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| Project: | Lease Liability in a Sale and Leaseback | Meeting: | November 2022 (M191) |
| Topic: | Ballot Draft AASB 2022-X Amendments to Australian Accounting Standards – Lease Liability in a Sale and Leaseback for Board Voting | Agenda Item: | 9.1 |
| | | Date: | 25 October 2022 |
| Contact(s): | James Wake jwake@auasb.gov.au Kimberley Carney kcarney@aab.gov.au | Project Priority: | Medium |
| | | Decision-Making: | High |
| | | Project Status: | Ballot draft for Board voting |

Objective of this paper

- The objective of this paper is to provide the Board with:
 - an update on the IASB's Lease Liability in a Sale and Leaseback project; and
 - a ballot draft version of amending Standard AASB 2022-X *Amendments to Australian Accounting Standards – Lease Liability in a Sale and Leaseback* for voting.

Attachments

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| Agenda paper 9.2 | Ballot Draft: AASB 2022-X <i>Amendments to Australian Accounting Standards – Lease Liability in a Sale and Leaseback</i> |
| Agenda paper 9.3 | AASB Comment Letter on IASB ED/2020/4 <i>Lease Liability in a Sale and Leaseback</i> [supporting material folder] |
| Agenda paper 9.4 | Comment Letters received on AASB ED 305 <i>Lease Liability in a Sale and Leaseback</i> [supporting material folder] |

Background

- The IFRS Interpretations Committee (IFRS IC) received a request about a sale and leaseback transaction that includes variable lease payments, highlighting the absence of specific subsequent measurement requirements for sale and leaseback transactions. As a result, the IFRS IC recommended that the IASB consider amending IFRS 16 *Leases* to address subsequent accounting for sale and leaseback transactions to avoid divergent practices that could lead to material differences in the financial statements.
- In November 2020, the IASB issued Exposure Draft [ED/2020/4 Lease Liability in a Sale and Leaseback](#), which proposed amendments to IFRS 16 to require a seller-lessee to estimate the variable lease payments it expects to make over the lease term. The seller-lessee would then use this estimate to measure the right-of-use asset and lease liability.

- 4 Specifically, the proposed amendments would require the seller-lessee to:
- (a) initially measure the right-of-use asset by comparing the present value of expected lease payments, even if they are variable and not linked to a rate or index, to the fair value of the asset sold; and
 - (b) include expected lease payments in the lease liability, even if they are variable and not linked to a rate or index. Over the lease term, the seller-lessee would reduce the lease liability as if the expected lease payments had been paid and recognise the difference between expected and actual payments in the profit or loss.
- 5 The proposed amendments would apply retrospectively except when hindsight would be required. However, where hindsight would be required, the expected lease payments would be determined when the proposed amendments are first applied.
- 6 In December 2020, the Board issued an equivalent Exposure Draft [ED 305 Lease Liability in a Sale and Leaseback](#) to gauge Australian stakeholders' feedback on the proposals. Staff received feedback on the proposals in the Exposure Draft via:
- (a) two formal comment letters;
 - (b) targeted consultation with key stakeholders, including professional bodies and auditors; and
 - (c) consultation with the User Advisory Committee, comprising a range of primary users of financial statements.
- 7 Based on the feedback received by Australian stakeholders, staff submitted a comment letter to the IASB on ED/2020/4 in March 2021. The key points raised in the comment letter were that:
- (a) the Board did not support the proposed amendments to require entities to incorporate estimated variable lease payments that are not based on a rate or index into the initial measurement of lease liabilities and right-of-use assets arising from sale and leaseback transactions. This was on the basis that:
 - (i) the proposals would create an inconsistency in the application of IFRS 16 to sale and leaseback transactions, and general lease transactions, as estimated variable lease payments that are not linked to a rate or index are excluded when accounting for general leases; and
 - (ii) determining variable future lease payments that are not based on a rate or index will lead to increased measurement uncertainty due to the significant judgement that may be required; and
 - (b) the Board suggested that making the proposed amendments before the post-implementation review of IFRS 16 may be premature and that considering the need for possible amendments as part of the post-implementation review would allow for more time to obtain a greater understanding of the significance and prevalence of the issue.

Project update

- 8 After considering stakeholder feedback on ED/2020/4, in September 2022, the IASB finalised its proposals and issued *Lease Liability in a Sale and Leaseback* (Amendments to IFRS 16).¹
- 9 Respondents to ED/2020/4 specifically raised conceptual and practical concerns about the proposal to estimate expected lease payments which could include variable payments that do not depend on a rate or index.
- 10 In response to this feedback, the IASB decided not to prescribe specific measurement requirements for the subsequent measurement of lease liabilities arising from sale and leaseback transactions.

