Staff paper

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IASB® meeting

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Project	**Post-implementation Review of IFRS 16 *Leases***
Topic	**Feedback analysis—Applying IFRS 16 with other IFRS Accounting Standards**
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Purpose and structure of this paper

1. This paper analyses feedback on interactions between the requirements in IFRS 16 *Leases* and other IFRS Accounting Standards and provides staff recommendations on which interactions to include in a request for information (RFI) on the Post-implementation Review (PIR) of IFRS 16.

2. This paper includes:

   (a) analysis of feedback on the most commonly raised interactions between IFRS 16 and other IFRS Accounting Standards. These other IFRS Accounting Standards are:

      (i) IFRS 3 *Business Combinations* (paragraphs 3–9);

      (ii) IFRS 9 *Financial Instruments* (paragraphs 10–26);

      (iii) IFRS 10 *Consolidated Financial Statements* (paragraphs 27–37);

      (iv) IFRS 15 *Revenue from Contracts with Customers* (paragraphs 38–56); and

      (v) IAS 36 *Impairment of Assets* (paragraphs 57–68);

(b) summary of staff recommendations (paragraphs 69–71);

(c) questions for the International Accounting Standards Board (IASB); and

(d) Appendix A—Other interactions between IFRS 16 and other IFRS Accounting Standards.

Applying IFRS 16 with IFRS 3 *Business Combinations*

Background

3. Paragraph 28A of IFRS 3 requires the acquirer to recognise right-of-use assets and lease liabilities for leases identified in accordance with IFRS 16 in which the acquiree is the lessee. However, the acquirer is not required to recognise right-of-use assets and lease liabilities for:

(a) leases for which the lease term (as defined in IFRS 16) ends within 12 months of the acquisition date; or

(b) leases for which the underlying asset is of low value.

4. As an exception to the measurement principles of IFRS 3, paragraph 28B of IFRS 3 requires the acquirer to measure the lease liability at the present value of the remaining lease payments (as defined in IFRS 16) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

Feedback summary

5. Some stakeholders (mostly preparers) raised concerns over ongoing costs of applying IFRS 16 because of its interaction with IFRS 3. They said application of IFRS 3 is onerous, because it requires them to measure acquired leases (in a business combination) as if they were new leases at the acquisition date. Entities might also need to maintain two sets of accounting records, for example, if the acquiree is

required to prepare individual financial statements, in which leases would be reported as if the acquisition had not happened.

Staff analysis and recommendations

6. In our view, the feedback does not relate to the clarity of the requirements in the two Accounting Standards or does not identify any unintended consequences or inconsistencies between the requirements in IFRS 16 or IFRS 3. Stakeholders' comments relate to onerous accounting and some operational complexities—similar to feedback about the ongoing costs of applying IFRS 16 (see Agenda Paper 7B).

7. We note that when developing IFRS 16, the IASB considered costs and benefits of applying the Standard together with IFRS 3. It considered whether an acquirer should be required to follow the general principle in IFRS 3 and measure the acquiree's right-of-use assets and lease liabilities at fair value on the date of acquisition. However, in the IASB's view, the costs associated with measuring lease assets and lease liabilities at fair value would outweigh the benefits because obtaining fair value information might be difficult and, thus, costly. The IASB also noted that, when the acquiree is a lessee, the requirements of IFRS 3 (as amended by IFRS 16) for the measurement of lease assets and lease liabilities would result in the recognition of a net carrying amount for the lease at the date of acquisition that approximates the fair value of the lease at that date.

8. The IASB also considered whether to require an acquirer to recognise assets and liabilities relating to any off-market terms if an acquiree is the lessee in a lease for which either the short-term lease or low-value asset lease exemptions described in paragraph 5 of IFRS 16 are applied. Such a requirement would be consistent with the general principles of IFRS 3, under which assets and liabilities relating to contracts with off-market terms are recognised separately in the balance sheet and not subsumed within goodwill on acquisition. However, the IASB observed that the effect of any such off-market terms would rarely be material for short-term leases and leases of low-value assets. Consequently, it decided not to include this requirement in IFRS 3.

9. However, given the prevalence of comments about ongoing costs and complexities which might indicate the ongoing costs of applying IFRS 16 are not only marginally higher compared to those incurred applying IAS 17, we think it would be helpful to gather further information to determine whether the IASB should take any action in relation to the requirements for acquired lease contracts that would improve the balance between the benefits (of the resulting information) and costs (of providing it). Therefore, the staff recommend including in the RFI a question about the application of IFRS 16 with IFRS 3.

Applying IFRS 16 with IFRS 9 *Financial Instruments*

Background

10. IFRS 16 defines a *lease modification* as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual term).

11. For a lease modification that is not accounted for as a separate lease, IFRS 16 requires the lessee to remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The lessee accounts for the remeasurement of the lease liability by:

    (a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee recognises in profit or loss any gain or loss relating to the partial or full termination of the lease.

