Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Sale and leaseback transactions

Accounting considerations under NZ IFRS 16 *Leases*

Staff Guidance

March 2023

Overview

Why have we issued this guidance?

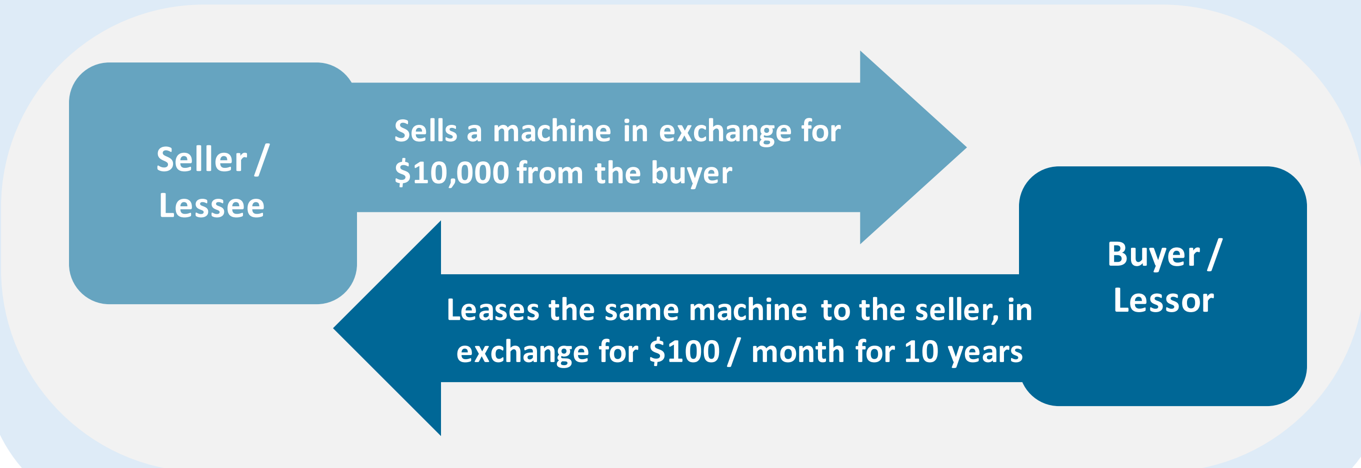
This guidance is for Tier 1 and Tier 2 for-profit entities who have sale and leaseback transactions; we have issued it for two reasons:

- Accounting for sale and leaseback transactions can be complex, and because they occur infrequently you may not have looked at the accounting requirements under NZ IFRS 16. The guidance highlights key accounting considerations to be aware of; and
- In November 2022 the XRB issued narrow-scope amendments to requirements for sale and leaseback transactions in NZ IFRS 16 clarifying how an entity accounts for a sale and leaseback after the date of the transaction. If your entity has entered into a sale and leaseback transaction since implementing NZ IFRS 16, you'll need to understand the recently issued changes to the subsequent accounting requirements which are effective from 1 January 2024. This is important because it requires **retrospective application.**

What is a sale and leaseback?

In a sale and leaseback transaction, an entity (the seller-lessee) sells an asset to another entity (the buyer-lessor) and leases the same asset back.

Example of a sale and leaseback transaction



Key accounting considerations for sale and leasebacks

The accounting depends on whether the transfer of the asset is a sale

Both the seller-lessee and the buyer-lessor are required to apply NZ IFRS 15 *Revenue from Contracts with Customers* to determine whether to account for a sale and leaseback transaction as a sale and purchase of an asset. Specifically, they will consider the requirements in NZ IFRS 15 on when an entity satisfies a performance obligation by transferring control of an asset.

If control of the underlying asset passes to the buyer-lessor, the transaction is accounted for as a sale / purchase of the asset and a lease (assuming lease accounting requirements are met). If not, both the seller-lessee and the buyer-lessor account for the transaction as a financing transaction.

Transfer of the asset is a sale

Seller-lessee

- Derecognises the underlying asset
- Recognises a lease liability and right-of-use asset
- Recognises the gain or loss that relates only to the rights transferred to the buyer-lessor (if any), adjusted for off-market terms

Buyer-lessor

- Accounts for the purchase of the asset in accordance with other standards based on the nature of the asset (e.g., NZ IAS 16 for property, plant and equipment).
- Adjusts the purchase price of the asset for off-market terms
- Account for the lease in accordance with NZ IFRS 16

Transfer of the asset is not a sale

Seller-lessee

- Retains the underlying asset subject to the sale and leaseback on its balance sheet
- Accounts for amounts received as a financial liability in accordance with NZ IFRS 9 *Financial Instruments*
- Decreases the financial liability by the payments made less the portion considered to be interest expense

Buyer-lessor

- Does not recognise the transferred asset
- Accounts for the amounts paid as a receivable in accordance with NZ IFRS 9

Adjustment for off-market terms

Adjustments are required if consideration for the sale is not at fair value and/or payments for the lease are not at market rates. These adjustments result in recognition by the seller-lessee of:

- a prepayment to reflect below-market terms
- additional financing provided by the buyer-lessor to the seller-lessee to reflect above-market terms.

Lease Liability in a Sale and Leaseback

Periods beginning on or after 1 Jan 2024 (early application permitted on a voluntary basis)

Background

In June 2020, the IFRS Interpretations Committee issued an agenda decision addressing how a seller-lessee should measure the right-of-use asset arising from a leaseback with variable payments, including how it should determine the gain or loss recognised at the date of the transaction.

While the agenda decision provided an approach for the initial measurement of the right-of-use asset and the lease liability arising from the leaseback, the Interpretations Committee noted that the standard did not address how the lease liability would be subsequently measured. The IASB has addressed that gap with these amendments.

This narrow-scope amendment to NZ IFRS 16 clarifies how an entity 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 rate **are most likely to be impacted.** This is because these payments are otherwise excluded from the measurement of a lease liability not related to a sale and leaseback transaction.

Why has it changed?

Without these new requirements, a seller-lessee could have recognised a gain on the right of use it retains solely because of a remeasurement (e.g., following a lease modification).

NZ IFRS 16 does not permit such gains to be recognised on initial measurement, and this amendment clarifies that such gains should also not be recognised in subsequent measurement of the lease.

What has changed?

When subsequently measuring the lease liability in a sale and leaseback transaction, the seller-lessee may not recognise any gain or loss relating to the right of use it retains.

The amendments do not prescribe a particular method of subsequent measurement. However, they include examples illustrating the initial and subsequent measurement of the lease liability including where there are variable payments that do not depend on an index or rate.

When does it apply?

The amendments are effective for annual reporting periods beginning on or after **1 January 2024**, but can be early adopted.

What are the transition requirements?

An entity applies the requirements **retrospectively** for sale and leaseback transactions that were entered into after the date when the entity initially applied NZ IFRS 16.

Further reading

This publication is not a substitute for reading NZ IFRS 16 *Leases* or *Lease Liability in a Sale and Leaseback*, or the relevant guidance in NZ IFRS 15 *Revenue from Contracts with Customers*.

Relevant IFRS Interpretations Committee agenda decision:

- *Sale and Leaseback with Variable Payments (IFRS 16 Leases)—June 2020*

Contact us

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