Lease liability in a sale and leaseback: amendments to IFRS 16

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Key points

The IASB has issued narrow-scope amendments to the requirements for sale and leaseback transactions in IFRS 16 explaining how a seller-lessee accounts for a sale and leaseback after the date of the transaction. Sale and leaseback transactions where some or all the lease payments are variable lease payments that do not depend on an index or a rate are most likely to be impacted.

Links to IFRS Standards and PwC Manual of Accounting (Standing text, FAQ & EX) work only for Viewpoint subscribers.

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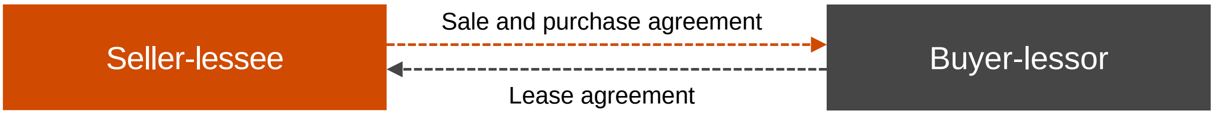
Background

A sale and leaseback is a transaction in which the owner of an asset sells the asset and leases that asset back from the buyer for a period of time. The seller-lessee must determine if the transaction qualifies as a sale for which a gain (or loss) is recognised, or if the transaction is treated as a collateralised borrowing.

Sale and leaseback transaction



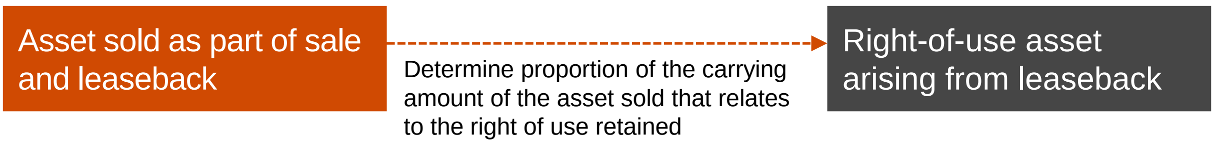
The accounting for sale and leaseback transactions under IFRS 16, ‘Leases’, depends on whether the transfer of the asset qualifies as a sale in accordance with IFRS 15, ‘Revenue from contracts with customers’. A sale and leaseback qualifies as a sale if the buyer-lessor obtains control of the underlying asset. Where the transfer of the asset qualifies as a sale, the seller-lessee also recognises the leaseback by recognising a lease liability, reflecting the payment terms of the leaseback and a right-of-use asset for the right of use retained. The seller-lessee recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

In March 2020, the IFRS Interpretations Committee (IFRS IC) discussed a submission about a sale and leaseback transaction with variable payments that do not depend on an index or a rate. The submitter asked how the seller-lessee measures the right-of-use asset arising from the leaseback and, thus, determines any gain or loss recognised at the date of the transaction. For example, if all of the lease payments in the leaseback depend on the future sales of the seller-lessee (that is, they are fully variable payments), the submitter questioned if it would be acceptable for the lessee to measure the right-of-use asset and lease liability at zero and, therefore, recognise a full gain or loss on the sale at the date of the transaction.

In June 2020, in response to the submission, the IFRS IC issued an agenda decision addressing how a seller-lessee should measure the right-of-use asset arising from such a leaseback with variable lease payments. The agenda decision notes that, because the right of use that the seller-lessee retains is measured as a proportion of the previous carrying amount of the property, plant and equipment (PP&E), the amount of the gain or loss recognised must relate only to the rights transferred to the buyer-lessor. In other words, it would not be acceptable for the seller-lessee to recognise a full gain or loss at the date of the sale and leaseback transaction.

IFRS 16 requires a seller-lessee to account for a right-of-use asset arising from a sale and leaseback in this manner to reflect that, from an economic standpoint, the seller-lessee has sold only its interest in the value of the underlying asset at the end of the leaseback – it has retained its right to use the asset for the duration of the leaseback. The seller-lessee had already obtained that right to use the asset at the time when it purchased the asset, since the right of use is an embedded part of the rights that an entity obtains when it purchases, for example, an item of PP&E. Recognising only the amount of the gain or loss that relates to the rights transferred to the buyer-lessor – and thus not recognising the amount of the gain or loss that relates to the rights retained by the seller-lessee – appropriately reflects the economics of a sale and leaseback transaction.

Measuring the right-of-use asset arising from the leaseback



The IFRS IC concluded that IFRS 16 provides an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction submitted. However, the IFRS IC’s discussions highlighted the improvements that could be made to IFRS 16 by adding subsequent measurement requirements for sale and leaseback transactions.

When originally issued, IFRS 16 included no specific subsequent measurement requirements for sale and leaseback transactions. Consequently, it was not always clear how to subsequently measure the liability arising from a leaseback, particularly where the payments for the lease include payments that do not meet the definition of ‘lease payments’ in IFRS 16 – for example, where the payments include variable lease payments that do not depend on an index or a rate. As a result, in September 2022, the IASB issued Lease Liability in a Sale and Leaseback, which amends IFRS 16 to address the issue of subsequent measurement of the lease liability.