    (b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.[1]

[1] Paragraphs 44–46 of IFRS 16.

12. Paragraph 2.1(b)(ii) of IFRS 9 states that 'lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 3.3.1' of IFRS 9.

13. Paragraph 3.3.1 of IFRS 9 states that 'an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.'

14. Paragraph 3.3.3 of IFRS 9 states that the 'difference between the carrying amount of a financial liability (or part of a financial liability) extinguished […] and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss'.

15. At its March 2022 meeting, the IFRS Interpretations Committee (Interpretations Committee) discussed a request about a lessor's and a lessee's application of IFRS 9 and IFRS 16 in accounting for a rent concession in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under the contract. The Interpretations Committee addressed a *lessor's* application of IFRS 9 and IFRS 16 in Agenda Decision Lessor Forgiveness of Lease Payments (IFRS 9 and IFRS 16) published in October 2022. In summary, the Interpretations Committee concluded that the lessor accounts for the rent concession described in the request on the date it is granted by applying:

    (a) the derecognition requirements in IFRS 9 to forgiven lease payments that the lessor has recognised as an operating lease receivable; and

    (b) the lease modification requirements in IFRS 16 to forgiven lease payments that the lessor has not recognised as an operating lease receivable.

16. With regard to *lessee* accounting, the Interpretations Committee agreed with the staff conclusions (paragraphs 68–69 of Agenda Paper 4 for the March 2022 Interpretations Committee meeting) that there is more than one way for a lessee to read the principles and requirements in IFRS Accounting Standards in accounting for the rent concession in the submitted fact pattern. The lessee could:

(a) apply paragraphs 3.3.1 and 3.3.3 of IFRS 9 to the part of the lease liability that is extinguished and paragraphs 45–46 of IFRS 16 in accounting for the lease modification (after having applied the derecognition requirements in IFRS 9 to the part of the lease liability extinguished). Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments in profit or loss at the date on which the rent concession is granted.

(b) account for the forgiveness of lease payments by applying the lease modification requirements in IFRS 16. Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments as a decrease in the carrying amount of the right-of-use asset.

17. Consequently, the Interpretations Committee recommended that the IASB consider undertaking narrow-scope standard-setting, potentially as an annual improvement. However, the Interpretations Committee's subsequent discussion in March 2023 about *how* a lessee distinguishes between a lease modification as defined in IFRS 16 and an extinguishment (or a partial extinguishment) of a lease liability led the IASB to conclude that clarifying that interaction between IFRS 9 and IFRS 16 is beyond the scope of an annual improvement.

18. The IASB did issue *Annual Improvements to IFRS Accounting Standards—Derecognition of Lease Liabilities (Amendments to IFRS 9)* in July 2024. These Annual Improvements sought to address stakeholders' feedback that it was unclear whether a lessee recognises the gain or loss on extinguishment of the lease liability in profit or loss in accordance with paragraph 3.3.3 of IFRS 9, or by making a corresponding adjustment to the right-of-use asset recognised in accordance with IFRS 16, when a lessee has determined that a lease liability has been extinguished in accordance with IFRS 9. The IASB decided to clarify this issue by amending paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3. The amendment clarifies that, when a lessee has determined that a lease liability has been extinguished in accordance with IFRS 9, the lessee is required to apply paragraph 3.3.3 and recognise any resulting gain or loss in profit or loss.

19. However, the broader question of how a lessee distinguishes between a lease modification as defined in IFRS 16 and an extinguishment (or a partial extinguishment) of a lease liability in IFRS 9 remains because in issuing the annual improvement the IASB concluded that clarifying that interaction between IFRS 9 and IFRS 16 was beyond the scope of an annual improvement.[2] The staff think the matter could be considered as part of the PIR of IFRS 16.

Feedback summary

20. Some stakeholders (mostly standard-setters) said there is still lack of clarity about the interaction between IFRS 9 and IFRS 16 when a lessee accounts for a lease payment forgiven (rent concession). They questioned how a lessee distinguishes between the partial extinguishment of a lease liability to which IFRS 9 applies and a lease modification to which IFRS 16 applies. They said the distinction has substantial consequences, because it determines whether the lessee recognises an amount in profit or loss for the gain or loss on partial extinguishment of the lease liability or instead adjusts the right-of-use asset.

