UK Endorsement Board

Endorsement Criteria Assessment of *Lease Liability in a Sale and Leaseback*—Amendments to IFRS 16

April 2023

Contents

Introduction		4
1.	Section 1: UK statutory requirements for adoption	7
2.	Section 2: Description and assessment of the Amendments	11

Introduction

Purpose

1. The purpose of this Endorsement Criteria Assessment (ECA) is to determine whether *Lease Liability in a Sale and Leaseback*—Amendments to IFRS 16 (the Amendments), issued by the International Accounting Standards Board (IASB) in September 2022, meet the UK's statutory requirements for adoption. The Amendments have an effective date of 1 January 2024 with earlier application permitted.

2. The IASB's proposals were set out in Exposure Draft ED/2020/4 *Lease Liability in a Sale and Leaseback* (the ED). The UKEB Secretariat submitted its Final Comment Letter (FCL) on the ED to the IASB on 26 March 2021[1] before the Board's statutory functions had been delegated by the Secretary of State[2]. The Board was therefore not involved in the development of the FCL. However, the IASB considered the comments in the UKEB Secretariat FCL, and those made by UK respondents directly to the IASB, during its discussion of the stakeholder feedback on the ED.

Background to the Amendments

3. The Amendments add subsequent measurement requirements for sale and leaseback transactions[3] to improve the requirements for such transactions in IFRS 16 *Leases* as part of the IASB's continuous effort to maintain and improve international accounting standards and to support their consistent application.

4. The Amendments, which are narrow in scope, were issued and exposed for public comment as the IASB considered they merited consultation and outreach.

5. Section 2 in this ECA provides a brief description of the Amendments.

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1 Final Comment Letter - Lease Liability in a Sale and Leaseback (Proposed amendment to IFRS 16).pdf (kc-usercontent.com)

2 The Statutory Functions were delegated by the Secretary of State to the UKEB on 22 May 2021.

3 All references to sale and leaseback transactions in this ECA are only to those in which the transfer satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale.

Exclusions from the adoption assessment

6. The Amendments include a new example (Example 25 of IFRS 16) illustrating the application of the requirements in paragraph 102A and in paragraphs 29–46 of IFRS 16 to a sale and leaseback transaction with variable lease payments that do not depend on an index or rate. The Amendments also amend existing Illustrative Example 24 of IFRS 16.

7. These amendments to the IFRS 16 Illustrative Examples have not been included as part of the UKEB's assessment as UK-adopted international accounting standards comprise only the mandatory[4] sections of standards. However, we have reviewed Illustrative Examples 24 and 25 and have not identified any inconsistencies with the Amendments.

Structure of the assessment

8. We have presented our analysis in the following sections:

   a) **Section 1** describes UK statutory requirements for adoption of new or amended international accounting standards; and

   b) **Section 2** discusses how the Amendments meet the criteria in Section 1.

Do the Amendments lead to a significant change in accounting practice?

9. A standard adopted by the UKEB under Regulation 6 of The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 No. 685 (SI 2019/685) that it considers is likely to lead to a 'significant change in accounting practice', is subject to the requirements in paragraph 3 of Regulation 11 of SI 2019/685 that the UKEB:

   a) "carry out a review of the impact of the adoption of the standard; and

   b) publish a report setting out the conclusions of the review no later than 5 years after the date on which the standard takes effect (being the first day of the first financial year in respect of which it must be used)".

[4] Mandatory pronouncements are IFRS Standards, IAS Standards, Interpretations and mandatory application guidance. Non-mandatory guidance includes bases for conclusions, dissenting opinions, implementation guidance and illustrative examples, together with the IFRS practice statements. This categorisation is set out in the Introduction to the IASB yearly Bound Volumes.

10. **Section 2** of this ECA discusses whether the Amendments lead to a significant change in accounting practice and concludes that they do not.

1. Section 1: UK statutory requirements for adoption

UK statutory requirements

1.1 Paragraph 1 of Regulation 7 of SI 2019/685 requires that an international accounting standard only be adopted if:

a) "the standard[5] is not contrary to either of the following principles—

i. an undertaking's accounts must give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss;

ii. consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the accounts taken as a whole, so far as concerns members of the undertaking;

b) the use of the standard is likely to be conducive to the long term public good in the United Kingdom; and

c) the standard meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management."

