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International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Board Members,

RESPONSE TO EXPOSURE DRAFT – LEASE LIABILITY IN A SALE AND LEASEBACK ("ED")

ISCA sought views from its members on the above ED through a two-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms, preparers and other stakeholders.

We acknowledge and agree that there is a lack of guidance in IFRS 16 with regards to the measurement for sale and leaseback transactions with variable lease payments that are not dependent on an index or rate. Hence, we appreciate and support the Board's initiative to propose amendments to IFRS 16 to address this issue.

However, we have concerns regarding the proposed expansion of the measurement requirement to include variable lease payments (specifically for sale and leaseback transactions) which contradicts the measurement requirement of a lease liability arising from a lease other than a sale and leaseback (in paragraph 27 of IFRS 16).

In addition, we have included other suggested improvements to the proposals in the ED for the Board's consideration.

Our detailed comments and responses to the questions in the ED are set out below.

Question 1 – Measurement of the right-of-use asset and lease arising in a sale and leaseback transaction (paragraphs 100(a)(i), 100A and 102B of the draft amendment to IFRS 16)
The draft amendment to IFRS 16 *Leases* applies to sale and leaseback transactions in which, applying paragraph 99 of IFRS 16, the transfer of the asset satisfies the requirements to be accounted for as a sale of the asset. The draft amendment proposes: a) to require a seller-lessee to determine the initial measurement of the right-of use asset by comparing the present value of the expected lease payments, discounted using the rate specified in paragraph 26 of IFRS 16, to the fair value of the asset sold (paragraph 100(a)(i)); b) to specify the payments that comprise the expected lease payments for sale and leaseback transactions (paragraph 100A); and c) to specify how a seller-lessee subsequently measures the lease liability arising in a sale and leaseback transaction (paragraph 102B). Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Under the current IFRS 16 *Leases*, we note that paragraph 100(a) requires the seller-lessee to measure the **right-of-use asset** arising from the leaseback at the proportion of the previous carrying amount that relates to the right of use retained by the seller-lessee, and accordingly recognise only the amount of gain or loss relating to the rights transferred to the buyer-lessor. However, IFRS 16 is silent with regards to the measurement of the **liability** arising from the leaseback. As such, entities would typically look to Illustrative Example 24 for guidance on the measurement of the right-of-use asset and the liability (termed as 'financial liability' in the illustrative example) arising from the sale and leaseback transaction.

However, Illustrative Example 24 only addresses the scenario of a sale and leaseback transaction with fixed payments. The scenario of a sale and leaseback transaction with variable payments (which are not dependent on an index or a rate) is not addressed. Hence, the illustrative example may be construed to mean that such variable payments are to be excluded from the measurement of the proportion of the previous carrying amount that relates to the right of use retained by the seller-lessee and the liability, which is in line with the existing measurement requirement of 'lease liability' under paragraph 27 of IFRS 16.

We are pleased to note that the Board has proposed to add on the new Illustrative Example 25 to address the scenario of a sale and leaseback transaction with variable payments (which are not dependent on an index or a rate). This new illustrative example is useful in providing the necessary clarification to the matter noted in the preceding paragraph.

We also note that the proposed Illustrative Example 25 has termed the liability arising from the sale and leaseback transaction as 'lease liability'. This is in light of:

- the Board's view that the liability arising from a leaseback transaction is a lease liability (as explained in the proposed paragraph BC4 of the ED); and

- the Board's proposal to expand the measurement requirement of 'lease liability' to include variable lease payments (which are not dependent on an index or a rate) (proposed new paragraph 100A of IFRS 16).

We are concerned that the expanded measurement requirement of 'lease liability' solely for the purpose of computing the liability arising from sale and leaseback transactions may confuse the marketplace as it contradicts the measurement requirement of a lease liability arising from a lease other than a sale and leaseback (in paragraph 27 of IFRS 16).

Accordingly, we would like to urge the Board to consider not expanding the measurement requirement of 'lease liability'. Instead, the Board could consider regarding and measuring the liability arising from the leaseback as a 'financial liability' under IFRS 9 *Financial Instruments.* This is in line with the existing requirement under paragraph 103(a) of IFRS 16 to account for the transfer of an asset that is not a sale.

In our view, the liability arising from the leaseback is akin to the scenario where that portion of the asset is not "sold" to the buyer-lessor and is in substance, a loan obtained from the buyer-lessor. The said loan is then "repaid" to the buyer-lessor over the period of the leaseback.