Scope

1. What transactions do the amendments apply to?

The amendments only impact a seller-lessee's accounting for a sale and leaseback transaction that satisfies the requirements in IFRS 15 to be accounted for as a sale. These amendments do not change the accounting for leases other than those arising in a sale and leaseback transaction. Furthermore, the amendments apply to all sale and leaseback transactions, but they are expected to only affect sale and leaseback transactions that include variable lease payments that do not depend on an index or a rate (and are not in-substance fixed payments).

The amendments address the subsequent accounting for a seller-lessee only.

Without the amendments, a seller-lessee would subsequently account for a leaseback by applying the general subsequent measurement requirements for a lease liability. The general subsequent measurement requirements for a lease liability refer to 'lease payments' and 'revised lease payments'. Variable lease payments that do not depend on an index or a rate do not meet the definition of 'lease payments'. Hence, without the amendment, applying the general subsequent measurement requirements to a sale and leaseback with variable payments that do not depend on an index or a rate might have resulted in a seller-lessee recognising a gain on the right of use retained, in the event of a modification or change in leaseback term (as a consequence of remeasuring the lease liability to exclude variable lease payments because they do not meet the definition of 'lease payment'), even though no transaction or event would have occurred to give rise to that gain.

The amendments also incorporate the example included in the IFRS IC's June 2020 agenda decision on the measurement of the initial liability into the illustrative examples in IFRS 16. However, since entities should already be applying the agenda decision on initial measurement, we do not believe that this will change practice for initial measurement of sale and leaseback transactions.

2. Do the amendments change lessor accounting?

The amendments only impact the accounting for the seller-lessee. The amendments do not change the accounting for the buyer-lessor.

Measurement

3. How does a seller-lessee determine the proportion of the right-of-use asset retained at the sale and leaseback transaction date?

For a sale and leaseback that qualifies as a sale, the seller-lessee measures a right-of-use asset arising from the leaseback as the proportion of the previous carrying amount of the asset that relates to the right of use retained. IFRS 16 does not prescribe a particular method for determining that proportion.

The seller-lessee could determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by comparing, for example:

- the present value of expected payments for the lease (including those that are variable) with the fair value of the asset at the date of the transaction;
- the expected term over which the asset is used by the seller-lessee under the leaseback with the remaining economic life of the asset; or
- the fair value of the asset at the date of the transaction less the present value of the expected residual value of the asset at the end of the leaseback with the fair value of the asset at the date of the transaction.

Determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by comparing, for example:

Present value of expected payments for the lease (including those that are variable) with the	Expected term over which the asset is used by the seller-lessee under the lease-back with the	Fair value of the asset at the date of transaction less present value of the expected residual value of the asset at the end of the lease-back with the
Fair value of the asset at the date of transaction	Remaining economic life of the asset	Fair value of the asset at the date of the transaction

The above approaches are expected to result in a similar, but not necessarily the same, outcome. The approach(es) that meet the requirement in the standard, to determine the proportion of the previous carrying amount of the asset that relates to the right of use retained, will depend on the specific facts and circumstances.

There might be other acceptable approaches to determine the proportion of the right-of-use asset retained.

4. How does a seller-lessee determine the lease liability at the sale and leaseback transaction date?

As noted in Question 3 above, the seller-lessee measures a right-of-use asset arising from the leaseback as the proportion of the previous carrying amount of the asset that relates to the right of use retained. The gain (or loss) that the seller-lessee recognises is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor.

The initial measurement of the lease liability that arises from a sale and leaseback transaction is a consequence of how the seller-lessee measures the right-of-use asset and the gain or loss recognised at the date of the transaction.

In other words, the initial measurement of the lease liability is determined as a balancing figure once the right-of-use asset and gain (or loss) have been determined.

This means that the seller-lessee should always recognise a lease liability at the date of the transaction, even if all of the payments for the lease are variable (whether or not they depend on an index or a rate).

Example 1 – Seller-lessee accounting for a right-of-use asset and lease liability at the commencement date in a sale and leaseback transaction with variable lease payments that do not depend on an index or a rate

An entity (seller-lessee) sells a building to another entity (buyer-lessor) for cash of C1,800,000 (the fair value of the building at the date of sale). Immediately before the transaction, the building is carried at a cost of C1,000,000.

At the same time, the seller-lessee enters into a contract with the buyer-lessor for the right to use the building for an initial period of five years.

Lease payments (which are at market rates), payable annually, comprise fixed payments and variable payments that do not depend on an index or a rate.

The terms and conditions of the transaction are such that the transfer of the building by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the building. Accordingly, the seller-lessee accounts for the transaction as a sale and leaseback.

Determining the proportion of the right of use retained

Applying paragraph 100(a) of IFRS 16, the seller-lessee is required to determine the proportion of the building transferred to the buyer-lessor that relates to the right of use that it retains. Paragraph 100(a) does not prescribe a particular method for determining that proportion.