21. We observed the September 2024 meeting of the IFRS Accounting Standards Discussion Group (IDG)—an advisory body of the Canadian Accounting Standards Board—at which they discussed distinguishing between a lease modification and an extinguishment of a lease liability in three fact patterns.[3] IDG members' comments included:

    (a) the irrevocable waiver of a lease payment currently due could fall within the scope of IFRS 16 as it meets the definition of a lease modification which includes a change in the consideration for a lease, and could also fall within the scope of paragraph 3.3.1 of IFRS 9, which applies to partial

[2] Paragraph BC2.45 of the Basis for Conclusions on IFRS 9.

[3] A lessee leases a restaurant space within a shopping centre. Fixed lease payments of $3,000 are due in advance on the first day of each month. The discussion considered three fact patterns: (1) on 1 July 2024, the lessor irrevocably waives $3,000 that is due on that day; (2) same as fact pattern (1) and the lessor also extends the lease term; and (3) same as fact pattern (1) and the lessor also reduces the future monthly payment that will be due on 1 August 2024.

extinguishments of financial liabilities (including lease liabilities)—most IDG members said they could not preclude either view in fact pattern 1.

(b) the forgiveness of the currently due lease payment combined with the extension of the lease term should be accounted for as a lease modification under IFRS 16, because these two amendments were likely negotiated together, making it challenging to account for them separately—most IDG members' view in relation to fact pattern 2.

(c) determining which Accounting Standard to apply depends on whether the whole lease contract or the individual lease payments is determined to be the unit of account for the transaction. For example, in relation to fact pattern 2, in some IDG members' view:

(i) if the whole lease contract is the unit of account, the lessee should apply lease modification requirements in IFRS 16; and

(ii) if the individual lease payments are the unit of account, the lessee should consider splitting the amendment to the contract between IFRS 9 (forgiveness of the currently due lease payment) and IFRS 16 (lease term extension), acknowledging the practical challenges associated with doing so.

(d) in fact pattern 3, the lessee might apply:

(i) the lease modification requirements in IFRS 16 to the forgiveness of the currently due lease payment and the reduction of the future lease payment. This was the majority view, for the same reasons provided in the discussion on fact pattern 2.

(ii) the derecognition requirements in IFRS 9 to the forgiveness of the currently due lease payment and the lease modification requirements in IFRS 16 to the reduction of the future lease payment—this view was held by some who considered the unit of account to be the individual lease payment rather than the lease contract as a whole.

(iii) the derecognition requirements in IFRS 9 to both the forgiveness of the currently due lease payment and the reduction of the future lease payment. Some thought this additional view could be supportable as the reduction in cash outflows represents a partial derecognition of the lease liability within the scope of IFRS 9.

Staff analysis and recommendations

22. Feedback indicates that there are still questions about the clarity of the requirements, but it is unclear whether the matter has widespread effect.

23. We note the staff conducted outreach before the matter was first considered by the Interpretations Committee in March 2022.[4] The staff received 14 responses—seven from national standard-setters, five from large accounting firms and two from organisations representing securities regulators.

24. This earlier outreach found that half of respondents said the lessee fact pattern is not common and the accounting has no material effect for lessees. The other half of respondents said the lessee fact pattern is (or could be) common and the accounting has (or could have) a material effect. Some said their observations are not specific to a jurisdiction or industry and some said they relate only to particular jurisdictions and industries (which varied by respondent). Some respondents said the lessee fact pattern could be common going forward in a few jurisdictions, while other respondents expect the prevalence of rent concessions to decrease compared to COVID-19-related rent concessions in 2020 and 2021.

25. In relation to diversity in practice, the 2022 outreach found that many respondents said they had observed no material diversity in accounting for the lessee fact pattern. Some respondents said they observed material diversity that is not specific to a jurisdiction or industry, while a few others said they observed material diversity only in particular jurisdictions and industries (which varied by respondent).

[4] See Agenda Paper 4 for the March 2022 Interpretations Committee meeting.

26. We recommend that the IASB include this matter in the RFI to obtain further evidence to determine whether the matter (lack of clarity whether a lessee applies IFRS 9 or IFRS 16 to a lease payment forgiven) has widespread effect and whether the IASB should take any action.

Applying IFRS 16 with IFRS 10 *Consolidated Financial Statements*

Background

27. IFRS 10 defines a subsidiary as an entity that is controlled by another entity. It also sets out requirements for the loss of control of a subsidiary. In essence, IFRS 10 requires a parent that loses control of a subsidiary:

    (a) to derecognise the assets and liabilities of the subsidiary at their carrying amounts at the date when control is lost;

    (b) to recognise the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and

    (c) to recognise any resulting difference as a gain or loss in profit or loss ('full' gain recognition).[5]

28. IFRS 16 sets the requirements for sale and leaseback transactions. If the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset, the seller-lessee is required to measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor ('partial' gain recognition).[6]

[5] Paragraphs 25 and B97–B99 of IFRS 10.

[6] Paragraph 100(a) of IFRS 16.