In this regard, BC 266 of IFRS 16 supports the concept that economically, the retained interest in the underlying asset is not considered as an asset sale and leaseback by the seller-lessee. Accordingly, the seller-lessee should have no "lease liability" under a lease but a normal finance liability relating to an advance received.

BC266 to IFRS 16 – Gain or loss on a sale and leaseback

The IASB decided that the gain or loss recognised by a seller-lessee on a completed sale in a sale and leaseback transaction should reflect the amount that relates to the rights transferred to the buyer-lessor. In reaching this decision, the IASB considered requiring the sale element of the transaction (ie the sale of the underlying asset) to be accounted for applying IFRS 15 because, from a legal standpoint, the seller-lessee will often have sold the entire underlying asset to the buyer-lessor. <u>However, 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.</u> The seller-lessee had already obtained that right to use the asset at the time that it purchased the asset— the right of use is an embedded part of the rights that an entity obtains when it purchases, for example, an item of property, plant and equipment. Accordingly, in the IASB's view, recognising the gain that relates to the rights transferred to the buyer-lessor appropriately reflects the economics of the transaction.

However, should the Board adopt the proposals in this ED, the section on "Initial measurement of the lease liability" (i.e. paragraphs 26 to 28 of IFRS 16) should be expanded to include references to measurement of lease liability under a sale and leaseback transaction.

Other suggested improvements to the proposals in the ED for consideration

(i) To provide clarity on the term 'expected'

Paragraph 100(a)(i) of IFRS 16 is amended to introduce the term "expected lease payments" for the first time. We wish to highlight that the term 'expected' appears to suggest the need to consider probability weighted scenarios in determining the lease payments to be included in the computation. Hence, we would suggest for the Board to provide clarity on the term.

(ii) To provide clarity on the rationale for the replacement of "present value of payments for the lease at market rates" with "present value of the expected lease payments"

Paragraph 102(b) of IFRS 16 is amended to replace "present value of payments for the lease at market rates" with "present value of the expected lease payments". We understand that paragraph 102 is intended to determine the fair value of the consideration paid and reference to market rates would continue to be important and relevant. It is unclear as to the rationale of the Board removing the reference to market rates. Hence, we would suggest for the Board to provide clarity on the rationale.

(iii) To expand Illustrative Example 24 to include the scenario of a sale and leaseback transaction with fixed payments and below-market terms

We note that illustrative Example 24 is useful in illustrating the application of the requirements in paragraph 101(b) of IFRS 16 with regards to the accounting of above-market terms in a sale and leaseback transaction.

It would be helpful if the Board could expand Illustrative Example 24 to illustrate the application of the requirements in paragraph 101(a) of IFRS 16 with regards to the accounting of below-market terms in a sale and leaseback transaction.

(iv) To provide clarity on the concept 'recoveries of shortfalls'

The new proposed paragraph 102B(d) introduced the concept "recoveries of shortfall" for the first time. As the concept is not defined or explained elsewhere, we urge the Board to provide clarity on the said concept to avoid any confusion.

Question 2—Transition (paragraph C20E of the draft amendment to IFRS 16)
Paragraph C20E of the draft amendment to IFRS 16 proposes that a seller-lessee apply the draft amendment to IFRS 16 retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to sale and leaseback transactions entered into after the date of initial application of IFRS 16. However, if retrospective application to a sale and leaseback transaction that includes variable lease payments is possible only with the use of hindsight, the seller-lessee would determine the expected lease payments for that transaction at the beginning of the annual reporting period in which it first applies the amendment. Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

We agree with the Board's proposals.

As the current IFRS 1 *First-time Adoption of International Financial Reporting Standards* does not specify any exemptions for sale and leaseback transactions, the Board may wish to consider including exemptions for first-time adopters.

Should you require any further clarification, please feel free to contact myself, Ms Felicia Tay or Mr Marcus Chan, TECHNICAL: Financial Reporting, from ISCA via email at jumay.lim@isca.org.sg, felicia.tay@isca.org.sg or marcus.chan@isca.org.sg.

Yours faithfully,

Ms Ju May, LIM
Deputy Director
TECHNICAL: Financial & Corporate Reporting;
Ethics & Specialised Industries;
Audit & Assurance