The seller-lessee could determine this proportion by comparing, for example, the present value of expected payments for the lease (including those that are variable) with the fair value of the building at the date of the transaction. Assume that the seller-lessee estimates the expected payments over the lease term, and it discounts those expected payments using the incremental borrowing rate (since the rate implicit in the lease cannot be readily determined), resulting in a present value of the expected payments for the lease of C450,000. In this example, the proportion of the building that relates to the right of use retained is 25%, calculated as C450,000 (that is, the present value of expected payments for the lease) divided by C1,800,000 (that is, the fair value of the building).

Examples of other possible methods that might be appropriate, depending on the facts and circumstances, include:

- Comparing the expected term over which the asset is used by the seller-lessee under the leaseback with the remaining economic life of the asset.

  For example, if the remaining economic useful life of the building is 20 years, the proportion of the building that relates to the right of use retained is 25%, calculated as 5 (lease term) divided by 20 (economic useful life).
- Comparing the fair value of the asset at the date of the transaction less the present value of the expected residual value of the asset at the end of the leaseback with the fair value of the asset at the date of the transaction.

  For example, if the present value of the expected residual value of the asset at the end of the leaseback is C1,350,000 and the fair value of the asset at the date of the transaction is C1,800,000, the value of the rights retained by the seller-lessee is C450,000 (C1,800,000 – C1,350,000), and the proportion of the building that relates to the right of use retained is 25%, calculated as C450,000 divided by C1,800,000.

Under all of the approaches, the lease liability is the balancing figure based on the amount of gain that can be recognised.

Determining the gain on rights transferred

If, for example, the seller-lessee determines that the proportion of the building transferred to the buyer-lessor that relates to the right of use that it retains is 25%, at the commencement date, the seller-lessee accounts for the transaction as follows.

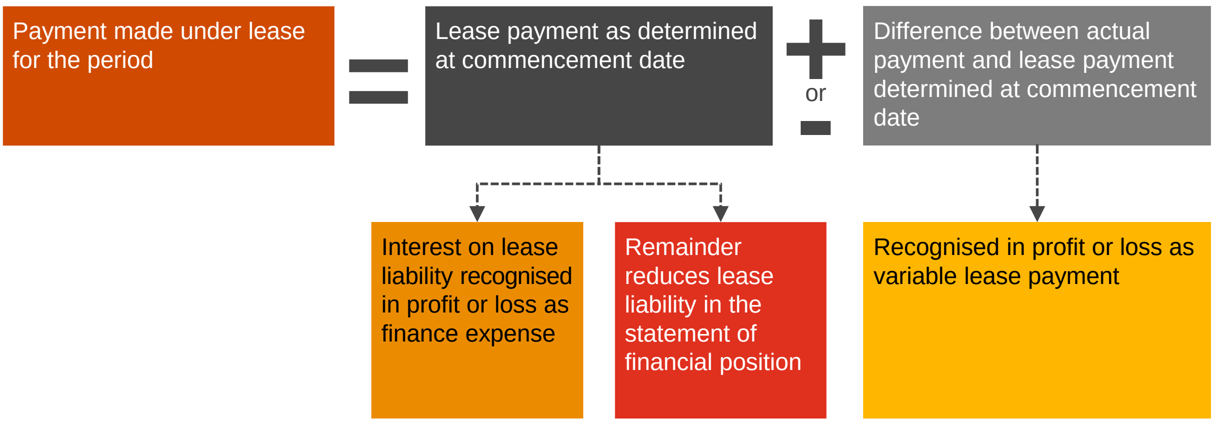
Cash		C1,800,000	
Right-of-use asset (C1,000,000 × 25%)		C250,000	
	Building		C1,000,000
	Lease liability		C450,000
	Gain on rights transferred ((C1,800,000 – C1,000,000) × 75%)		C60

5. How does a seller-lessee subsequently measure the right-of-use asset and lease liability in a sale and leaseback transaction?

The amendments to IFRS 16 require a seller-lessee to apply the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction to lease liabilities arising from a leaseback in a way that it recognises no amount of the gain or loss related to the right of use that it retains. This entails:

- increasing the carrying amount of the lease liability to reflect interest on the lease liability (using the interest rate implicit in the lease, or the incremental borrowing rate if the interest rate implicit in the lease cannot be readily determined);
- reducing the carrying amount of the lease liability with an amount of ‘lease payments’ that was determined at the commencement date of the lease; and
- recognising in profit or loss, as a variable lease payment, the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability.

Subsequent measurement of the lease liability after commencement date



The IASB has not prescribed a particular method for determining the ‘lease payments’ at the commencement date that, when discounted, equal the carrying amount of the lease liability at the commencement date. The amendments illustrate two different approaches for determining the ‘lease payments’ at the commencement date that can be used to reduce the carrying amount of the lease liability over the leaseback term, where there are variable lease payments that do not depend on an index or a rate.