29. At its September 2020 meeting, the Interpretations Committee discussed a submission about the applicability of the sale and leaseback requirements in IFRS 16 to a transaction in which an entity sells its equity interest in a subsidiary that holds only a real estate asset (a single-asset entity) and then leases that real estate asset back. The request asked whether the entity in its consolidated financial statements applies the sale and leaseback requirements in IFRS 16 and therefore recognises only the amount of the gain that relates to the rights transferred to the third party.

30. The Interpretations Committee tentatively concluded that, in the transaction described in the request:

    (a) the entity applies paragraphs 25 and B97–B99 of IFRS 10 to account for the loss of control of the subsidiary.

    (b) the transfer of the building satisfies the requirements in IFRS 15 to be accounted for as a sale of the building (paragraph 99 of IFRS 16)—the entity therefore applies paragraph 100(a) of IFRS 16. Consequently, the gain the entity recognises on the transaction reflects the requirements in paragraph 100(a) of IFRS 16 (partial gain).

31. At its February 2021 meeting, the Interpretations Committee discussed feedback on the tentative agenda decision. Most Interpretations Committee members agreed with the technical analysis and outcome but recommended narrow-scope standard-setting because, in their view, finalising an agenda decision would:

    (a) codify a principle, which is outside the Interpretations Committee's scope of work;

    (b) be misinterpreted as setting a hierarchy of IFRS Accounting Standards;

    (c) be inconsistent with existing cross-references to IFRS 16 in paragraphs 68–69 of IAS 16 *Property, Plant and Equipment*, paragraphs 113–114 of IAS 38 *Intangible Assets* and paragraphs 67 and 69 of IAS 40 *Investment Property*; and

(d) have limited utility because it applies to a narrow and unrealistic fact pattern.

32. The matter (Sale and Leaseback of an Asset in a Single-asset Entity) is now included in the IASB's Maintenance project pipeline.

Feedback summary

33. A few stakeholders (a national standard-setter, a preparer and a large accounting firm) said it is important to address this interaction. The matter has substantial consequences, because without further clarifications a seller-lessee that loses control of its subsidiary and leases back one of its assets (or its only asset) might decide to recognise either a full gain or partial gain. For example, our review of European enforcers' decisions relating to IFRS 16 found that in the absence of specific requirements from the IASB, a regulator accepted the entity's accounting for the transaction applying IFRS 10 and recognising the full gain on the sale, but disagreed with the entity not disclosing the accounting policy (Decision reference EECS/0123-01).

Staff analysis and recommendations

34. Feedback indicates that there are still questions about the clarity of the requirements, but it is unclear whether the matter has widespread effect. We note the staff's observations in paragraph 17 of Agenda Paper 2 for the September 2020 Interpretations Committee meeting that:

(a) single-asset entities—holding real estate—are common in some jurisdictions (often structured in that way for tax reasons);

(b) sale and leaseback transactions are common; and

(c) when sale and leaseback transactions occur, they often relate to high-value items of property, plant and equipment and are often highly structured.

35. In our view, it would be useful to gather more information about market developments since the Interpretations Committee discussed feedback on the tentative agenda decision at its meeting in February 2021.

36. Therefore, we recommend that the IASB include in the RFI a specific question about the interaction between IFRS 10 and IFRS 16. This will help the IASB determine whether the matter has widespread effect. In particular, we think it would be useful to gather more information from users of financial statements to understand whether the matter is important to them and whether the lack of clarify (and potential diversity in accounting) creates difficulties for their analyses and comparisons.

37. We also recommend the IASB seek feedback on potential narrow-scope standard-setting solutions that would help to solve the matter. To help stakeholders identify potential solutions and provide more focused feedback, we plan to provide a brief summary of the previous discussions on this matter in the RFI.

Applying IFRS 16 with IFRS 15 *Revenue from Contracts with Customers* in sale and leaseback transactions

Background

38. IFRS 15 requires an entity to recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.[7]

39. When (or as) a performance obligation is satisfied, IFRS 15 requires an entity to recognise as revenue the amount of the transaction price that is allocated to that

[7] Paragraphs 31 and 33 of IFRS 15.

performance obligation. IFRS 15 defines transaction price (for a contract with a customer) as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

40. IFRS 16 requires entities to apply the requirements for determining when a performance obligation is satisfied in IFRS 15 to determine whether the transfer of the asset is accounted for as a sale of that asset. If the transfer of the asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset, the seller-lessee recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor ('partial' gain recognition) and measures the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee.[8] Otherwise, the seller-lessee continues to recognise the transferred asset and recognises a financial liability equal to the transfer proceeds.

41. We note that the FASB decided to require a seller-lessee to account for any gain or loss on sale consistently with the guidance that would apply to any other sale of an asset ('full' gain recognition).

