

IASB's Exposure Draft: Lease liability in a sale and leaseback



What is the issue?

In a sale and leaseback transaction, one entity (the seller-lessee) transfers an asset to another party (the buyer-lessor) and leases back that same asset. If the transfer of the asset by the seller-lessee satisfies the requirements of IFRS 15 "Revenue from Contracts with Customers" to be accounted for as a sale of the asset, the seller-lessee should:

- measure the right-of-use ("ROU") asset arising from the leaseback at the proportion of the carrying amount of the previously owned underlying asset;
- recognise a lease liability arising from the leaseback; and
- recognise any gain or loss that relates to the rights transferred to the buyer-lessor.

Illustration:

RM250,000 (ROU asset)	=	RM1,000,000 (carrying amount of previously owned underlying asset)	X	$\frac{\text{RM450,000}}{\text{RM1,800,000}}$ <p>(lease liability = PV of unpaid lease payments during the lease term) (fair value of the underlying asset)</p>
RM600,000 (gain on rights transferred to buyer-lessor)	=	RM1,800,000 – RM1,000,000 (total gain of the underlying asset)	X	$\frac{\text{RM1,800,000} - \text{RM450,000}}{\text{RM1,800,000}}$ <p>(fair value of the underlying asset – lease liability) (fair value of the underlying asset)</p>

The question is how the seller-lessee should measure the lease liability in a sale and leaseback transaction when the leaseback payments do not meet the definition of the lease payments in IFRS 16¹. This impacts not only the measurement of lease liability, but also the gain relates to the rights transferred to the buyer-lessor as illustrated above.

¹ IFRS 16 Appendix A defines lease payments as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- fixed payments (including in-substance fixed payments), less any lease incentives;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option;
- payments of penalties for terminating the lease, if the lease term reflect the lessee exercising an option to terminate the lease.



What are the proposed amendment?

The International Accounting Standards Board (“IASB”) proposes an amendment to IFRS 16 to provide guidance on how the lease liability in a sale and leaseback transaction should be measured. The seller-lessee is required to measure the lease liability in a sale and leaseback transaction at the present value of the expected lease payments at market rates which comprise fixed and variable lease payments.

The expected lease payments at market rates include variable lease payments that do not meet the definition of the lease payments in IFRS 16, e.g. variable lease payments linked to the seller-lessee’s sales or the performance of the underlying asset. This means that for example, when the lease payments are linked to the seller-lessee’s sales, the seller-lessee needs to forecast the sales over the lease term in order to determine the expected lease payments. This is an exception to the basic lease model in IFRS 16.

When there is a change in the seller-lessee’s expectations of future variable lease payments related to a sale and leaseback transaction, the seller-lessee does not remeasure the lease liability to reflect the change, other than for changes in the lease term or lease modifications. Any difference between the actual payments made for the lease and the expected lease payments is recognised in profit or loss.



What are the proposed transition provisions?

The amendment to IFRS 16 proposes that a seller-lessee apply 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 of IFRS 16.

However, if retrospective application to a sale and leaseback transaction that includes variable lease payments is possible only with the use of hindsight, the seller-lessee would determine the expected lease payments for that transaction at the beginning of the annual reporting period in which it first applies the proposed amendment.



What is the impact and for whom?

The proposed amendment would apply to all sale and leaseback transactions but is expected to particularly affect sale and leaseback transactions that include variable lease payments not dependent on an index or rate.



What you can do?

You may submit your comments on the [Exposure Draft](#) directly to the [IASB](#) before 29 March 2021 or through the [MASB](#) before 26 February 2021.

Do you need further information on this topic?

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