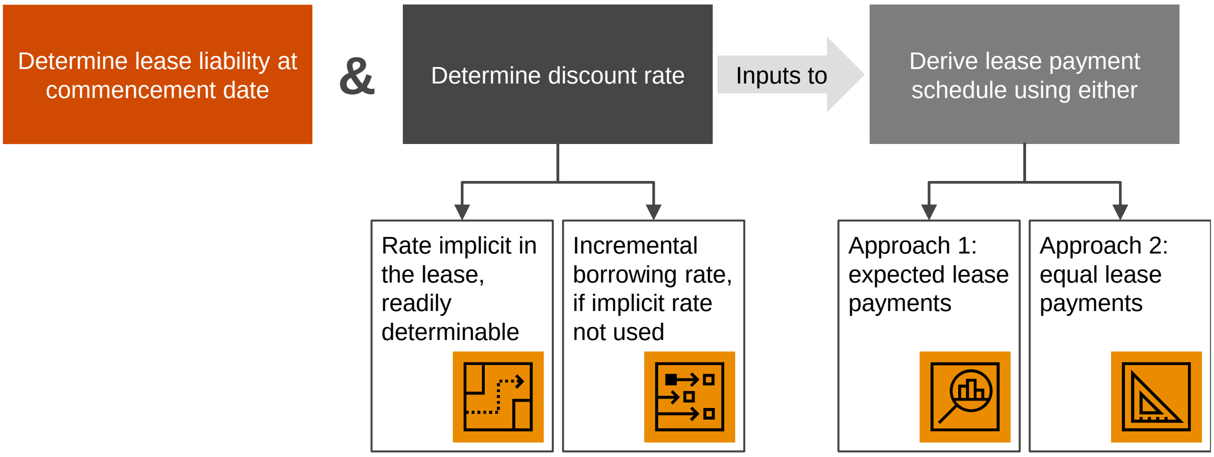
Depending on the circumstances, including which method the seller-lessee used to initially measure the right-of-use asset, either approach could be used to meet the new requirement included in the amendments. The two approaches, set out in a new illustrative example to IFRS 16, are

1. the ‘expected lease payments at the commencement date’ approach; and
2. the ‘equal lease payments over the lease term’ approach.

Both approaches are illustrated in Example 2.

Regardless of which approach is used to subsequently measure the lease liability, the discount rate that the seller-lessee uses to discount the lease payments must be determined in accordance with IFRS 16. The discount rate that the seller-lessee uses is the interest rate implicit in the lease, if that rate can be readily determined. The seller-lessee should carefully consider whether it can readily determine the interest rate implicit in the lease, based on the information that it has available. The seller-lessee uses its incremental borrowing rate if the interest rate implicit in the lease cannot be readily determined.

Determining lease payments at commencement date



Example 2 – 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 a rate

The facts are the same as in Example 1. In addition, the interest rate implicit in the lease cannot be readily determined. The seller-lessee's incremental borrowing rate is 3% per annum.

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

In subsequently measuring the lease liability, the 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 that it retains. Depending on the circumstances and the method that the seller-lessee used for determining the measurement of the right-of-use asset and the gain recognised on the transaction at the commencement date (see Example 1), either Approach 1 or Approach 2 described below could meet the requirements in paragraph 102A. Paragraph 102A of IFRS 16 requires the seller-lessee to determine 'lease payments' or 'revised lease payments' in a way that it would not recognise any amount of the gain or loss that relates to the right of use retained by the seller-lessee.

Approach 1: Expected lease payments at the commencement date

The seller-lessee determines 'lease payments' to reflect the timing and amount of the expected lease payments at the commencement date. These payments, when discounted using the entity's incremental borrowing rate, result in the carrying amount of the lease liability at that date of C450,000. Under this approach, the seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date. The lease liability is not remeasured to account for changes in the lessee's expectations for future lease payments subsequent to the commencement date.

The lease liability and the right-of-use asset recognised over the leaseback term would be:

Lease liability					Right-of-use asset		
Year	Beginning balance	Lease payments	Interest expense (3%)	Ending balance	Beginning balance	Depreciation charge	Ending balance
	C	C	C	C	C	C	C
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

The seller-lessee recognises, in profit and loss, the difference between the payments actually due under the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if the seller-lessee pays C99,321 for the use of the building in Year 2, it recognises C1,197 (C99,321 – C98,124) in profit or loss for that year.

This approach might be challenging to apply if the proportion of the rights retained by the seller-lessee was calculated using a method other than one that determines the present value of expected payments for the lease – for example, where the right-of-use asset at the commencement date is determined by comparing the expected term over which the asset is used by the seller-lessee under the leaseback with the remaining economic life of the asset (see Example 1).

Approach 2: Equal lease payments over the lease term

An alternative approach is for the seller-lessee to determine '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 C450,000. Under this approach, the seller-lessee reduces the carrying amount of the lease liability by the 'lease payments' that reflect the equal periodic payments over the lease term.

The lease liability and the right-of-use asset recognised over the leaseback term would be:

Lease liability					Right-of-use asset		
Year	Beginning balance	Lease payments	Interest expense (3%)	Ending balance	Beginning balance	Depreciation charge	Ending balance
	C	C	C	C	C	C	C
1	450,000	(98,260)	13,500	365,240	250,000	(50,000)	200,000
2	365,240	(98,260)	10,957	277,938	200,000	(50,000)	150,000
3	277,938	(98,260)	8,338	188,017	150,000	(50,000)	100,000
4	188,017	(98,260)	5,641	95,398	100,000	(50,000	50,000
5	95,398	(98,260)	2,862	0	50,000	(50,000)	0

The seller-lessee recognises, in profit and loss, the difference between the payments actually made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if the seller-lessee pays C99,321 for the use of the building in Year 2, it recognises C1,061 (C99,321 – C98,260) in profit or loss.