1.2 The ECA assesses the criteria above in the following order:

a) Whether the Amendments meet the criteria of relevance, reliability, understandability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management (Regulation 7(1)(c)).

b) Whether the Amendments are not contrary to the principle that an entity's accounts must give a true and fair view (Regulation 7(1)(a)).

5 The term "standard" includes standards (International Accounting Standards (IAS), International Financial Reporting Standards (IFRS)), amendments to those standards and related Interpretations (SIC-IFRIC interpretations) issued or adopted by the International Accounting Standards Board (IASB). This ECA relates to amendments to those standards.

c) Whether use of the Amendments is likely to be conducive to the long term public good in the UK (Regulation 7(1)(b)). Regulation 7(2) of SI 2019/685 includes specific areas to consider for this assessment. They are:

   i. whether the Amendments are likely to improve the quality of financial reporting;

   ii. the costs and benefits that are likely to result from use of the Amendments; and

   iii. whether the Amendments are likely to have an adverse effect on the economy of the UK, including on economic growth.

Relevance, Reliability, Understandability and Comparability [6]

1.3 Information is **relevant** if it is capable of making a difference in the decision-making of users or in their assessment of the stewardship of management. The information may aid predictions of the future, confirm or change evaluations of the past, or both.

1.4 Financial information is **reliable** if, within the bounds of materiality, it:

a) can be depended on by users to represent faithfully what it either purports to represent or could reasonably be expected to represent;

b) is complete; and

c) is free from material error and bias.

1.5 Financial information should be readily **understandable** by users with a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information with reasonable diligence.

1.6 Information is **comparable** if it enables users to identify and understand similarities in, and differences among, items. Information about an entity should be comparable with similar information about other entities and with similar information about the same entity for another period.

1.7 In conducting our overall assessment against the technical accounting criteria we are required to adopt an absolute, rather than a relative, approach. This means that this assessment is an absolute one against the criteria (do the Amendments provide information that is understandable, relevant, reliable and comparable?) rather than a relative one (do the Amendments provide information that is more understandable, relevant, reliable and comparable than current, or any other, accounting?). When an assessment of any individual aspect or requirement of the

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6 These descriptions are based on the qualitative characteristics of financial statements in the *Framework for the Preparation and Presentation of Financial Statements* adopted by the IASB in April 2001. These qualitative characteristics became part of the criteria for endorsement and adoption of IFRS in the EU's IAS Regulation (1606/2002), and, subsequently, in SI 2019/685.

Amendments uses comparative language (e.g. ‘enhances comparability’), this does not mean that our objective is to reflect a real comparison in relative terms. Instead, our objective is to explain that any individual aspect or requirement of the Amendments has the potential to “enhance” one or more of the qualitative characteristics. The overall assessment of the Amendments against the technical accounting criteria is an absolute one. Consideration of whether the Amendments are likely to improve the quality of financial reporting is separate from this assessment and is included within the UK long term public good assessment in Section 2.

True and fair view assessment

1.8 As noted above, the first adoption criterion set out in Regulation 7(1) of SI 2019/685 requires that an international accounting standard can be adopted only if:

> “the standard is not contrary to either of the following principles—
>
> i. an undertaking’s accounts must give a true and fair view of the undertaking’s assets, liabilities, financial position and profit or loss;
>
> ii. consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the accounts taken as a whole, so far as concerns members of the undertaking; [….]”

1.9 For the sake of brevity, we refer to our assessment against this endorsement criterion as ‘the true and fair view assessment’ and to the principles set out in Regulation 7(1)(a) as the ‘true and fair principle’. However, these abbreviated expressions do not imply that our assessment has considered anything other than the full terms of the endorsement criterion set out above.

1.10 The duty of the UKEB under Regulation 7(1)(a) is to determine generically, before a standard is applied to a set of accounts, whether that standard is ‘not contrary’ to the true and fair principle. In other words, it is an ex-ante assessment. We have therefore considered whether the Amendments contain any requirement that would prevent accounts prepared using the Amendments from giving a true and fair view.

1.11 Our approach is to determine whether the Amendments are not contrary to the true and fair principle in respect of any of the specific items identified in Regulation 7(1)(a) (namely, the assets, liabilities, financial position and profit or loss) in the context of the preparation of the accounts as a whole. A holistic approach has been taken to this assessment, considering the impact of the Amendments taken as a whole, including their interaction with other UK-adopted international accounting standards.