1 [IFRS - Lease Liability in a Sale and Leaseback](#)

Instead, the amendments require a seller-lessee to subsequently measure lease liabilities arising from a leaseback so that it does not recognise any amount of the gain or loss related to the right of use it retains.²

- 11 Under these requirements, a seller-lessee could determine 'lease payments' or 'revised lease payments' in a way that is different to the definition of 'lease payments' in Appendix A of IFRS 16 — for example, by including variable lease payments that are not linked to a rate or index, as illustrated in the amended IASB Illustrative Examples.
- 12 The amendments must be applied by seller-lessees retrospectively to sale and leaseback transactions entered into after the date of initial application, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 13 Without these requirements, a seller-lessee could have recognised a gain on the right of use it retains solely because of remeasurement (for example, following a lease modification or change in the lease term) if it had applied the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction. This could have particularly been the case in a leaseback that includes variable lease payments that do not depend on an index or rate — because these payments are excluded from 'lease payments' as defined in Appendix A of IFRS 16.

Due process requirements

- 14 As per the *AASB For-Profit Entity Standard-Setting Framework*, "In accordance with the Financial Reporting Council's broad strategic directions to the AASB, the AASB sets Standards that:
 - (a) enable 'publicly accountable' private sector entities to maintain IFRS compliance;
 - (b) for other entities, use IFRS Standards (where they exist) and the principle of transaction neutrality (modified as necessary), or develop Australian-specific Standards and guidance ...".³
- 15 Additionally, per the *AASB For-Profit Entity Standard-Setting Framework*, "differences between Accounting Standards issued in Australia and New Zealand for for-profit entities should be minimised wherever possible to reduce the costs for entities operating trans-Tasman."⁴
- 16 Staff note that, "Only in rare and exceptional circumstances will additions to IFRS Standards be justified. The AASB disagreeing with the IASB's treatment is unlikely to provide a good reason, in and of itself, for changing the requirement in an IFRS Standard."⁵

Staff recommendation

- 17 Staff recommend that Board members vote to make *AASB 2022-X Amendments to Australian Accounting Standards – Lease Liability in a Sale and Leaseback* (including any revisions agreed by the members).
- 18 If Board members vote to make the proposed amending Standard, the content of the Standard will be finalised by replacing "AASB 2022-X" with the next Standard number in the sequence and the various dates formally inserted into the Standard as indicated. The Standard would then be registered on the Federal Register of Legislation and published on the AASB website.

2 IFRS 16 already requires a seller-lessee to account for sale and leaseback transactions so that it does not recognise any amount of the gain or loss related to the right of use retained by the seller-lessee at the date of the transaction. The amendments made by IASB ensure that a similar approach is applied by also requiring a seller-lessee to subsequently measure lease liabilities arising from a leaseback in a way that does not recognise any amount of the gain or loss related to the right of use it retains.

3 *AASB For-Profit Entity Standard-Setting Framework* paragraph 3.

4 *AASB For-Profit Entity Standard-Setting Framework* paragraph 27.

5 *AASB For-Profit Entity Standard-Setting Framework* paragraph 37.

- 19 Although the Board did not support the IASB’s proposals in relation to variable lease payments not linked to a rate or index, staff do not consider the amendments to AASB 16 to be significant enough to warrant:
- (a) a departure from the IFRS Standards; or
 - (b) compromising trans-Tasman convergence for for-profit entities.⁶
- 20 Regarding not-for-profit (NFP) entities, staff note that the NZASB have deferred public benefit entity (PBE) considerations until the IPSASB finishes their work in this area.⁷ However, AASB staff do not consider a similar deferral for NFP entities in Australia is warranted because:
- (a) ED 305 asked stakeholders whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals for NFP and public sector entities, and stakeholders did not raise any concerns; and
 - (b) as per the *AASB Not-for-Profit Entity Standard-Setting Framework*, staff do not consider that there are any justifiable circumstances warranting NFP-specific Standards or guidance.

Question to Board members

Q1: Do Board members have any questions or comments?

Q2: Do Board members vote in favour of making *AASB 2022-X Amendments to Australian Accounting Standards – Lease Liability in a Sale and Leaseback*?

6 At the NZASB Board meeting held on 18 October 2022, the NZASB voted to issue the New Zealand equivalent amending Standard, which will apply only to for-profit entities.

7 As per NZASB policy, “in the case of limited-scope amendments or amendments to an NZ IFRS that the NZASB considers are minor, there is a rebuttable presumption that the change should not be incorporated into the equivalent PBE Standard in advance of the IPSASB considering the change”. Considering this rebuttable presumption and that there is no indication that sale and leaseback transactions with variable payments would be a common occurrence for the PBE sector in New Zealand, the NZASB has elected to wait for the IPSASB on this matter.