6. Does an entity have to estimate expected variable lease payments?

Entities are not required to estimate expected variable lease payments when initially and subsequently measuring the right-of-use asset and the lease liability. However, estimates of expected lease payments at the sale and leaseback transaction date might be used to initially measure the right-of-use asset (as explained in Question 3 above) and to subsequently measure the lease liability (as explained in Question 5 above). The lease liability is not remeasured to account for changes in the lessee's expectations for future lease payments subsequent to the commencement date. An exception to this might be when the lease term is reassessed or the leaseback is modified (see Question 8 below).

7. How does the seller-lessee account for a partial or full termination of the leaseback?

Generally under IFRS 16, where there is a partial or full termination of a lease, the lessee first accounts for the partial or full termination by decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination and recognising any resulting gain or loss in profit or loss. Secondly, the lease liability is remeasured, considering any revised terms, using a revised discount rate. The difference between the remaining carrying amount of the lease liability after the partial derecognition and the modified lease liability is recognised as an adjustment to the right-of-use asset.

When applied to a leaseback under the amendments, the first step relating to determining the gain or loss on partial or full termination is the same as for other leases. The amendments do not prevent a seller-lessee from recognising in profit or loss any gain or loss relating to the partial or full termination of a lease. This is because a partial or full termination of a leaseback terminates part or all of the right of use that the seller-lessee held before the change to the lease. Any gain or loss relating to the partial or full termination of the lease does not, therefore, relate to a right of use retained but to the right of use now terminated.

However, for the second step when the lease liability is remeasured, the requirements of the amendments apply to the remeasurement of the revised lease payments in order to not recognise any additional gain or loss relating to the right of use retained. See Question 8 below for determining ‘revised lease payments’.

8. How does the seller-lessee measure ‘revised lease payments’ for the leaseback under the amendments on a remeasurement/ modification date?

As noted in Question 5 above, the amendments to IFRS 16 require a seller-lessee to apply the subsequent measurement requirements for lease liabilities to lease liabilities arising from a leaseback in a way that recognises no amount of the gain or loss related to the right of use that it retains. These subsequent measurement requirements include the requirements relating to reassessment of the lease liability and lease modifications.

The amendments to IFRS 16 do not illustrate how a seller-lessee applies the amendments if, subsequently, the seller-lessee accounts for a lease term reassessment or a lease modification (referred to as ‘remeasurements’ in this question).

The Basis for Conclusions to the amendments explains that, without the new requirements, a seller-lessee could have recognised a gain on the right of use that it retains solely because of a remeasurement if it had applied the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction. Particularly, this could have been the case in a leaseback that includes variable lease payments that do not depend on an index or a rate (and that are not in-substance fixed payments); this is because these payments are excluded from ‘lease payments’ as defined in Appendix A to IFRS 16.

For example, assume that the lease payments in Example 1 are wholly variable lease payments that do not depend on an index or a rate. Assume that there is an extension of the leaseback term subsequent to the commencement date. Applying the lease modification requirements in IFRS 16 for leases unrelated to a sale and leaseback transaction, the seller-lessee would remeasure the lease liability by discounting the revised lease payments using a revised discount rate. As noted above, ‘lease payments’ is a defined term in IFRS 16, and it excludes from the measurement of the lease liability variable payments that do not depend on an index or a rate (and that are not in-substance fixed payments). As a result, without the amendments, the subsequent measurement of the lease liability would have been the present value of zero discounted at the revised discount rate. The lease liability would therefore be reduced to nil, with a corresponding adjustment to the right-of-use asset and a resulting gain to profit or loss.

The amendments address the risk of the seller-lessee recognising a gain in this scenario, even though no transaction or event would have occurred to give rise to that gain. The application of the amendments could result in a seller-lessee determining ‘lease payments’ or ‘revised lease payments’ in a way that would be different from the definition of ‘lease payments’ in Appendix A. In other words, the application of the amendments in this scenario would result in the seller-lessee including variable lease payments (whether or not they depend on an index or a rate) in the calculation of ‘revised lease payments’ when remeasuring the lease liability.

Since the amendments do not prescribe a method of determining ‘revised lease payments’ in these circumstances, a seller-lessee should develop an accounting policy that provides useful information about the leaseback transaction. Paragraph 10 of IAS 8 requires the seller-lessee to develop and apply an accounting policy that results in information that is relevant and reliable.

