



**KPMG IFRG Limited**  
15 Canada Square  
London E14 5GL  
United Kingdom

[reinhard.dotzlaw@kpmgifrg.com](mailto:reinhard.dotzlaw@kpmgifrg.com)

Ms Sue Lloyd  
International Accounting Standards Board  
Columbus Building  
7 Westferry Circus  
London  
E14 4HD

Our ref BOD/288

13 May 2020

Dear Ms Lloyd

**Tentative agenda decision: *Sale and Leaseback with Variable Payments (IFRS 16 Leases)***

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee) tentative agenda decision *Sale and Leaseback with Variable Payments (IFRS 16 Leases)* (IFRIC Update March 2020). We have consulted with, and this letter represents the views of, the KPMG network.

We support the Committee's tentative conclusion that the seller-lessee initially measures the right-of-use asset as a proportion of the previous carrying amount of the underlying asset. However, we disagree that the seller-lessee recognises a lease liability when all payments for the lease are variable. We believe that this conclusion is inconsistent with the measurement requirements of IFRS 16. See the Appendix to this letter for our detailed analysis of this question.

Therefore, we recommend that:

- the Committee finalise the agenda decision confirming that the seller-lessee initially measures the right-of-use asset as a proportion of the previous carrying amount of the underlying asset; and
- the International Accounting Standards Board (the Board) consider both the initial and subsequent accounting for the liability that arises in such transactions in its proposed narrow-scope standard-setting project.



Please contact Reinhard Dotzlaw or Kimber Bascom at +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

*KPMG IFRG Limited*

KPMG IFRG Limited

## **Appendix – Detailed comments**

### ***The seller-lessee’s liability***

We disagree with the Committee’s tentative conclusion that the liability recognised by the seller-lessee is a lease liability for the following reasons:

- IFRS 16 contains specific guidance on the initial measurement of a lease liability, which should be applied to all lease liabilities;
- that guidance excludes variable lease payments that do not depend on an index or rate from the measurement of the lease liability;
- it is unclear whether the discount rate to be used by the seller-lessee complies with IFRS 16;
- the tentative conclusion raises questions over accounting for more complex sale and leaseback transactions; and
- specifying that the liability is a lease liability impacts subsequent accounting.

For these reasons, we recommend that the Board consider both the initial and subsequent accounting for the liability that arises in such transactions in its proposed narrow-scope standard-setting project.

\* \* \*

### *IFRS 16 contains specific guidance on the initial measurement of a lease liability*

IFRS 16 contains guidance on initial measurement of a lease liability in paragraphs 26-28. It does not contain alternative guidance that applies when a lease liability arises in the context of a sale and leaseback transaction. We therefore believe that the lease liability should be measured initially in accordance with paragraphs 26-28.

We note that the question in the submission to the Committee arose because IFRS 16 includes guidance on initial measurement of a right-of-use asset in paragraphs 23-25, and also in paragraph 100. The Committee concluded that the guidance in paragraph 100 applies. However, there is no equivalent question regarding initial measurement of lease liabilities, as IFRS 16 sets out a single approach.

*IFRS 16 excludes variable payments that do not depend on an index or rate from measurement of a lease liability*

IFRS 16 lists the lease payments that are included in the initial measurement of a lease liability in paragraph 27. This list does not include variable lease payments that do not depend on an index or a rate.

We note that the Committee agenda paper argues that the seller-lessee's obligation to make variable payments to the buyer-lessor arises in consideration for the right to use the underlying asset during the term of the leaseback. This observation applies equally to every other lease that includes variable lease payments. It does not in itself justify a departure from the requirements of paragraph 27 of IFRS 16.

We note that the Board decided to exclude most variable payments from the measurement of a lease liability on practical grounds. This exclusion is a requirement, not a choice. There are many situations in which this exclusion may result in counterintuitive accounting – notably when all lease payments are variable.

If a Committee agenda decision promotes departure from such a clear requirement of IFRS 16 in one case, this will raise practice questions as to what other situations justify such a departure.

*It is unclear whether the discount rate to be used by the seller-lessee complies with IFRS 16*

The Committee did not discuss the discount rate to be used by the seller-lessee to discount the variable lease payments. The Committee agenda paper implied this would be a market rate.

Under paragraph 26 of IFRS 16, a lessee measures a lease liability by discounting the lease payments using either the rate implicit in the lease or the lessee's incremental borrowing rate. It is not clear how the seller-lessee can comply with that requirement given the methodology used in the agenda paper to calculate the initial carrying amount of the liability.

*The tentative conclusion raises questions over accounting for more complex sale and leaseback transactions*

The fact pattern considered by the Committee is relatively simple: the transaction is on market terms and all payments are variable. Additional issues will arise with the application of the Committee's conclusions to more complex fact patterns.

For example, in the fact pattern considered by the Committee, the transaction is assumed to be at market. IFRS 16 provides guidance on accounting for sale and

leaseback transactions that are not at market in paragraphs 101-102 and in Illustrative Example 24. Paragraph 101(b) states that above-market terms shall be accounted for as “additional financing”, and Illustrative Example 24 specifies that the liability arising is a “financial liability”.

It is unclear whether the Committee’s tentative conclusion also applies to the liability recognised by a seller-lessee under paragraph 101(b).

Further, in the fact pattern considered by the Committee, all payments are variable. If some of the payments were fixed – for example, if there were a minimum guaranteed payment under the leaseback – then many of the issues already noted would be exacerbated. For example, would the lessee be required to use its incremental borrowing rate to discount the fixed lease payments and some other “market-based” rate to discount the variable payments?

*Specifying that the liability is a lease liability impacts subsequent accounting*

We note that the Board has already discussed a narrow-scope standard-setting project on subsequent accounting for the liability. However, until any changes to IFRS 16 arising from that project become effective, the seller-lessee would have to apply the currently effective requirements of IFRS 16 to the liability if the Committee specifies that it is a lease liability.

One complexity already noted is that it is not clear whether the seller-lessee can comply with the requirements of IFRS 16 regarding the discount rate. This impacts both the initial and subsequent accounting for the liability.

In addition, if the liability is a lease liability, then it is subject to the guidance in IFRS 16 on reassessments and modifications. We are concerned that a reassessment or insubstantial modification could result in remeasurement of the right-of-use asset and liability to nil. This would frustrate the intention of the Committee in specifying the measurement of the right-of-use asset.

***Other comments on the tentative agenda decision***

We recommend that the Committee should make the following clarifications to the agenda decision.

- Include within the agenda decision the statement in the Committee agenda paper that an entity would not comply with IFRS 16 if it were to measure the right-of-use asset at zero. We believe that this would be helpful given that the approach illustrated in the tentative agenda decision is a departure from the approach illustrated in Example 24.

- Clarify that all payments for the lease are variable payments to avoid any implication that the payments may include a mix of fixed and variable payments.
- Refer more broadly to paragraphs 99-102 of IFRS 16 as being applicable to sale and leaseback transactions where the transfer of the asset is a sale rather than just paragraph 100.
- Note that paragraphs 101-102 of IFRS 16 do not apply to the transaction described in the request because the lease payments are at market rates.