1.12 For the purposes of our assessment, we consider the requirement in IAS 1 for financial statements to ‘present fairly the financial position, financial performance and cash flows of an entity’[7] to be equivalent to the Companies Act 2006 requirement for accounts to give a true and fair view.

1.13 Our assessment is separate from the duty of directors under section 393(1) of the Companies Act 2006, which requires directors to be satisfied that a specific set of accounts gives a true and fair view of an undertaking’s or group’s assets, liabilities, financial position and profit or loss.

Adoption decision

1.14 **Section 2** of this ECA discusses how the Amendments meet the statutory endorsement criteria set out in this **Section 1**.

1.15 On the basis of these assessments, the UKEB concludes that the Amendments meet the statutory endorsement criteria. The UKEB is therefore of the view that it will adopt the Amendments for use in the UK.

7 Paragraph 15 of IAS 1 *Presentation of Financial Statements*.

2. Section 2: Description and assessment of the Amendments

Title and issue date of the final Amendments	*Lease Liability in a Sale and Leaseback*— Amendments to IFRS 16 issued on 22 September 2022.
Origin	The IFRS Interpretations Committee (the Committee) was asked to consider the application of paragraph 100(a) of IFRS 16 to a sale and leaseback transaction that includes variable lease payments that in turn do not depend on an index or rate. The request asked how the seller-lessee should measure the right-of-use asset arising from the leaseback and, thus, determine any gain or loss to be recognised at the date of the transaction. The Committee concluded that IFRS 16 provides an adequate basis for determining the accounting for the sale and leaseback at the date of the transaction. However, it observed that IFRS 16 does not include specific requirements for the subsequent measurement of sale and leaseback transactions. Therefore, the Committee referred this issue to the IASB and the Amendments are the outcome of the IASB's standard-setting project to fill the gap in IFRS 16.
What has changed?	The Amendments add new paragraph 102A to IFRS 16 to require the seller-lessee to apply paragraphs 29–35 to subsequently measure 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 paragraph 102A 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). There were no consequential amendments to any other international accounting standards.
Transition requirements	The Amendments are effective for annual periods beginning on or after 1 January 2024, with earlier application permitted. If a seller-lessee applies the Amendments for an earlier period, it shall disclose that fact.

	The Amendments should be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to sale and leaseback transactions entered into after the date of initial application. The date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 16.
Technical criteria assessment	
Relevance and reliability	The Committee concluded that a seller-lessee recognises a liability at the date of the sale and leaseback transaction, even if all the payments for the lease are variable and do not depend on an index or rate (i.e. are linked to future performance or use of an underlying asset). The initial measurement of the liability is a consequence of how the right-of-use asset, and the gain or loss on the transaction, are measured. However, lease payments as defined in Appendix A of IFRS 16 exclude variable lease payments that do not depend on an index or rate. Prior to the Amendments, IFRS 16 did not include specific requirements for the subsequent measurement of sale and leaseback transactions. In the case of sale and leaseback transactions involving variable lease payments that do not depend on an index or rate, there is therefore a risk that the subsequent measurement of the lease liability could exclude such variable payments, giving rise to an inconsistency with the initial measurement. In particular, if there is a modification in the contract or a change in lease term, the necessary remeasurement could result in the seller-lessee recognising a gain or loss on the right-of-use asset it retained. The Amendments address this risk by requiring a seller-lessee to subsequently measure lease liabilities arising from a leaseback in a way that it does not recognise any amount of the gain or loss that relates to the right-of-use it retains. This treatment appropriately reflects the economics of a sale and leaseback transaction because the seller-lessee has transferred only its interest in the asset at the end of the leaseback and has retained the right to use the asset for the period of the lease. Preventing the recognition of remeasurement gains in the absence of any transaction will result in relevant and reliable information. The Amendments do not prescribe how, at the commencement date, a seller-lessee determines the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains (and therefore the initial measurement of the resulting lease liability). This allows a seller-lessee to determine the most appropriate approach for each sale and leaseback transaction, based on the specific facts and circumstances (for example, the level of uncertainty regarding the amount of leaseback payments to be made). In addition, an entity is required

