions but not general lease liabilities represents an inconsistency that requires standard-setting that encompasses initial recognition;
  - (b) including variable lease payments linked to future performance would lead to a high level of material uncertainty due to the subjectivity associated with determining such payments. Such subjectivity was further identified as something which the IASB considered best avoided when developing IFRS 16. For example, seller-lessees exposed only to lease payments linked to future performance would record a gain if their activities cease applying the proposed requirements. In their view, this is an unfair reflection of economic performance; and
  - (c) as the seller-lessee has to share benefits from the asset with the buyer-lessor, they no longer bear the same risks and such a significant change in the economic circumstances justifies full derecognition of the asset sold and recognition of any related gain in full.

**Feedback on the Exposure Draft**

- 11 As of 8 February 2021, the AASB has not received any comment letters on ED 305. However, staff has received some preliminary informal feedback via targeted outreach. Staff will conduct further targeted outreach and provide the Board with an update at the February meeting.
- 12 As of 8 February 2021, the IASB has received four comment letters.

*Feedback to the IASB*

- 13 Overall, responses received by the IASB to date appear supportive of the proposed amendments to IFRS 16. Respondents agree that the changes support greater clarity in accounting for sale and leaseback transactions both at initial recognition and subsequently.
- 14 Most observed that the inclusion of variable lease payments (regardless of whether they are based on an index or rate) in the measurement of expected lease payments gives rise to inconsistencies in applying IFRS 16 between sale and leaseback transactions and general lease transactions. However, they also acknowledged that the substance of a sale and leaseback transaction is different from a general lease transaction.
- 15 One respondent also suggested that the IASB consider amending the requirements for general leases to include variable lease payments (regardless of whether they are based on an index or rate).
- 16 All respondents agreed with the retrospective application of the proposals, including the alternative transition approach to avoid the use of hindsight in retrospective application.
- 17 One respondent also suggested that the proposed transition provisions in the Exposure Draft also be provided to first-time adopters in the form of an exemption to IFRS 1.

#### *Feedback to the AASB*

- 18 Preliminary feedback received from one stakeholder by AASB staff expressed concern that the IASB is being inconsistent between the proposed amendments and the general requirements of IFRS 16. In particular, there is concern that an entity would be required to include an estimate of variable lease payments in the measurement of the lease liability (and right-of-use asset) if it occurs through a sale and leaseback transaction. In contrast, the estimation of the variable lease payments are excluded in the measurement of the lease liability (and right-of-use asset) for general leases. This is due to the inherent measurement uncertainty.
- 19 While it is acknowledged that the IASB has explained its reasons for this in the Basis for Conclusions accompanying the Exposure Draft, in their view, an unreasonable inconsistency in the proposals remains.

#### **Whether the Board should make a submission to the IASB**

- 20 Staff recommends the AASB make a submission to the IASB.
- 21 Staff considers that commenting is appropriate under the AASB's third strategy – to actively influence IASB standards.
- 22 While staff acknowledged that the AASB and the IASB had received limited feedback to date, staff intend to perform additional targeted outreach. Staff will provide Board members with an update on the outcomes of this targeted outreach and whether any comment letters were received.

#### **Question for Board members**

Q1. Do Board members agree with the staff recommendation to submit a comment letter to the IASB on the Exposure Draft?
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#### **Next steps**

- 23 Subject to the Board agreeing with the staff recommendation in paragraph 20, staff recommends targeted outreach (noting time constraints preclude broader outreach) with stakeholder groups to help inform a response to the Exposure Draft.
- 24 Due to time constraints, staff recommends finalising the comment letter via the Chair.

**Question for Board members**

Q2. Do Board members agree with the staff recommendation to finalise the comment letter via the Chair? Alternatively, Board members may prefer to form a sub-committee to develop and approve the comment letter.