

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Lease Liability in a Sale and Leaseback Cover Note

Objective

- 1 The objectives of the session is to discuss and approve a final comment letter in response to the IASB's exposure draft *Lease Liability in a Sale and Leaseback*, issued by the IASB on 27 November 2020 (the 'ED').

Background

- 2 On 27 November 2020, the IASB issued the ED to amend IFRS 16. The proposed amendment would specify 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.
- 3 EFRAG's draft comment letter prepared was approved by the EFRAG Board through written procedure and issued on 22 December 2020 with a comment period ending (as extended) 23 March 2021.
- 4 The published ED can be found on EFRAG's website [here](#).

Feedback received

- 5 EFRAG's draft comment letter contained three main assessments:
 - (a) EFRAG supported the proposals in the ED as they provided a practical 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.
 - (c) EFRAG also considered that there are 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.

Comment letters received

- 6 EFRAG had received a total of 9 comment letters by the time of the EFRAG TEG meeting which showed split views.
- 7 **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.
- 8 **Five respondents**¹ 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.
- 9 However, some of these 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 gain. 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.

EFRAG TEG recommendation

- 10 At its webcast meeting on 30 March EFRAG TEG considered the feedback received in response to the draft comment letter consultation and discussed two drafting options:
 - (a) Option 1 (presented under agenda paper 03-03) essentially reiterating the views expressed in the DCL supporting the proposals as a practical solution but urging the IASB to consider more broadly the existing conflict of principles as part of the post-implementation review of IFRS 16 and noting a number of practical implementation issues.
 - (b) Option 2 (presented under agenda paper 03-02) emphasising the need timely to address the broader conflict of principles as the main concern; proposing an alternative simpler accounting of the liability as a deferred gain rather than a lease liability and stressing the temporary and therefore necessarily imperfect nature of the proposed alternative and its implications in terms of subsequent v accounting in the statement of account; noting a number of practical implementation issues.
- 11 It was noted that the two options have commonalities (the need to reconsider the issue more broadly, the agreement with the outcome that a seller lessee should recognised a gain only to the proportion of the rights it has transferred; the practical implementation issues).
- 12 But they differ in two main points as:
 - (a) Option 2 puts more emphasis on the fact that EFRAG accepts the proposed accounting only as a temporary, faster and not perfect solution to address the

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

Lease Liability in a Sale and Leaseback - Cover Note

lack of guidance in IFRS 16, pending a more holistic and fundamental review of the matter.

- (b) Only Option 2 suggests recognising a non-lease liability or a deferred gain instead of a lease liability as a simpler temporary solution achieving the same outcome; and discusses the effects on subsequent accounting.
- 13 After discussion, EFRAG TEG recommended a Final Comment Letter based on Option 2 to the Board. However, EFRAG TEG did not reach a consensus on which option to support. The reason for the split is the different approach to the variable lease payments. Those that supported Option 2 were concerned not to create a precedent for a treatment as part of the lease liability, while on the contrary those that supported Option 1 were mainly convinced that this treatment would be more informative for the users or could accept this treatment as a temporary approach. The EFRAG TEG was split as follows:
- (a) Six members supported Option 1: Ana Cortez, Nicklas Grip, Erlend Kvaal and David Procházka, Ambrogio Virgilio and Jed Wrigley.
 - (b) Six members supported Option 2: Chiara Del Prete, Jens Berger, Emmanuelle Guyomard, Tommaso Fabi, Vincent Louis, Olivier Scherer.
- 14 Other members were absent (Jenny Carter, Geert Ewalts and Christoph Schauerte).
- 15 After considering the tied vote, Option 2 was approved for recommendation to the EFRAG Board on the basis of EFRAG TEG's chairwoman additional casting vote.

Questions for EFRAG TEG

- 16 Does EFRAG Board members have questions on the summary of the feedback and on EFRAG TEG's recommendation?
 - 17 Does EFRAG Board approve the Option 2 final comment letter (paper 03-02) for publication?
- 18 In addition to this cover note, the following agenda papers have been provided for the session:
- (a) 03-02 –Comment Letter Recommended by EFRAG TEG
 - (b) 03-03 – Alternative Comment Letter (not recommended by EFRAG TEG)

Appendix – List of respondents

	Respondent	Type	Country
1	NASB	Standard Setter	Norway
2	CNC	Standard Setter	Portugal
3	DASB	Standard Setter	Netherlands
4	ICAC	Standard Setter	Spain
5	SEAG	Organisation of preparers	Sweden
6	ASCG	Standard Setter	Germany
7	Businessseurope	Professional organisation	Europe
8	Autorité des Normes Comptables	Standard Setter	France
9	Swedish Financial Reporting Board	Standard Setter	Sweden

In addition to the above 9 letters, a tenth letter was received after EFRAG TEG discussion and therefore not included in the deliberations and recommendation to EFRAG Board

10	ACTEO/MEDEF/AFEF	Standard Setter	France
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