	to disclose its material accounting policies[8].This approach is likely to lead to accounting treatments that appropriately reflect the economics of the transaction and hence provide relevant and reliable information[9]. A seller-lessee is required to apply the Amendments retrospectively in accordance with IAS 8 to sale and leaseback transactions entered into after the date of initial application of IFRS 16, resulting in relevant and reliable information also for the comparative period.
Understandability	The Amendments will result in accounting that fairly reflects the economic substance of sale and leaseback transactions with variable lease payments by preventing the recognition of remeasurement gains in the absence of any transaction. Consequently, it will provide useful information to users of accounts about transactions covered by the Amendments, increasing the understandability of the accounts. The Amendments will also ensure the subsequent measurement of the lease liability is consistent with its initial measurement as well as with the subsequent measurement of lease liabilities unrelated to a sale and leaseback transaction, thereby enhancing understandability of the accounts.
Comparability	The Amendments fill a gap in IFRS 16 and therefore have the potential to reduce any diversity of practice, and prevent such diversity arising in future, promoting consistency and comparability of accounts. The Amendments do not prescribe a method for determining the proportion of the previous carrying amount of the asset that relates to the right of use the seller-lessee retains. Prescribing a single method could bring further comparability to the measurement of the right-of-use asset and leaseback liability. However, this could increase comparability at the cost of impairing relevance and reliability—by not prescribing a method, entities will be able to apply a method based on their specific facts and circumstances which better reflects the economics and thus results in more relevant information. Further, this situation (the lack of a prescribed method) already exists under IFRS 16. Retrospective application of the Amendments, as required by the transitional requirements, will enhance comparability.

8 See IAS 1 paragraph 122.

9 The requirements of IAS 8 paragraph 10 require a seller-lessee to develop and apply an accounting policy that results in information that is relevant and reliable.

Conclusion	Overall, we conclude that the Amendments meet the criteria of relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management, as required by SI 2019/685.
True and fair view assessment	
Description	The previous section of this ECA concludes that the Amendments meet the technical accounting criteria, including that of reliability. Reliability includes the notion of faithful representation of the economic substance of transactions and events. The technical accounting criteria assessment therefore underpins the overall true and fair view assessment. The Amendments do not change the requirements for leases unrelated to a sale and leaseback transaction. Additionally, the Amendments do not change the initial measurement of the right-of-use asset and the leaseback liability in IFRS 16. They merely extend and adapt the existing subsequent measurement requirements in IFRS 16 for all leases to sale and leaseback transactions. Consequently, the Amendments are narrow in scope and do not introduce new principles.
Conclusion	Our assessment has not identified any requirement of the Amendments, either alone or in conjunction with international accounting standards adopted for use in the UK, that would prevent individual or group accounts prepared using the Amendments from giving a true and fair view of the undertaking's or group's assets, liabilities, financial position and profit or loss. We are satisfied, therefore, that the circumstances in which the application of the Amendments would result in accounts which did not give a true and fair view would be extremely rare. Overall, we conclude that the Amendments are not contrary to the true and fair view principle set out in Regulation 7(1) of SI 2019/685.
UK long term public good	
Description of entities that will be impacted	The Amendments will, in principle, affect all companies that apply UK-adopted international accounting standards. There are currently approximately 1,500 entities with equity listed in the London Stock Exchange (Main Market and AIM) that prepare their accounts in accordance with UK-adopted international accounting standards[10]. In addition, UK law allows unlisted companies the

[10] Estimate based on LSEG and Reuters-Eikon data.

	option to use UK-adopted international accounting standards and approximately 14,000 companies currently take up this option[11]. However, based on feedback from stakeholders[12], the type of transaction covered by the Amendments, i.e. sale and leaseback transactions that include variable leaseback payments that do not depend on an index or rate, is rare in the UK.[13]
Do the Amendments improve financial reporting?	The Amendments will improve the quality of financial reporting because: • They prevent a seller-lessee from recognising a gain on the right of use it retains solely because of a subsequent remeasurement and thereby avoid distortions in the income statement. • They will reduce potential diversity in practice by specifying requirements in respect of an issue not currently addressed by IFRS 16, i.e. subsequent measurement of the right-of-use asset and lease liabilities in sale and leaseback transactions.
Costs for preparers and users	When considering the cost for preparers we took into consideration feedback which indicated that sale and leaseback transactions affected by the Amendments (those entered into since the implementation of IFRS 16 that include variable leaseback payments that do not depend on an index or rate) are rare in the UK. However, the possibility exists that such transactions occur in UK groups and may occur in the future, and when they occur such transactions may be material and the leaseback terms could be long. Preparers: Given that the Amendments are narrow in scope, we estimated preparers' adoption costs by conducting a qualitative assessment of the costs likely to be borne by preparers. We assessed whether preparers would face costs related to: • familiarisation; • design of data collection processes; • IT system changes; • governance processes; • external audit; and

11 Estimate based on FAME, Companies Watch and proprietary data.

12 Including feedback from the UKEB's Accounting Firms & Institutes Advisory Group (AFIAG).

13 It is possible that UK entities might have overseas operations that enter into such transactions. However, the IASB performed a search in June 2021 to obtain further evidence about the volume of material sale and leaseback transactions with variable payments. Their search identified one seller-lessee that disclosed two sale and leaseback transactions for which the leaseback payments are based entirely on a percentage of its revenue generated using the underlying asset.