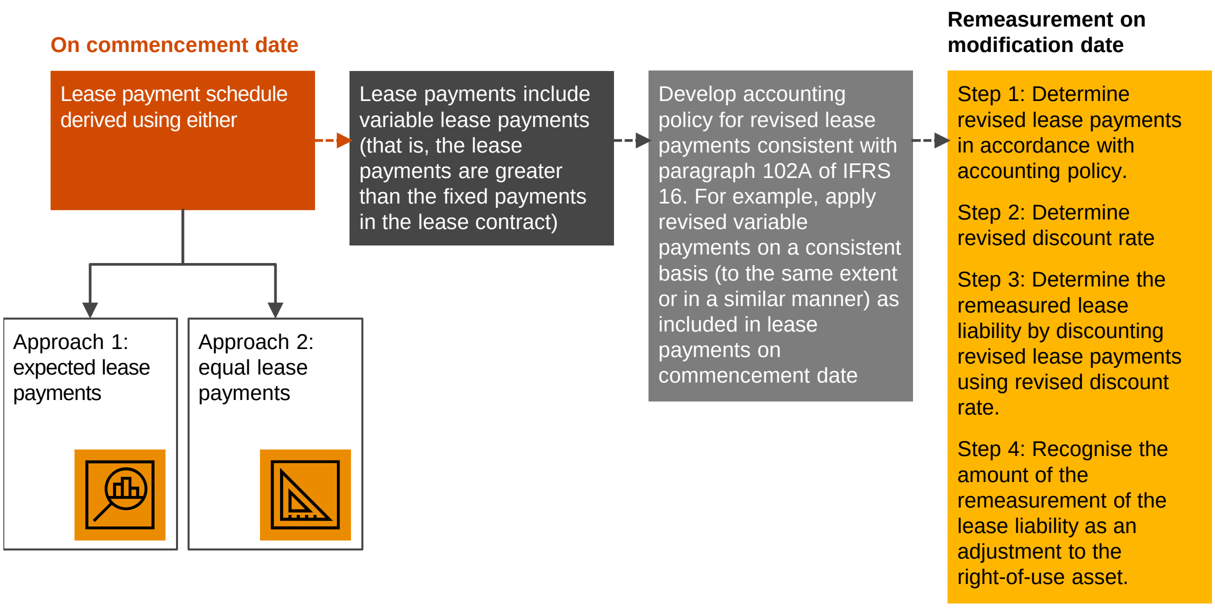
We believe that an accounting policy for determining ‘revised lease payments’ that results in relevant and reliable information would entail determining ‘revised lease payments’ consistently with the determination of ‘lease payments’ prior to the modification or lease term reassessment, as discussed in Question 5 above.

In Example 2 above, the seller-lessee would be able to determine whether the lease payments determined on the commencement date include variable lease payments that do not depend on an index or a rate. For example, if lease payments under the lease contract include fixed lease payments and variable lease payments that do not depend on an index or a rate, and the lease payments (determined using either Approach 1 or Approach 2) exceed the fixed payments, the lease payments used in the example include variable lease payments that do not depend on an index or a rate to some extent. In such a situation, we believe that including contractual variable lease payments that do not depend on an index or a rate in revised lease payments to the same extent or in a similar manner would result in relevant and reliable information, in the event of a remeasurement subsequent to the commencement date. This is illustrated in Example 3 below.

We believe that, if the ‘revised lease payments’ are calculated on a consistent basis as noted above, the requirements in the amendments would be met even if the right-of-use asset is reduced and a gain is recognised for other reasons (such as changes in discount rate, or subsequent modifications that affect the method of determining the variable payments).

If the seller-lessee uses the expected lease payment approach to subsequently measure the lease liability, we believe that it would be acceptable for the seller-lessee to use its revised estimates of variable lease payments as at the remeasurement date to determine 'revised lease payments' if the seller-lessee's expectations of the variable lease payments have changed since the commencement date. This is illustrated in Example 3 below.

Seller-lessee accounting at a remeasurement or modification date



Example 3 – Accounting by a seller-lessee for remeasurement/modification subsequent to the commencement date where the expected lease payment approach is applied to subsequently measure the lease liability

The facts are the same as in Example 1. In addition:

- The lease contract includes an option to extend the lease by two years after the five-year period, with both fixed and variable lease payments determined in the same way as Year 5 of the lease. At the commencement date, the seller-lessee determines that it is not reasonably certain to exercise the extension option, and so it concludes that the lease term is five years.
- Lease payments, payable annually, comprise fixed payments (C50,000 a year) and variable payments that do not depend on an index or a rate (determined as 1% of the seller-lessee's revenue reported during the last 12 months before the lease payment is due).
- The interest rate implicit in the lease cannot be readily determined. The seller-lessee's incremental borrowing rate at the commencement of the leaseback is 3% per annum.

The proportion of the building transferred to the buyer-lessor that relates to the right of use that it retains was determined to be 25% by comparing the present value of expected payments for the lease, including those that are variable (which equals C450,000), with the fair value of the building at the date of the transaction. A lease liability of C450,000 is recognised at the commencement date which is determined as a balancing figure.

The seller-lessee elects to determine 'lease payments' to reflect the timing and amount of the expected lease payments at the commencement date. These payments, when discounted using the entity's incremental borrowing rate, result in the carrying amount of the lease liability at that date of CU450,000. Under this approach, the seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date.

