April 27, 2020

IFRS Foundation
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Canary Wharf
London E14 4HD
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Dear Colleagues,

The Saudi Organization for Certified Public Accountants (SOCPA) appreciates the efforts of the IFRS Interpretations Committee (Committee) and welcomes the opportunity to comment on the *Tentative Agenda Decision—Sale and Leaseback with Variable Payments (IFRS 16).*

We appreciate the extensive work of the staff on this topic and the detailed examples they have provided. However, it seems that in the attempt to apply the principle in paragraph 100 of IFRS 16, the proposal contradicts 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. The Basis for Conclusions accompanying IFRS 16 clearly describes why IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities. Consequently, any method to calculate the lease liability, directly or indirectly, at initial recognition in any situation using variable lease payments linked to future performance or use of an underlying asset is, in itself, a contradiction of the requirements of the Standard. Therefore, the proposal's conclusion 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*" does not have authoritative support. Also, the proposal's conclusion that "*The initial measurement of the lease liability is a consequence of how the right-of-use asset is measured—and the gain or loss on the sale and leaseback transaction determined*" contradicts paragraphs 26-28 without justification. Moreover, it contradicts the definition of liability itself. In fact, and according to paragraph 24, the right of use asset is the one that is a consequence of how lease liability is measured.

To eliminate any contradiction in the Standard, we need to read paragraph 100 in light of paragraph 24 of IFRS 16, which determines the cost components of the right of use asset, one of which is the amount of the initial measurement of the lease liability. Variable lease payments linked to future performance or use of an underlying asset are not part of the amount of the initial measurement of the lease liability. If there is no right of use asset recognised according to paragraph 24, there is no need to apportion the gain on sale between right retained and right transferred. Considering this, we see paragraph 100 as a 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 as measured by paragraph 24. When there is a right of use asset (as measured by paragraph 24), it shall be reduced by the amount of unrecognised gain that relates to the right retained by the seller-lessee. This is supported by paragraph BC266 of the basis for conclusions accompanying IFRS 16, which tells us that paragraph 100 is mainly about recognition of the gain. The right of use asset in a sale and lease back transaction is effectively measured by reducing the right of use asset, as measured according to paragraph 24, by the amount of unrecognised gain. **Otherwise, there is a contradiction in the Standard that needs to be resolved.**

In light of the above, when the lease payments are only in form of variable lease payments linked to future performance or use of an underlying asset, there is no right of use asset to be recognised in the first place. Thus, the first requirement of paragraph 100 of IFRS 16 is not applicable without causing contradiction with other requirements in the Standard. However, to attain the main goal of paragraph 100 of IFRS 16 (i.e., the recognition of gain on sale) in case there is no right of use asset, the Committee may deliberate whether to issue an interpretation or to recommend to the Board (a standard setting activity) to develop an approach similar (in nature) to the one included in IAS 17 to defer, and amortize over the contract 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.

Another problem in paragraph 100 is the limit on recognition of loss on sale. This is a contradiction to the general principle throughout IFRSs, where loss is usually recognised immediately.

Therefore, we see this subject as an opportunity to recommend revisiting paragraph 100 to fulfil the objective of the Board stated in paragraph BC 266 of the basis for conclusions of IFRS 16 and to resolve the issue of not recognising loss in full. We suggest amending that paragraph to read:

100 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:

(a) the seller-lessee shall:

- **i. determine the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee and that relates to the right of use transferred to the buyer-lessor. This can be done, for example by comparing the remaining useful life of the underlying assets to the lease term;**
- **ii. recognise in profit or loss only the amount of any gain that relates to the rights transferred to the buyer-lessor;**
- **iii. reduce the right of use asset (as measured according to paragraph 24), if any, by the amount of any gain that relates to the right of use retained by the seller-lessee;**
- **iv. In case there is no right of use asset (as measured according to paragraph 24, for example, where all lease payments are variable lease payments linked to future performance or use of an underlying asset), defer and amortize over the lease term in a systematic basis any gain that relates to the right of use retained by the seller-lessee; and**
- **v. recognise in full any loss resulted from the sale transaction.**

(b) the buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.

We notice the Staff paper (Agenda ref 12A, April 2020), which suggests a limited amendment to IFRS 16 to tackle the problem of subsequent measurement of lease liability that initially measured at the expected amount of lease payment linked to performance or use of the underlying assets. We believe our suggestion to amend paragraph 100 is more in line with the principles of IFRS 16, and the framework in general, simpler and less costly than the approach suggested by the staff in the aforementioned staff paper.

Applying the suggested modification to paragraph 100, and using the example in the draft decision, at the date of the transaction, seller-lessee may account for the transaction as follows (which would comply with paragraph 100 of IFRS 16 in respect of recognising gain in proportion to the useful life transferred assuming that the lease term is for the 25% of the remaining useful life of the asset, while in the same time comply with the Standard in respect of not to include variable lease payments in the lease liability):

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*Nill*	
Cr. PPE		*CU1,000,000*
Cr. Deferred gain on sale of PPE (to be amortized over the life of the lease contract)		*CU200,000*
Cr. Gain on sale of PPE		*CU600,000*

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,

Dr. Ahmad Almeghames
Secretary General