Feedback summary

42. Stakeholders provided comments that can be classified into two categories:

(a) determining whether a sale occurs (paragraphs 43–45); and

(b) recognising a gain or loss in a sale and leaseback (paragraphs 46–48).

[8] Paragraph 100(a) of IFRS 16.

Determining whether a sale occurs

43. Some stakeholders (mostly standard-setters and regulators) said in some situations it is difficult to determine whether the transfer of an asset by the seller-lessee in a sale and leaseback transaction is a sale as defined in IFRS 15, including:

(a) whether a seller-lessee's renewal options in a leaseback transaction that would permit the seller-lessee to extend the lease for substantially all of the remaining economic life of the underlying asset preclude accounting for the transaction as a sale;

(b) whether the unit of account in assessing whether the transfer of an asset is a sale under IFRS 15 needs to be the same as in the leaseback transaction—for example, when an entire building is sold, and some floors of the building are leased back;

(c) if the seller-lessee sells land and leases back the land with a building on it or sells an unrenovated building and leases back a renovated building (unit of account matter);

(d) if the lessee has a right of first refusal; and

(e) if the leaseback is classified as a finance lease.

44. We note that in the PIR of IFRS 15, some stakeholders also commented on applying IFRS 15 with IFRS 16. They asked for additional guidance and/or illustrative examples on assessing whether the transfer of an asset in a sale and leaseback transaction is a sale in accordance with IFRS 15 and provided examples of fact patterns, in which determination of whether a sale occurs might be difficult. Some of these examples and questions were similar to those in paragraph 43 and also included:

(a) whether the determination of transfer of control of the underlying asset can be subsequently reassessed—for example, when a repurchase option expires unexercised; and

(b) what percentage of asset value or asset life of a leaseback precludes accounting for the transaction as a sale.

45. In the PIR of IFRS 15, the IASB decided to gather further evidence during the PIR of IFRS 16 on matters related to assessing whether the transfer of an asset is a sale in a sale and leaseback transaction.[9]

Recognising a gain or loss in a sale and leaseback

46. Some stakeholders (mostly standard-setters and regulators) raised concerns about the partial gain or loss recognition in a sale and leaseback transaction, because in their view such accounting is inconsistent with the accounting model in IFRS 15, to which sale and leaseback requirements cross-refer. Stakeholders' comments also included:

(a) the measurement of the right-of-use asset and lease liability in a sale and leaseback transaction is different from the initial measurement requirements for assets and liabilities arising from outright leases (that are not part of sale and leaseback transactions);

(b) accounting for variable lease payments in a sale and leaseback transaction is different from accounting for such payments applying general requirements of IFRS 16 and provides structuring opportunities to achieve a desired reporting outcome; and

(c) the partial gain or loss recognition model requires entities to make complex and costly calculations and is difficult for users of financial statements to understand and use for forecasting future cash flows.

47. A standard-setter and two accounting firms suggested the IASB clarify that sale and leaseback accounting requirements should not apply when control transfers over time, such as when the seller-lessee constructs the asset for the buyer-lessor. They noted that in these cases, the asset sold differs from the asset leased back.

[9] See page 39 of [Project Summary and Feedback Statement: Post-implementation Review IFRS 15 Revenue from Contracts with Customers].

48. A preparer suggested the sale and leaseback requirements are converged with the requirements of the FASB's ASC Topic 842, Leases, which are aligned with revenue recognition for contracts with customers ('full' gain recognition).

Staff analysis and recommendations

Determining whether a sale occurs

49. We note that, when developing IFRS 16, the IASB considered whether to include additional application guidance in IFRS 16 regarding the determination of whether there is a sale in a sale and leaseback transaction. Such guidance would be intended to help entities to apply the IFRS 15 requirements relating to the satisfaction of performance obligations to sale and leaseback transactions. However, the IASB concluded that this was not necessary because, in its view, the principles in IFRS 15 can be applied appropriately and consistently to sale and leaseback transactions without any further guidance.[10]

50. However, feedback summarised in paragraphs 43–44 suggests that some entities continue to have questions about the clarity of the requirements in IFRS 16 and how to apply them together with the requirements in IFRS 15.

51. In addition, we note that in the PIR of IFRS 15, the IASB decided to gather further evidence during the PIR of IFRS 16 on matters related to assessing whether the transfer of an asset is a sale in a sale and leaseback transaction.

52. To help the IASB determine whether to take any action, we recommend seeking further evidence on matters related to how an entity assesses whether the transfer of an asset is a sale in a sale and leaseback transaction. Therefore, we recommend including this matter in the RFI.

[10] See paragraph BC264 of the Basis for Conclusions on IFRS 16.