At the commencement date:

Year	Estimated revenue	Estimated variable lease payment (1% of estimated revenue)	Fixed lease payment	Total expected lease payments
	C	C	C	C
1	4,590,200	45,902	50,000	95,902

2	4,812,400	48,124	50,000	98,124
3	4,924,300	49,243	50,000	99,243
4	5,010,100	50,101	50,000	100,101
5	4,812,100	48,121	50,000	98,121

The lease liability and the right-of-use asset recognised over the leaseback term would be:

Lease liability					**Right-of-use asset**		
Year	**Beginning balance**	**Lease payments**	**Interest expense (3%)**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
	C	**C**	**C**	**C**	**C**	**C**	**C**
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

The lease payments at the commencement date include variable lease payments that do not depend on an index or a rate, because the lease payments per annum exceed the fixed lease payment of C50,000 per annum.

Scenario 1: Change in lease term at the end of the first year of the lease

At the end of the first year of the lease, a significant change in circumstances, that is within the lessee's control, occurs in the lessee's business that indicates that the lessee is reasonably certain to exercise the extension option. The lessee reassesses the extension option in accordance with paragraph 20 of IFRS 16 and determines that the remaining lease term is six years.

Assume that the revised discount rate (the seller-lessee's incremental borrowing rate) at the remeasurement date is 7.5%.

To be consistent with the measurement of the lease liability at the commencement date, both fixed lease payments and variable lease payments that do not depend on an index or a rate are included in 'revised lease payments' and are discounted using the revised discount rate.

At the remeasurement date:

At the end of the first year, the seller-lessee's expectation of revenue over the remaining lease term has changed. The seller-lessee used its revised estimates of revenue at the remeasurement date to calculate its expected 'revised lease payments'.

Year	**Revised estimated revenue**	**Revised estimated variable lease payment (1% of estimated revenue)**	**Fixed lease payment**	**Total revised expected lease payments**
	C	**C**	**C**	**C**
2	4,331,160	43,312	50,000	93,312
3	4,431,870	44,319	50,000	94,319
4	4,509,090	45,091	50,000	95,091
5	4,330,890	43,309	50,000	93,309
6	4,200,000	42,000	50,000	92,000
7	4,100,000	41,000	50,000	91,000

Since both fixed lease payments and expected variable lease payments that do not depend on an index or a rate are included in 'revised lease payments' and discounted using the revised discount rate, the remeasured lease liability would be C437,881 (calculated by discounting the 'total revised lease payments', as determined in the table above using the revised discount rate of 7.5%) at the remeasurement date.

Lease liability				
Year	Beginning balance	Revised lease payments	Interest expense (7.5%)	Ending balance
	C	C	C	C
2	437,881	(93,312)	32,841	377,410
3	377,410	(94,319)	28,306	311,397
4	311,397	(95,091)	23,355	239,661
5	239,661	(93,309)	17,975	164,327
6	164,327	(92,000)	12,324	84,651
7	84,651	(91,000)	6,349	0

The remeasurement of the lease liability would be recognised as follows:

Right-of-use asset		C70,283	
	Lease liability (C437,881 – C367,598)		C70,283

Scenario 2: Lease modification at the end of the first year of the lease; change in lease consideration with no change in scope

At the end of the first year, the lease is amended such that the fixed lease payment is modified to C75,000 a year for the remaining lease term, and the variable lease payment is 0.5% of the seller-lessee's revenue for the remainder of the lease term.

Assume that the revised discount at the modification date is 7.5%.

Consistent with the commencement date, both fixed lease payments and variable lease payments are included in 'revised lease payments' and are discounted using the revised discount rate.

At the modification date:

At the end of the first year, the seller-lessee's expectation of revenue over the remaining lease term has changed. The seller-lessee used its revised estimates of revenue at the modification date to calculate its expected 'revised lease payments'.

Year	Revised estimated revenue	Revised estimated variable lease payment (0.5% of estimated revenue)	Fixed lease payment	Total revised expected lease payments
	C	C	C	C
2	4,331,160	21,656	75,000	96,656
3	4,431,870	22,159	75,000	97,159
4	4,509,090	22,545	75,000	97,545
5	4,330,890	21,654	75,000	96,654

If both fixed lease payments and variable lease payments that do not depend on an index or a rate are included in 'revised lease payments' and discounted using the revised discount rate, the remeasured lease liability would be C324,883 (calculated by discounting the 'total revised lease payments', as determined in the table above using the revised discount rate of 7.5%) at the modification date:

Lease liability				
Year	Beginning balance	Revised lease payments	Interest expense (7.5%)	Ending balance
	C	C	C	C
2	324,883	(96,656)	24,366	252,593
3	252,593	(97,159)	18,944	174,378
4	174,378	(97,545)	13,078	89,911
5	89,911	(96,654)	6,743	0

<table>
<tr><td colspan="4">The remeasurement of the lease liability would be recognised as follows:</td></tr>
<tr><td colspan="2">Lease liability (C367,598 – C324,883)</td><td>C42,715</td><td></td></tr>
<tr><td></td><td colspan="2">Right-of-use asset</td><td>C42,715</td></tr>
<tr><td colspan="4">While this results in a lower lease liability and right-of-use asset (and reduced depreciation expense going forward), the treatment complies with the sale and leaseback amendments, since it does not reflect any recognition of a gain on the right of use retained by the seller-lessee. This is because the reduction in the lease liability is due to the increase in the discount rate since the commencement date and the reduction in estimated revenue over the lease term.

