ED/ Ind AS 116/2022/3

Exposure Draft

Lease Liability in a Sale and Leaseback

Amendments to Ind AS 116, Leases

(Last date for Comments: January 30, 2023)

Issued by

Accounting Standards Board

The Institute of Chartered Accountants of India

Para wise comments:

Para: 102A

The newly inserted para reads as follows:

"After the commencement date, the seller-lessee shall apply paragraphs 29–35 to the right-of-use asset arising from the leaseback and paragraphs 36–46 to the lease liability arising from the leaseback. In applying paragraphs 36–46, the seller-lessee shall determine 'lease payments' or 'revised lease payments' in a way that the seller-lessee would not recognise any amount of the gain or loss that relates to the right of use retained by the seller-lessee. Applying the requirements in this paragraph does not prevent the seller-lessee from recognising in profit or loss any gain or loss relating to the partial or full termination of a lease as required by paragraph 46(a)."

Comments:

1. SIRC of ICAI agrees that without the Amendments, a seller-lessee would have potentially been required or allowed to recognise a loss or a gain on the right-of-use it retains solely because of a remeasurement (for example, following a lease modification or change in the lease term) if it had applied the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction rather than the approach established in the newly introduced paragraph 102A. SIRC of ICAI considered that recognising such remeasurement gain in the absence of any transactions would not have resulted in relevant information.

2. It is to be accepted without the Amendments, a simple modification in the leaseback term could have resulted in the seller-lessee measuring the leaseback liability differently from its initial measurement by excluding variable payments that do not depend on an index or rate; thus, recognising a gain or loss on the right-of-use the seller-lessee retains at the time of remeasurement. That gain or loss, recognised in the absence of any transactions, would not have reflected the economics the transaction and therefore would not have provided reliable information by overstating the loss or gain recognised.

3. SIRC of ICAI also observes that the Amendments do not prescribe a specific method to measure the proportion or rights retained or sold in the transaction or to determine the lease payments be recognised over the lease term. The Amendments may not ensure full comparability as they are not prescribing a specific method to measure the proportion of rights retained or sold in the transaction and to calculate the lease payments to be recognised over the lease term.

4. Further it is observed that, in the case of a leaseback variable payments not based on an index or rate, the absence of specific guidance on how to determine the lease

payments (and therefore the interplay between payments and accrued interest over the leaseback term) may have an effect on the overall relevance of the information in terms of a users' ability to forecasting a seller-lessee's future cash flows and in assessing its long-term prospects.

5. SIRC of ICAI has assessed that the Amendments would not result in the omission of relevant information and, therefore, satisfy the relevance criterion. It is further observed that the Amendments do not introduce any new complexity that may impair understandability. The Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view. Therefore, SIRC of ICAI believe that the Amendments will generally bring improved financial reporting when compared to current guidance.

Appendix C

This newly inserted part reads as follows:

"Effective date and transition Effective date ... C1D Lease Liability in a Sale and Leaseback, amended paragraph C2 and added paragraphs 102A and C20E. A seller-lessee shall apply these amendments for annual reporting periods beginning on or after 1 April 2024."

Comments:

1. The ED may permit to apply the Ind As 116 in advance of that date (01 April 2024) provided that it also-

• discloses that fact; and

• applies Ind AS 115 Revenue from Contracts with Customers at or before the date of initial application of Ind AS 116.

This permission will enable the stakeholders to compare the data of 24-25 with 23-24.

Appendix D

1. The Illustrations are replica of IFRS16. However, to put it in a simple way, this part may add-

1. The Title 'Transfer of the asset is a sale' may be given and below that the following fundamental rule may be added-

In the case of sale of the asset-

The seller-Lessee-

- Derecognise underlying asset

– Recognise right-of-use asset (proportion of previous carrying amount)

– Recognise lease liability

– Gain/loss on sale of rights transferred

The Buyer-lessor-

- Recognise purchase of asset

– Apply lessor accounting

Where there is no sale of asset-

The Seller Lessee-

– Continue to recognise asset

– Recognise financial liability as per applicable Ind AS

Buyer-lessor-

– Do not recognise asset

– Recognise financial asset as per applicable Ind AS

Comments in General:

1. The definition of “lease payments’ in Appendix-A may be modified to include-

“The seller-lessee would apply the term ‘lease payments’ or ‘revised lease payments’ in such a manner that it does not recognise any amount of the gain or loss that relates to the right of use retained.”

2. There are two approaches in Appendix-D. The differences between the approaches can materially affect:

(a) The presentation in the balance sheet on the liability side (Approach 1) or both the asset and liability sides (Approach 2);

and

(b) The subsequent statements of income (both for line items and bottom line) over the lease term as regards in particular the amount of interest expense accrued, variable rent expense/ income and deferred gain or losses lines.

3. The seller-lessee shall initially measure right-of-use assets and lease liabilities at the present value of expected lease payments, which include variable lease payments that do not depend on an index or rate, discounted using the interest rate implicit in the lease (or the lessee's incremental borrowing rate) as specified in Ind As 116. However, the interest rate implicit in the lease, by definition, is not supposed to reflect variable lease payments that do not depend on an index or rate. As a result, the outcome of present value would be inappropriate, deviated from the original concept. Thus, SIRC of ICAI suggest that the ED should explicitly state that a risk factor related to variable lease payments that do not depend on an index or rate should be incorporated in the measurement requirement.

4. In order to improve the understandability of financial statements, additional disclosure is highly recommended for the breakdown of lease liabilities, showing amounts related to sale and leaseback transactions and those related to other leases. Moreover, the calculation basis should also be disclosed for lease liabilities, right-of-use assets and gain or loss on sale associated with sale and leaseback transactions as proposed in the ED, given that the amounts involve a lot of estimates and assumptions to be derived. Further, the disclosure requirements of presentation requirement when actual lease payments are lower than expected lease payments (when gain is recognised); and the cashflow classification as well as the liability reconciliation regarding the difference between actual lease payments and expected lease payments should be clearly stated in the finalised standard.

5. The ED's proposal to include variable lease payments linked to future performance or use of the underlying asset into the initial measurement of the lease liability and right-of-use asset. This appears to be inconsistent with the general principles of Ind AS 116 and also does not seem to meet the definition of a liability under Ind AS.