INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

Our Ref: STA/001

09 May 2020

International Financial Reporting Standards Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Members of the IFRS Interpretations Committee,

TENTATIVE AGENDA DECISION AND COMMENT LETTERS: SALE AND LEASEBACK WITH VARIABLE PAYMENTS (IFRS 16)

The Institute of Certified Public Accountants of Uganda (ICPAU) appreciates the opportunity to comment on the above tentative agenda decision as published in the March 2020 IFRIC Update.

Enclosed in **Appendix 1** are our comments in detail. We hope that you find them helpful.

In case of any queries relating to this comment letter, please contact the undersigned at clutimba@icpau.co.ug

Yours faithfully,

CPA Charles Lutimba
MANAGER STANDARDS AND TECHNICAL SUPPORT
For: **SECRETARY/CEO**

Encl (ICPAU's Comments on Tentative Agenda Decision: Sale And Leaseback with Variable Payments (IFRS 16))

NNN/…….

Appendix 1

The IFRS Interpretations Committee (Committee) received a request about a sale and leaseback transaction with variable payments.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

<u>Our Comments</u>

Although paragraph 100 of IFRS 16 provides clear guidance on accounting for the transfer of an asset in a sale and leaseback transaction, the Institute of Certified Public Accountants of Uganda (ICPAU) does not consider these adequate in addressing the sale and leaseback transaction with variable payments described in the request. We believe that in addressing the inquiry, the Committee should consider paragraph 24 of IFRS 16 which states that "the cost of the right-of-use asset shall comprise (a) the amount of the initial measurement of the lease liability…"

Further, paragraph 27(b) provides that the lease payments included in the measurement of the lease liability comprise variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date for the right to use the underlying asset during the lease term that are not paid at the commencement date.

In paragraph 28, IFRS 16 gives examples of variable lease payments that depend on an index or a rate described in paragraph 27(b) to include, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. Because these do not include payments calculated as a percentage of the seller-lessee's revenue generated during the lease term, we doubt that this paragraph would be helpful to the transaction described in the request which does not seem to depend on an index or rate. Therefore, any attempt to apply the principle in paragraph 100 of IFRS 16, would make the Committee's proposal contradict the requirements of measuring the lease liability, which exclude variable lease payments that do not depend on an index or a rate, such as those linked to future performance or use of an underlying asset.

Further to this, the Basis for Conclusions accompanying IFRS 16 clearly describe why IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. We thus find it improper for the Committee to conclude that the seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. This does not only contradict with the provisions of the standard but equally lacks authoritative justification.

Additionally, based on paragraph 24 of IFRS 16, initial measurement of the lease liability cannot be as a consequence of how the right-of-use asset is measured because this would contradict the order. The paragraph suggests that a seller-lesser should first measure the lease liability before right-of-use asset is measured, and not the other way round.

To settle any contradictions in the Standard, paragraph 100 needs to be read in light of paragraph 24 of IFRS 16, which determines the cost components of the right of use asset, including as among the components the amount of the initial measurement of the lease liability. Paragraph 27 does not include variable lease payments linked to future performance or use of an underlying asset as part of the amount of the initial measurement of the lease liability.

Therefore, as per paragraph 24, a right of use is a consequence of how a lease liability is measured. In the event that a lease liability cannot be measured, a right of use cannot equally arise; and there would be no need to apportion the gain on sale between right retained and right transferred as guided under paragraph 100 (Paragraph 100 seems to provide guidance on how to apportion the gain on sale between the right transferred and the right retained only where there is a right of use asset).

With the above foregoing, the Committee may request the Board to consider re-introducing an approach similar to the one in paragraph 59 of IAS 17 to defer, and amortize over the lease term, a proportion of the gain related to the proportion of the remaining asset's useful life retained by the seller-lessee in case that lease payments are only in form of variable lease payments linked to future performance or use of an underlying asset.

In conclusion, ICPAU considers this matter may require narrow-scope amendment of IFRS 16 as there are some areas that need clarity such as;

(a) Initial measurement of expected lease liabilities in a sale and lease back transaction where the variable lease payments are linked to future performance or use of an underlying asset;
(b) Subsequent measurement of a lease liability arising in a sale and leaseback transaction; and
(c) Re-assessment of variable lease liabilities in a sale and lease back transaction.