

ED/2020/4 - Lease Liability in a Sale and Leaseback

Feedback to respondents – EFRAG Final Comment Letter

11 May 2021

This Feedback Statement has been compiled by the EFRAG Secretariat to summarise the main comments received by EFRAG on its draft comment letter and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its final comment letter. The content of this Feedback Statement does not constitute any form of advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG.

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Introduction

Objective of this feedback statement

EFRAG published its final comment letter on the Exposure Draft ED/2020/4 *Lease Liability in a Sale and Leaseback (Proposed amendment to IFRS 16)* (‘the ED’) on 9 April 2021. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

Background to the ED

The proposed amendment in the ED specifies the method a seller-lessee uses in initially measuring the right-of-use asset and liability arising in a sale and leaseback transaction and how the seller-lessee subsequently measures that liability. Further details are available on the [IASB website](#).

EFRAG’s draft comment letter

- 1 EFRAG published a [draft comment letter](#) on the proposals on 22 December 2020 with a deadline for comments on 22 February 2021 which was subsequently extended to 23 March 2021. The letter contained three main assessments:
 - (a) EFRAG supported the proposals in the ED as they provided a practical and temporary fix on an area not currently addressed by the IFRS 16 and would result in a seller lessee recognising a gain only to the proportion of the rights it has transferred to the buyer-lessor.
 - (b) However, EFRAG considered that there was a broader issue to consider by the IASB because of a conflict in the principles in IFRS 16 between:
 - (i) the measurement principle for a lease liability in paragraph 27 of IFRS 16 that excludes from the lease payments those that are linked to future performance or use; and
 - (ii) the principles underpinning paragraphs 100–102 for sale and leaseback transactions that a gain arising on the interest retained by the seller-lessee in a sale and leaseback transaction cannot be recognised.

EFRAG therefore encouraged the IASB to reconsider the matter more broadly as part of the future Post Implementation Review of IFRS 16.

EFRAG also considered that there were challenges and complexity associated with the proposals in the ED, in particular regarding the level of judgement involved in estimating the future lease payments. To address the matter, EFRAG suggested that the IASB considers additional disclosures regarding the judgement applied in estimating the future payments.

Comments received from respondents

EFRAG has received and considered nine comment letters¹ from 9 respondents. These comment letters are available on the EFRAG [website](#).

The comment letters received came from national standard setters, business associations, professional organisations, listed companies and EU authorities.

Measurement of the right-of-use asset and lease liability arising in a sale and leaseback transaction

Four respondents supported like EFRAG the proposals as a practical solution in an area not covered by IFRS 16, and in particular agreed with the outcome that only the gain on transferred rights is recognised. Like EFRAG these respondents called for a broader review of the principles underpinning the accounting of leaseback transactions in IFRS 16 possibly as part of the post-implementation review.

Five respondents did not support the proposals in the ED. These respondents expressed concerns that the proposals in this ED may lead to further inconsistency arising from the use of two different definitions of variable lease payments if they are not accompanied with clear analyses and explanation of the reason for the discrepancy. These respondents urged the IASB to reconsider the matter more broadly; possibly as part of the future Post Implementation Review of IFRS 16 or the IASB's research project on Variable and Contingent Consideration.

A majority of respondents considered, like EFRAG, that the gain ought to be limited to the transferred right. However, several respondents urged the IASB, if the amendments were to be finalised, to consider a simpler temporary solution to achieve a similar outcome by recognising the present value of the variable lease payments as a non-lease liability or a deferred income. This would result in lease contracts with the same characteristics being accounted for in the same way, irrespective of whether they were entered into directly or via a leaseback. Under this alternative the non-lease liability would be released on a straight-line basis over the expected term of the leaseback similar to the accounting that existed in the predecessor standard to IFRS 16.

For leases with only variable payments (not based on an index or rate) one respondent considered that no right-of-use asset or lease liability would be recognised separately and only the deferred income or loss would be presented in the balance sheet on a net basis.

¹ A tenth letter was received after the EFRAG TEG meeting (therefore not included in their deliberation). See list of respondents in Appendix.

Finally, respondents noted the following operational challenges with the proposals in the ED:

- The determination of an appropriate discount rate considering the specificities of variable payments linked to future performance or use of the underlying asset in terms of higher uncertainties that affect cash flows;
- The fact that the future variable lease payments are not subsequently reassessed to reflect changes in estimates; meaning that, the latest estimate of expected cash outflows will not be reflected at the end of each accounting period.

Transition requirements

Few respondents explicitly commented on the transition requirement. Those who did generally did not object to the proposed transition requirements if the amendments were to be finalised. However, one respondent recommended that the IASB reconsiders the effects and specific challenges of retrospective application for first time adopters of IFRS.

EFRAG’s final comment letter

EFRAG issued its final comment letter on 9 April 2021.