Recognising a gain or loss in a sale and leaseback

53. We note that, in developing IFRS 16, 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 (that is, 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. 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. 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.[11]

54. We also note that when developing *Lease Liability in a Sale and Leaseback* (Amendments to IFRS 16 issued in September 2022), the IASB considered an approach that would change the existing sale and leaseback requirements to initially measure the right-of-use asset and lease liability arising from a leaseback similarly to right-of-use assets and lease liabilities unrelated to a sale and leaseback transaction. Applying this approach, a seller-lessee would recognise a deferred gain for the amount of any gain that relates to the right of use it retains. However, such an approach would require the reconsideration of the sale and leaseback requirements in IFRS 16.[12]

55. The feedback summarised in paragraph 34 suggests that sale and leaseback transactions are common and when they do occur, the amounts are usually significant. However, as we summarised in paragraphs 46–47 some stakeholders question whether the information prepared applying sale and leaseback requirements results in useful

[11] Paragraph BC266 of the Basis for Conclusions on IFRS 16.

[12] Paragraph BC267ZF of the Basis for Conclusions on IFRS 16.

information and whether benefits to users of this information justify the costs and complexities in applying the requirements and preparing this information.

56. In our view, the IASB should seek further evidence to determine whether the effects (costs and benefits) of applying the requirements for sale and leaseback transactions are *not* significantly different than was expected. Therefore, the staff recommend including in the RFI a question on this matter.

Applying IFRS 16 with IAS 36 *Impairment of Assets*

Background

57. Paragraph 6 of IAS 36 states that a cash-generating unit (CGU) is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Paragraph 50 of IAS 36 states that estimates of future cash flows do not include cash inflows or outflows from financing activities, or income tax receipts or payments.

58. Paragraphs 74–79 of IAS 36 discuss the recoverable amount and carrying amount of a CGU in more detail. The Standard requires an entity to determine the carrying amount of a CGU on a basis consistent with the way the recoverable amount of the CGU is determined.

59. IAS 36 states that the carrying amount of a CGU does not include the carrying amount of any recognised liability, unless the recoverable amount of the CGU cannot be determined without consideration of this liability. Paragraph 78 of IAS 36 further states that:

> It may be necessary to consider some recognised liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs of disposal (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the price to sell

the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

60. Paragraphs A15–A21 of IAS 36 provide guidance for determining the discount rate to be used for calculating value in use. Interest rates used to discount cash flows do not reflect risks for which the estimated cash flows have been adjusted. The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset, because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

Feedback summary

61. A few stakeholders highlighted difficulties when applying IAS 36 to test CGUs containing right-of-use assets for impairment. They said the IASB should clarify, for example, whether:

(a) right-of-use assets and lease liabilities should be taken into account when testing CGUs for impairment;

(b) whether and how to reflect lease payments in future cash flows; and

(c) whether the cost of leases should be included in the discount rate.

62. A few respondents to the Discussion Paper *Business Combinations–Disclosures, Goodwill and Impairment* highlighted difficulties in determining cash outflows when applying IAS 36 to CGUs containing right-of-use assets recognised applying IFRS 16. These difficulties include:

(a) the definition of a CGU in paragraph 6 of IAS 36 does not include liabilities, and paragraph 50(a) of IAS 36 states that estimates of future cash flows should not include cash inflows or outflows from financing activities. A few respondents said preparers find it difficult to adjust management budgets to separate cash flows relating to leases that are included in the lease liability applying IFRS 16 from cash flows relating to leases that are not included in the lease liability. Some of those respondents suggested allowing entities to include lease liabilities relating to right-of-use assets in the carrying amount of a CGU and cash flows related to financing liabilities when estimating value in use.

(b) paragraph 33 of IAS 36 states that when an entity estimates value in use, cash flow projections and forecasts based on budgets shall cover a maximum period of five years, unless a longer period can be justified. A few respondents suggested providing guidance for cash flows relating to right-of-use assets beyond the forecast period, including guidance for cash flows from reinvesting these assets at the end of the lease term.

63. The comments in paragraph 62 were beyond the scope of the Business Combinations—Disclosures, Goodwill and Impairment project, therefore the IASB decided not to explore them further (see Appendix B to Agenda Paper 18D for the December 2022 IASB meeting).

Staff analysis and recommendations

64. We note that in May 2016 the Interpretations Committee published Agenda Decision *Recoverable amount and carrying amount of a cash-generating unit (IAS 36)* which includes explanatory material about the application of paragraph 78 of IAS 36, and which requires an entity to deduct the carrying amount of any recognised liabilities in determining both the CGU's carrying amount and its value in use (VIU). The Interpretations Committee observed that this approach of determining both the CGU's carrying amount and its VIU by deducting the same carrying amount of the recognised liability:

(a) makes the comparison between the CGU's carrying amount and the CGU's recoverable amount meaningful; and

(b) provides a straightforward and cost-effective method to perform a meaningful comparison of the measures involved in an impairment test for a CGU.