Conversely, if the seller-lessee did not include any amount for variable lease payments within the revised lease payments on the remeasurement date and, consequently, a larger adjustment was recognised to reduce the lease liability and right-of-use asset, we believe that this incremental adjustment would not be considered to comply with the sale and leaseback amendments, because it results from measuring the lease liability on an inconsistent basis at the remeasurement date compared to the commencement date.</td></tr>
</table>

Presentation and disclosure

9. How is the lease liability presented in the statement of financial position?

Regardless of which approach is used to determine the lease liability in a sale and leaseback (see Questions 4 and 5 above), it is presented in the same line item as other lease liabilities in the statement of financial position. A lessee should either present the lease liability in the statement of financial position or disclose it in the notes separately from other liabilities. If the lessee does not present lease liabilities separately in the statement of financial position, it should disclose which line items in the statement of financial position include those liabilities.

To the extent that a sale and leaseback transaction gives rise to additional financing provided by the buyer-lessor to the seller-lessee (for example, where the sale proceeds are above market), this is recognised as a separate financial liability and not as a lease liability.

10. Are additional disclosures required in the financial statements?

The amendments do not require specific additional disclosures (unless they are early adopted – see Question 11 below) relating to sale and leaseback transactions. However, a seller-lessee applying the amendments should disclose material accounting policy information relating to the initial and subsequent measurement of lease payments and revised lease payments for sale and leaseback transactions. For more information on determining what is material accounting policy information, please see PwC's Practice Aid on Accounting Policies Disclosures.

Entities should also consider the existing IFRS 16 disclosure requirements in the context of their sale and leaseback transactions. For example, IFRS 16 requires disclosure of the expense relating to variable lease payments that are not included in the measurement of lease liabilities. If variable lease payments have been included as lease payments that reduce the amount of the lease liability, only the excess variable payments recognised in profit or loss would be included in this disclosure (see Question 5 above). Any gains or losses on sale and leaseback transactions are required to be disclosed. IFRS 16 also requires qualitative and quantitative information that helps users to assess both sale and leaseback transactions and future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. These disclosures should be specific to the terms and conditions of the sale and leaseback transactions entered into by the entity.

Prior to adoption of the amendments, entities should provide the relevant IAS 8 disclosures relating to the possible impact that application of the amendments will have on the entity's financial statements in the period of initial application.

In the year of adoption of the amendments, disclosures might be required by IAS 8 to explain the change in accounting policy, including the transitional provisions, and the impact on the financial statements for both the current and prior periods.

Transition and effective date

11. When are the amendments effective?

The amendments are effective for annual reporting periods beginning on or after 1 January 2024. The amendments can be early adopted, and any entity doing so would disclose the early adoption in their financial statements.

12. How are the amendments applied generally?

An entity applies the requirements retrospectively to sale and leaseback transactions that were entered into after the date when the entity initially applied IFRS 16. For example, an entity that initially applied IFRS 16 from IAS 17 as of 1 January 2019 (as many IFRS reporters did) would apply the amendments to sale and leaseback transactions that were entered into after 1 January 2019.

The use of hindsight is not permitted when retrospectively applying the amendment. For example, an entity that uses the expected lease payment approach to subsequently measure the lease liability, as illustrated in Example 2, should use the estimates that were applicable at the relevant measurement date(s) that reflect circumstances that existed at those dates to estimate lease payments.

The amendments do not apply to sale and leaseback transactions entered into before the date when the entity initially applied IFRS 16. These leases would continue to be accounted for consistently with the original transitional provisions of IFRS 16, which require a seller-lessee in a sale and leaseback transaction that was accounted for as a sale and operating lease under IAS 17 to account for the leaseback in the same way as any other operating lease.

13. How are the amendments applied where an entity applied IFRS 16 in its first set of IFRS financial statements?

Where an entity applied IFRS for the first time after 1 January 2019, it would have applied IFRS 16, including any permitted exemptions in IFRS 1, in measuring all recognised right-of-use assets and lease liabilities on the date of transition to IFRS. In addition, similar to existing IFRS reporters being able to early adopt IFRS 16, first-time adopters prior to 1 January 2019 might have early adopted IFRS 16 in their first set of IFRS financial statements. We believe that an entity that applied IFRS 16 in its first set of IFRS financial statements would apply the sale and leaseback amendments retrospectively to transactions entered into after the date of transition to IFRS.

14. Should an entity present a third statement of financial position when adopting the amendments?

An opening statement of financial position should be presented where retrospective application has a material effect on the information in the statement of financial position at the beginning of the preceding period. In accordance with paragraphs 40A-40D of IAS 1, the third statement of financial position is presented as at the beginning of the preceding period, regardless of whether the entity's financial statements also present comparative information for earlier periods. Entities might also need to consider any incremental regulatory requirements related to the presentation of financial statements where there is retrospective application.