International Financial Reporting Standard

Lease Liability in a Sale and Leaseback

September 2022

ILLUSTRATIVE EXAMPLES – AMENDMENTS

[IFRS 16]

[Related to AASB 2022-5]

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Amendments to the Illustrative Examples accompanying IFRS 16 *Leases*

Sale and leaseback transactions (paragraphs 98–103)

Illustrative Example 24 has been amended. New text is underlined, and deleted text is struck through. Paragraph IE11 is not amended but is included in grey text for ease of reference. In this Illustrative Example, the headings 'Seller-lessee' and 'Buyer-lessor' are not amended; they are underlined here because that is how they appear in the published illustrative examples.

IE11 Example 24 illustrates the application of the requirements in paragraphs 99–102 of IFRS 16 for a seller-lessee and a buyer-lessor.

Example 24—Sale and leaseback transaction with fixed payments and above-market terms

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of ~~for determining when a performance obligation is satisfied in~~ IFRS 15 Revenue from Contracts with Customers *to be accounted for as a sale of the building. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. ~~This example ignores any initial direct costs.~~*

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. Applying paragraph 101(b) of IFRS 16, the~~The~~ amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) is ~~amounts to~~ CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Buyer-lessor classifies the lease of the building as an operating lease.

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Example 24—Sale and leaseback transaction with fixed payments and above-market terms

Seller-lessee

Applying paragraph 100(a) of IFRS 16, at ~~At~~ the commencement date~~,~~ Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. Seller-lessee calculates this amount ~~This is calculated~~ as: CU1,000,000 (the carrying amount of the building) ~~÷ CU1,800,000 (the fair value of the building)~~ × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset) ÷ CU1,800,000 (the fair value of the building).

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of the building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

(a) CU559,645 (CU800,000 ~~÷ CU1,800,000~~ × CU1,259,200 ÷ CU1,800,000) relates to the right to use the building retained by Seller-lessee; and

(b) CU240,355 (CU800,000 ~~÷ CU1,800,000~~ × (CU1,800,000 – CU1,259,200) ÷ CU1,800,000) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Lease liability		CU1,259,200
Financial liability		CU200,000 ~~CU1,459,200~~
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
Cash		CU2,000,000

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Example 24—Sale and leaseback transaction with fixed payments and above-market terms
After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

Paragraph IE12 and Illustrative Example 25 are added. This paragraph and illustrative example have not been underlined for ease of reading.

IE12 Example 25 illustrates the application of the requirements in paragraph 102A and paragraphs 29–46 of IFRS 16 in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate.

Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800,000 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for five years. Lease payments—payable annually—comprise fixed payments and variable payments that do not depend on an index or rate.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IFRS 15 Revenue from Contracts with Customers *to be accounted for as a sale of the building. Accordingly, Seller-lessee accounts for the transaction as a sale and leaseback.*

The interest rate implicit in the lease cannot be readily determined. Seller-lessee's incremental borrowing rate is 3 per cent per annum.

Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use it retains as 25 per cent.[(a)] Consequently, at the commencement date Seller-lessee accounts for the transaction as follows.

Cash	*CU1,800,000*	
Right-of-use asset (CU1,000,000 × 25 per cent)	*CU250,000*	
Building		*CU1,000,000*
Lease liability		*CU450,000*
Gain on rights transferred ((CU1,800,000 – CU1,000,000) × 75 per cent)		*CU600,000*

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Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

Seller-lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

In measuring the lease liability applying paragraphs 36–46 of IFRS 16, Seller-lessee develops an accounting policy for determining 'lease payments' in a way that it would not recognise any amount of the gain that relates to the right of use it retains. Depending on the circumstances (including the method Seller-lessee used—applying paragraph 100(a) of IFRS 16—for determining the measurement of the right-of-use asset and the gain recognised on the transaction at the commencement date), either Approach 1 or Approach 2 could meet the requirements in paragraph 102A.

Approach 1—Expected lease payments at the commencement date

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect the expected lease payments at the commencement date that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at that date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

	Lease liability				Right-of-use asset		
Year	Beginning balance	Lease payments[(b)]	3 per cent interest expense[(c)]	Ending balance	Beginning balance	Deprecia-tion charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	**450,000**	(95,902)	13,500	**367,598**	**250,000**	(50,000)	**200,000**
2	**367,598**	(98,124)	11,028	**280,502**	**200,000**	(50,000)	**150,000**
3	**280,502**	(99,243)	8,415	**189,674**	**150,000**	(50,000)	**100,000**
4	**189,674**	(100,101)	5,690	**95,263**	**100,000**	(50,000)	**50,000**
5	**95,263**	(98,121)	2,858	**0**	**50,000**	(50,000)	**0**

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,197 (CU99,321 – CU98,124) in profit or loss.

Approach 2—Equal lease payments over the lease term

Applying paragraph 102A of IFRS 16, Seller-lessee determines 'lease payments' to reflect equal periodic payments over the lease term that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at the commencement date of CU450,000.

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Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

The lease liability and the right-of-use asset arising from the leaseback are:

	Lease liability				Right-of-use asset		
Year	Beginning balance	Lease payments[d]	3 per cent interest expense[c]	Ending balance	Beginning balance	Deprecia-tion charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	**450,000**	(98,260)	13,500	**365,240**	**250,000**	(50,000)	**200,000**
2	**365,240**	(98,260)	10,957	**277,937**	**200,000**	(50,000)	**150,000**
3	**277,937**	(98,260)	8,338	**188,015**	**150,000**	(50,000)	**100,000**
4	**188,015**	(98,260)	5,640	**95,395**	**100,000**	(50,000)	**50,000**
5	**95,395**	(98,260)	2,865	**0**	**50,000**	(50,000)	**0**

In applying paragraph 102A and paragraph 38(b) of IFRS 16, Seller-lessee recognises in profit or loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognises CU1,061 (CU99,321 – CU98,260) in profit or loss.

(a) Applying paragraph 100(a) of IFRS 16, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use retained by comparing, at the commencement date, the right of use it retains via the leaseback to the rights comprising the entire building.
Paragraph 100(a) does not prescribe a particular method for determining that proportion.

(b) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date and, when discounted, result in the carrying amount of the lease liability at that date of CU450,000.

(c) Applying paragraph 102A and paragraph 36(a) of IFRS 16, Seller-lessee increases the carrying amount of the lease liability to reflect interest on the lease liability using its incremental borrowing rate.

(d) Applying paragraph 102A and paragraph 36(b) of IFRS 16, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect equal periodic payments over the lease term that, when discounted, result in the carrying amount of the lease liability at the commencement date of CU450,000.

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