65. We also note a regulator's enforcement decision (reference EECS/0122-07) relating to the impairment test of a CGU comprising right-of-use assets (published in the 26th Extract from the EECS's Database of Enforcement—see paragraph 20(d) of Agenda Paper 7A). The entity deducted lease liabilities when determining the net carrying amount of the CGU and calculated the VIU by deducting the estimated cash outflows to settle the lease liability from the projected cash flows of the CGU and then discounted these net cash flows. The entity used the weighted average cost of capital (WACC) to discount the cash flows without taking into account the application of IFRS 16 in the calculation of the WACC. The regulator concluded that:

(a) if the carrying amount of the lease liabilities is deducted from the carrying amount of the CGU, the *same amount* should be deducted from the recoverable amount of the CGU; and

(b) the discount rate used in VIU estimates should reflect the impact of IFRS 16 on the composition of the carrying amount of the CGU.

66. We acknowledge operational complexities and difficulties, for example, those summarised in paragraph 62(a) to adjust management budgets to separate cash flows relating to leases that are included in the lease liability applying IFRS 16 from cash flows relating to leases that are not included in the lease liability.

67. However, we note that the questions about exclusion (or inclusion) of recognised liabilities in the carrying amount of a CGU are not specific to leases and arose before IFRS 16 was issued—for example, in respect of applying IAS 36 to CGUs containing decommissioning liabilities or finance lease liabilities. In our view, the requirements in IAS 36 together with the explanatory material included in May 2016 Agenda Decision provide sufficient basis for entities to determine how to test CGUs containing right-of-use assets for impairment. We also think that the requirements in paragraphs 74–79 of IAS 36 are generally well understood—they have not changed since they were issued in June 1998—and practice is set.

68. Therefore, the staff recommend not including in the RFI a specific question on applying IFRS 16 with IAS 36. If significant, respondents would be able to raise their concerns in response to a catch-all question. When drafting the RFI, we will consider whether to include some limited information about what we heard on this matter.

Summary of staff recommendations

69. The staff recommend the IASB include questions in the RFI to assess whether any action is needed in relation to:

    (a) the requirements for acquired lease contracts in IFRS 3, with the objective of improving the balance between the benefits of providing the required information and costs of providing that information;

    (b) how a lessee distinguishes between a lease modification as defined in IFRS 16 and an extinguishment (or a partial extinguishment) of a lease liability (to which IFRS 9 applies) when it accounts for a rent concession in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under that contract;

    (c) the requirements in IFRS 15 which the seller-lessee applies when assessing whether the transfer of an asset in a sale and leaseback transaction is accounted for as a sale of that asset; and

    (d) the requirements in IFRS 16 about partial gain or loss recognition for sale and leaseback transactions, considering differences with the revenue recognition model in IFRS 15.

70. We recommend the IASB include a question in the RFI about relevant market developments since the February 2021 Interpretations Committee's deliberation of feedback on its tentative agenda decision relating to the application of IFRS 10 alongside IFRS 16 to sale and leaseback of an asset in a single-asset entity. The question will help the IASB assess whether the matter continues to have widespread effect and if so, what narrow-scope standard-setting solution would solve the matter efficiently.

71. We recommend the IASB include *no* questions in the RFI about the application of IFRS 16 alongside other IFRS Accounting Standards. Instead, these interactions, along with other matters not covered by specific questions in the RFI, will be covered by a general catch-all question.

Questions for the IASB

Questions for the IASB
1. Do IASB members agree with the staff recommendation in paragraphs 69–71 of this paper?
2. Are there any additional matters discussed in this paper that the IASB would like to seek feedback on in the request for information?

Appendix A—Other interactions between IFRS 16 and other IFRS Accounting Standards

A1. This appendix summarises feedback on other interactions between IFRS 16 and other IFRS Accounting Standards that only one or a few stakeholders suggested including in the RFI. We do not recommend seeking further feedback on these matters, because evidence that we have gathered does not indicate that the matters have widespread effect (that is, the evidence gathered does not indicate that the matters are prevalent and that there is diversity in the application of IFRS Accounting Standards that has, or is expected to have, a material effect on those affected).

A2. This appendix also includes a few matters for which, in our view, a standard-setting solution may be unnecessary or unworkable. For example, it includes matters that might indicate non-compliance with requirements or inappropriate exercise of judgement, or matters for which the solution might undermine the principle-based nature of IFRS Accounting Standards.