	• other costs. We note the Amendments do not require the seller-lessee to estimate expected lease payments[14] which could be a costly exercise. Instead, the seller-lessee could use an alternative method that is more straightforward when developing its accounting policy for determining 'lease payments' as required by paragraph 102A of the Amendments. We believe that preparers, if they enter into transactions covered by the Amendments, will face some **one-off familiarisation costs** related to the implementation of the Amendments. We expect these costs to be minimal because of the low frequency of such transactions. It is not expected that entities will incur significant additional costs related to the **design of data collection processes** or related to **IT system changes.** Given that transactions covered by the Amendments are likely to be one-off transactions, it is likely that key elements of the accounting information required by the Amendments will be manually derived. Other information is likely to be generated as part of the system already implemented when applying IFRS 16. The cost of applying the Amendments will be further limited as the Amendments are not required to be applied to sale and leaseback transactions entered into before the beginning of the annual reporting period in which the entity first applied IFRS 16 (1 January 2019 for most seller-lessees). We expect other costs (i.e. **governance processes, external audit costs and other**) to be minimal or nil, in particular since relevant transactions are expected to be rare in UK groups. Based on our assessment, we expect preparers' implementation costs to be nil or minimal (if they enter into transactions covered by the Amendments). <u>Users</u>: We do not expect implementation costs for users because the transactions covered by the Amendments are rare.
Benefits for preparers and users	<u>Preparers:</u> because the transactions covered by the Amendments are rare in the UK, we expect the benefits for preparers to be minimal. However, when the transactions covered by the Amendments occur, they may be material and with a long duration. Therefore, the Amendments could provide an overall benefit to preparers who enter into such transactions by providing clarity on the accounting requirements.

14 See paragraph BC294A of the Basis for Conclusions to the Amendments.

	Users: similarly, because the transactions covered by the Amendments are rare in the UK, we expect the benefits for users to be minimal. However, as a general consideration users will benefit from greater comparability of financial reporting amongst different entities as the Amendments fill a gap in IFRS 16 and therefore have the potential to reduce any diversity of practice. By preventing the recognition of remeasurement gains in the absence of any transaction, the Amendments benefit users in terms of providing them relevant and reliable information.
Whether the Amendments are likely to have an adverse effect on UK economy	The Amendments are limited in scope and will generally bring improved financial reporting as they fill a gap in current requirements for sale and leaseback transactions. The Amendments are likely to be conducive to the UK long term public good in that improved financial reporting better reflects the economics of transactions, thereby improving transparency. We have not identified any factors that would indicate that the Amendments would lead to changes that are detrimental to the UK economy. In addition, we do not expect the accounting under the Amendments to negatively affect economic behaviour in relation to sale and leaseback transactions with variable payments not linked to an index or rate. As a result, the Amendments are not likely to have an adverse effect on the UK economy, including on economic growth.
Conclusion	Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, the UKEB concludes that they are likely to be conducive to the long term public good in the UK as required by SI 2019/685.

Do the Amendments lead to a significant change in accounting practice?

2.1 As explained in paragraph 9 in the Introduction to this ECA, the UKEB is required to assess whether or not the Amendments are likely to lead to a 'significant change in accounting practice' and therefore meet the criteria for a post–implementation review.

2.2 The Amendments do not change the initial measurement of the right-of-use asset or the leaseback liability in IFRS 16. Instead, the Amendments merely adapt existing subsequent measurement principles in IFRS 16 for all leases to sale and leaseback transactions.

2.3 Whilst the above change will in principle be applicable to all companies that use UK-adopted international accounting standards to produce their accounts, based on the above analysis the number of entities that will be impacted is expected to be negligible. As a result, the UKEB concludes that the Amendments are not likely to lead to a significant change in accounting practice and do not meet the criteria for a post-implementation review under Regulation 11 in SI 2019/685.

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