Considering the feedback received and the split views expressed by respondents, EFRAG has amended its comment letter to reflect the following:

- Observe, first, that the proposals in the ED would result in a seller lessee only recognising a gain to the proportion of the rights it has transferred and that this would reflect the economics of the transaction;

- Emphasise, as a primary concern, the need to timely to address the existing broader conflict of principles in IFRS 16 and the further inconsistency that the ED may introduce from the use of two different definitions of variable lease payments. This could be addressed as part of the future Post Implementation Review of IFRS 16 or the IASB’s research project on Variable and Contingent Consideration.
- Accept that a temporary and faster solution is implemented to address the lack of guidance in IFRS 16, pending a more holistic review of the matter.
- However, encourage the IASB to consider a simpler solution to achieve the same desired outcome, such as by recognising the part of the gain or loss pertaining to the retained interest in leases asset as a non-lease liability or deferred income rather than a lease liability. Consider the implication in terms of subsequent accounting and effects on the statement of income.
- For sale and leaseback transactions with variable payments only, suggest that the IASB could also explore a further simplification by considering presentation on a net basis, instead of recognising separately a right-of-use asset and a non-lease liability (or deferred income).

Finally, EFRAG included in its final comment letter a number of operational challenges associated with implementing the proposals noted by some respondents that would require further consideration and guidance.

Detailed analysis of issues, comments received and changes made to EFRAG’s final comment letter

Measurement of the right-of-use asset and lease liability arising in a sale and leaseback transaction

Proposals in the ED

The [Draft] amendment to IFRS 16 *Leases* applies to sale and leaseback transactions in which, applying paragraph 99 of IFRS 16, the transfer of the asset satisfies the requirements to be accounted for as a sale of the asset. The [Draft] amendment proposes:

- (a) to require a seller-lessee to determine the initial measurement of the right-of use asset by comparing the present value of the expected lease payments, discounted using the rate specified in paragraph 26 of IFRS 16, to the fair value of the asset sold (paragraph 100(a)(i));
- (b) to specify the payments that comprise the expected lease payments for sale and leaseback transactions (paragraph 100A); and
- (c) to specify how a seller-lessee subsequently measures the lease liability arising in a sale and leaseback transaction (paragraph 102B).

EFRAG’s tentative position

In its draft comment letter, EFRAG supported the proposals in the ED as it provides guidance on an area not currently addressed by the IFRS 16 and can reduce the potential for diversity in practice, while relying on existing measurement principles, applicable to all leases, that have been assessed to result in relevant information.

EFRAG noted in particular the ED would result in recognising the gain on the sale and leaseback only to the proportion of the rights transferred to

EFRAG final position

EFRAG has revised its final comment letter to reflect the feedback provided by respondents to its consultation. In doing so, EFRAG gave consideration to the feedback received and, in particular, to:

- The concerns expressed by a majority of respondents that the proposals in this ED may lead to further inconsistency arising from the use of two different definitions of variable lease payments:
- The agreement, expressed by a majority of respondents, that the gain should not be recognised in full but only to the extent of the rights transferred in the transaction;
- The support for the message, expressed in EFRAG’s draft comment letter, that there is broader conflict of principles and for the IASB to address in a timely manner;
- The suggestions made by many to have a simpler solution that provides the same outcome without introducing inconsistencies and complexity.

Therefore, EFRAG’s final comment letter:

- First notes that the ED would result in a seller lessee recognising a gain only to the proportion of the rights it has transferred to the buyer-lessor and considers that recognising
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the buyer-lessee and that recognising the full gain would not have reflected the economics of the transaction.

Nonetheless, EFRAG stressed that there may be a broader issue to consider by the IASB as there is a conflict between two main principles in IFRS 16:

- the exclusion of variable lease payments (not based on an index or rate) from the definition of lease payments, and
- the principle that when entering into a sale and leaseback transaction there should not be any gain on the interest retained by the seller-lessee.

Although EFRAG agreed that the latter principle be given precedence, EFRAG encouraged the IASB to reconsider the matter more broadly possibly as part of the future Post-implementation review of IFRS 16.

EFRAG also noted a number of operational challenges associated with the proposals in the ED and in particular the significant judgement involved in estimating the future lease payments. To address the matter, EFRAG suggested that the IASB consider disclosures regarding the estimates of future lease payments.

Respondents’ comments

The tentative position in the draft comment letter, conveyed three main messages:

- (a) Broader issue to consider and challenges;
- (b) Challenges and complexity associated with the proposals in the ED; and
- (c) Practical temporary fix on an area not currently addressed by IFRS 16.

the full gain or loss on the sale would not have reflected the economics of a sale and leaseback transaction.