A3. Agenda Paper 27C and Agenda Paper 6D for the April 2024 IASB meeting provide a summary of feedback on various matters relating to interaction between IFRS 16 and IFRS 9 or IFRS 15 that had been raised by one or a few respondents to the previous PIRs. The IASB concluded that no action was required as a result of those PIRs.[13] We have considered these matters when consulting with stakeholders and to date we have not received any additional information that would indicate the matters have widespread effect. Therefore, this appendix omits these matters.

Applying IFRS 16 with …	Description of the interaction and summary of comments
… IFRS 5	Lack of clarity about whether right-of-use assets of a subsidiary that is held for sale are within the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*

[13] See the Project Summary and Feedback Statement: PIR of IFRS 15 and the Project Summary and Feedback Statement: PIR of IFRS 9—Impairment.

Applying IFRS 16 with …	Description of the interaction and summary of comments
… IFRS 9	When the net investment in the lease becomes credit-impaired, it is unclear whether the lessor recognises finance income by applying a constant periodic rate of return to the net investment in the lease (paragraph 75 of IFRS 16) or by applying an effective interest rate to the amortised cost of the carrying amount of the receivable (paragraph 5.4.1(b) of IFRS 9).
… IFRS 11	In March 2019 the Interpretations Committee issued Agenda Decision IFRS 11 *Joint Arrangements*—Liabilities in relation to a Joint Operator's Interest in a Joint Operation which explains how paragraph 20(b) of IFRS 11 applies to the recognition of liabilities by the operator. A standard-setter said it is unclear how the operator accounts for the right-of-use assets in the fact pattern described in the request to the Interpretations Committee and other similar fact patterns.
… IFRS 15	The IASB should clarify: • how to allocate transaction price between lease and non-lease components when the contract term determined for the non-lease component applying IFRS 15 differs from the lease term determined for the lease component. • whether a lessor continues recognising operating lease income (see paragraph 81 of IFRS 16) even when it is not probable that the lessor will collect the lease payments. Should the lessor analogise to the requirements in paragraph 9(e) of IFRS 15 and not accrue lease income until collectability is probable?
… IAS 16	Paragraph 32 of IFRS 16 requires a lessee to depreciate the right-of-use asset from the *commencement date*. A preparer said the IASB should permit lessees to apply paragraph 55 of IAS 16 (which states that depreciation of an asset begins when it is available for use), because in some circumstances this would better reflect the economics of the lease. For example, a lessor might grant a rent-free period for the lessee to make necessary leasehold improvements. In the preparer's view, depreciating the right-of-use asset during the rent-free-period, when the underlying asset is not available for use, does not faithfully represent the economics of the transaction.

Applying IFRS 16 with …	Description of the interaction and summary of comments
	It is unclear whether lessees can analogise to the requirements in: • paragraph 16(b) of IAS 16 and capitalise any costs directly attributable to bringing the underlying asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and • paragraph 43 of IAS 16 and depreciate separately each significant part of the right-of-use asset (componentisation).
… IAS 21	The requirement (in IAS 21 *The Effects of Changes in Foreign Exchange Rates*) to translate lease liabilities in a foreign currency using the closing rate and to translate right-of-use-assets using the exchange rate at the date of the transaction leads to an accounting mismatch and causes volatility in the income statement.
… IAS 29	The requirement (in IAS 29 *Financial Reporting in Hyperinflationary Economy*) to restate right-of-use assets by applying a general price index without restating monetary items (such as lease liabilities) does not provide useful information. The IASB should clarify whether paragraph 13 of IAS 29 applies to contracts with lease payments that depend on an index or a rate.
… IAS 37	The IASB should clarify how to account for contractual obligations to perform major maintenance of a leased asset that depend on usage of the asset, because there is diversity. Some entities recognise a provision at the commencement date and include the corresponding amount in the cost of the right-of-use asset (similar to the recognition of, for example, a decommissioning liability). Some other entities recognise a provision (and the corresponding amount in the income statement) as the underlying asset is used (or through the passage of time).[14]

[14] In November 2024, the IASB published Exposure Draft *Provisions—Targeted Improvements*. In this exposure draft, the IASB is proposing to make targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, including to one of the criteria for recognising a provision (the present obligation recognition criterion). If finalised, the amendments would change the timing of recognition of some provisions, such as provisions for costs, often levies, that are payable only if an entity takes two separate actions or if a measure of its activity in a specific period exceeds a specific threshold.

Applying IFRS 16 with …	Description of the interaction and summary of comments
… IAS 38	It is unclear whether a 'Software as a Service' cloud computing arrangement (in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier's application software for a specified term) is within the scope of IFRS 16, within the scope of IAS 38 *Intangible Assets* or within the scope of both Standards.
… IAS 40	Lack of clarity about whether an asset that an entity uses to earn rentals can be an investment property under IAS 40 *Investment Property* if the rental contract is not a lease under IFRS 16 because the entity has substantial substitution rights.