KPMG

Lease liability in a sale-and-leaseback

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Proposed approach differs from IFRS 16's general model for variable lease payments

Highlights

– What's the issue? – Plugging a gap in IFRS 16

– New approach proposes inclusion of variable lease payments

– Next steps – Comment by 29 March 2021

Under IFRS 16 *Leases*, a lessee does not generally include variable lease payments in the measurement of a lease liability, unless they depend on an index or a rate. However, the International Accounting Standards Board (the Board) is **proposing a new approach** to variable lease payments that arise in a sale-and-leaseback transaction.

Plugging a gap in IFRS 16

Questions have arisen in practice about how to measure the right-of-use asset and lease liability in a sale-and-leaseback transaction with variable lease payments – e.g. if all of the lease payments depend on the future sales of the lessee, then is it acceptable for the lessee to measure the right-of-use asset and lease liability at zero?

Initially, the IFRS Interpretations Committee responded and concluded in its **agenda decision** that the right-of use asset and liability are unlikely to be measured at zero at the date of a sale-and-leaseback transaction, even if all of the payments in the leaseback are variable. It recommended that the Board consider amending IFRS 16 to address subsequent accounting.

New approach proposes inclusion of variable lease payments

The Board's proposals confirm the Committee's conclusions but are more detailed and prescriptive. They would require a seller-lessee to estimate the variable lease payments it expects to make over the lease term. For example, if the lease payments depend on the seller-lessee's sales, then the seller-lessee would be required to estimate its expected future sales over the lease term.

The seller-lessee would then use this estimate to measure the right-of-use asset and lease liability as follows.

Right-of-use asset

The seller-lessee would initially measure the right-of-use asset by comparing the present value of the expected lease payments to the fair value of the asset sold. For example, if the carrying amount of the asset immediately before the sale is 80, the present value of the expected lease payments is 50, and the fair value of the asset sold is 100, then the right-of-use asset would be measured at $80 \times (50/100) = 40$.

Lease liability

The seller-lessee would include the 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 in profit or loss the difference between the expected lease payments and the amounts actually paid.

Transition

The proposed amendments would apply retrospectively except when hindsight would be required. In this case, the expected payments would be determined at the date the proposed amendments are first applied.

Next steps

The Board has requested comments on the proposed amendments by 29 March 2021. We encourage preparers and users of financial statements to read and comment on the proposals.

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