- Express concerns that the proposals in this ED may lead to further inconsistency arising from the use of two different definitions of variable lease payments.
 - Reiterates and emphasises the view that there is a broader issue to consider by the IASB as there exists conflict between two main principles in IFRS 16 regarding and urges the IASB to reconsider the matter more broadly; possibly as part of the future Post Implementation Review of IFRS 16 or the IASB's research project on Variable and Contingent Consideration.
 - Accepts that a temporary and faster solution is put in place to address the lack of guidance in IFRS 16, pending a more holistic review of the matter but recommends considering a simpler solution to achieve the same outcome, such as by recognising the profit attributable to the retained interest in the right-of-use asset as a non-lease liability or deferred income, rather than a lease liability. This approach, a temporary by nature, could be reassessed at a later stage, when the IASB completes the review of the conflict of principles.
 - Suggest that for sale and leaseback transactions with variable payments only, the IASB could also explore a further simplification by considering presentation on a net basis instead of recognising separately a right-of-use asset and a non-lease liability (or deferred income).
 - Suggests that, under the suggested simplified approaches, the IASB could further explore subsequent measurement and the effects on the statement of income.
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Respondents generally agreed with the existence of a conflict in principles, the need to address it more holistically and the existence of operational challenges to apply the proposals the proposed accounting (refer to a) and b) above).

However, respondents diverged on whether the proposals in the ED were acceptable as a 'temporary fix' to address the issue at stake:

Four respondents supported EFRAG's assessment. One of these respondents, however, while understanding EFRAG's assessment considered that the difference in the initial measurement of a lease liability arising from a leaseback and from a standalone lease was difficult to justify conceptually. This respondent suggested a presentation as a non-lease liability or deferred income rather than as lease liability, with amortisation over the lease term would not be preferable.

Five respondents did not support the assessment made by EFRAG. However, they expressed different reasons for their lack of support.

- One respondent assessed that the same measurement method existing in IFRS 16 should apply to all leases regardless of their origins and therefore the gain on a sale and leaseback with variable rents (not based on an index or rate) should be recognised in full.
- Two respondents considered that the recognition gain would depend on the economic factors and intention for which the sale and leaseback was entered into (financing, realising a capital gain, etc.) and there could be circumstances in which full or partial gain could be justified.
- Other respondents, while supporting the intention of limiting the gain or loss to be recognised by a seller-lessee, considered that the proposed accounting were too complex for the intended objective. If the Amendments were to be maintained, these

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- Notes that is a number of complexities and operational challenges associated with the proposals in the ED, in particular regarding the level of judgement involved in estimating the future variable payments or the estimation of the discount rate. Suggest that that would require further consideration and guidance.
 - Reiterates support for the proposed transition requirements, if the amendments were to be finalised based on the ED, and in particular the retrospective application of the proposed amendments, unless in circumstances where such retrospective application cannot be done without the use of hindsight.

respondents suggested, as an alternative, to simply consider the deferral of the gain or loss attributable to the retained interest in the lease asset as a non-lease liability or deferred income.

Two of these respondents considered that the IASB had stretched the scope of its ED too far by proposing amendments that would apply to all sales and leaseback. In these respondent's view, the IASB should only focus on sale and leaseback transactions that include variable payments linked to future performance or use of the underlying asset, which was the original fact pattern submitted to the IFRS Interpretations Committee. If the IASB were to proceed with the amendments they suggested to consider a simpler approach than the one included in the ED; for example, by recognising a deferred gain (amortised that gain in profit or loss over the lease term). This approach, temporary by nature, could be reassessed at a later stage, for example when the IASB reviews the overall approach for sale and leaseback transactions

Finally, one respondent noted that the proposal contained in the ED represents an exception to the relevant principles of IFRS 16 and therefore creates an internal contradiction to the principles of the existing standard as far as both initial and subsequent accounting are concerned. This respondent also noted that exceptions to the Framework which result in internal contradictions in a given standard should be made only in very rare circumstances.

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Transition

Proposals in the ED

Paragraph C20E of the [Draft] amendment to IFRS 16 proposes that a seller-lessee apply the [Draft] amendment to IFRS 16 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 amendment.

EFRAG’s tentative position

EFRAG supported the proposed transition requirements and in particular the retrospective application of the proposed amendments, unless in circumstances where such retrospective application cannot be done without the use of hindsight.

Respondents’ comments

Respondents who addressed the question did generally did not object to the proposed transition requirements if the amendments were to be finalised. However, one respondent recommended that the IASB reconsiders the effects and specific challenges of retrospective application for first time adopters of IFRS.

EFRAG final position

Given the responses received, generally supporting EFRAG’s tentative views, no changes were made to the tentative position in the draft comment letter.

Appendix 1: List of respondents

Table 1: List of respondents

Name of respondents	Country	Type / Category
Norwegian Accounting Standards Board (NASB)	Norway	Standard Setter
Comissão de Normalização Contabilística (CNC)	Portugal	Standard Setter
Dutch Accounting Standards Board (DASB)	Netherlands	Standard Setter
Instituto de Contabilidad y Auditoría de Cuentas de España - ICAC.	Spain	Standard Setter
The Swedish Enterprise Accounting Group (SEAG)	Sweden	Organisation of preparers
Accounting Standards Committee of Germany (ASCG)	Germany	Standard Setter
Business Europe	Europe	Professional organisation
Autorité des Normes Comptables	France	Standard Setter
Swedish Financial Reporting Board	Sweden	Standard Setter

A tenth letter was received from ACTEO/MEDEF/AFEP after the EFRAG TEG deliberation and recommendations to the EFRAG Board).