Accounting for Sale and Leaseback Transactions

Including the latest amendment

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Introduction

A sale and leaseback is a financial transaction where an entity sells an asset and then immediately turns around and leases the asset back from the buyer. In fact, it is a combination of transfer contract and the leaseback, because they are inseperable and happen at the same time.

The seller becomes the lessee, and the buyer becomes the lessor. The seller follows lessee accounting (ie, right-of-use asset and lease liability at the measurement date). The buyer follows lessor accounting depending on its accounting policy, ie, how it classifies the lease – a finance lease or an operating lease.

Purpose

Before the leaseback, the seller used to use the asset as the owner. After the leaseback, the seller continues to use the asset as a lessee. Therefore, a sale and leaseback is generally used for the purpose of raising capital. The sale of the asset brings in needed cash with the help of which the seller can fulfil its obligations or make new investments.

From seller's perspective, entering into the lease spreads the cost of using the asset over multiple periods through lease payments.

From buyer's perspective, it receives a steady stream of lease income from the seller for its investment in the asset.

Accounting for sale and leaseback transactions

If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying the following:

Assessing whether the transfer of the asset is a sale

An entity shall apply the requirements for determining when a performance obligation is satisfied in Ind AS 115 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the asset is a sale

If the transfer of an asset by the seller-lessee satisfies the requirements of Ind AS 115 to be accounted for as a sale of the asset:

(a) the seller-lessee shall measure the right-of-use asset from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right-of-use retained by the seller-lessee. This means, seller-lessee determines the proportion of the asset transferred to the buyer-lessor that relates to the right-of-use retained by comparing, at the commencement date, the right-of-use it retains via the leaseback to the rights comprising the entire asset.
Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

[The gain or loss recognised by a seller-lessee on a completed sale in a sale and leaseback transaction should reflect the amount that relates to the rights transferred to the buyer-lessor. The sale of the underlying asset is to be accounted for applying Ind AS 115 because, from a legal standpoint, the seller-lessee will often have sold the entire underlying asset to the buyer-seller. However, from an economic standpoint, the seller-lessee has sold only its interest in the value of the underlying asset at the end of the leaseback – it has retained its right to use the asset for the duration of the leaseback. The seller-lessee had already obtained that right to use the asset at the time that is purchased the asset – the right to use is an embedded part of the rights that the entity obtains when it purchases, eg, an item of property, plant and equipment. Accordingly, recognising the gain that relates to the rights transferred to the buyer-lessor appropriately reflects the economics of the 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.

If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

- any below-market terms shall be accounted for as a prepayment of lease payments; and
- any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

The entity shall measure any potential adjustment required by the above paragraph on the basis of the more readily determinable of:

(a) the difference between the fair value of the consideration for the sale and the fair value of the asset; and
(b) the difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Amendment

After the commencement date, 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 this requirement in this paragraph does not prevent the seller-lessee from recognising in profit and loss any gain or loss relating to the partial or full termination of a lease. **[Para 102 A]**

Application

A seller-lessee shall apply these amendments for annual reporting periods beginning on or after 1st April, 2024 retrospectively in accordance with Ind AS 8 to sale and leaseback transactions entered into after the date of initial application.

[The lease payments and the sale price in a sale and leaseback transaction are typically interdependent because they are negotiated as a package. For example, the sale price might be more than the fair value of the asset because the leaseback rentals are above a market rate; conversely, the sale price might be less than the fair value because the leaseback rentals are below a market rate. Accounting for the transaction using those amounts could result in the misstatement of gains or losses on disposal of the asset for the seller-lessee and the misstatement of the carrying amount of the asset for the buyer-lessor. Consequently, this Standard requires that if the sale consideration or leaseback rentals are not at market rates, any below-market terms should be accounted for as a prepayment of lease payments and any above-market terms should be

accounted for as additional financing provided by the buyer-lessor to the seller-lessee. Similarly, this Standard requires the seller-lessee to measure the right-of-use asset as a proportion of the asset retained as a result of the leaseback. Consequently, any off-market terms are effectively accounted for in measuring the gain or loss on sale.]

Transfer of the asset is not a sale

If the transfer of an asset by the seller-lessee does not satisfy the requirements of Ind AS 115 to be accounted for as a sale of the asset:

a) the seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying Ind AS 109.
b) the buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying Ind AS 109.

If the transfer of the asset does not meet the requirements for a transfer in Ind AS 115, then no sale is recognised by the seller-lessee and no purchase is recognised by the buyer-lessor. Instead, the seller-lessee and buyer-lessor will account for any amounts received or paid relating to the leaseback as a financial asset or financial liability applying Ind AS 109. This is because, such a transaction represents, in substance, a financing arrangement.

EXAMPLE 1

The seller-lessee shall measure the right-of-use asset (ROU asset) from the leaseback at the ***proportion*** of the previous carrying amount (CA) of the asset that relates to the *right-of-use retained* by the seller-lessee.

Since this standard does not prescribe a particular method for determining that procedure, a seller-lessee may determine the proportion of the asset transferred to buyer-lessor that relates to the right of use it retains as, eg, in this example 80% – based on the amount of lease liability as a proportion of fair value of the asset.

Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the *rights transferred* to the buyer-lessor.

Scenario 1

Entity A (seller-lessee) sells an item of property, plant and equipment (PPE) to Entity B (buyer-lessor) at its fair value of CU 11,250 (carrying amount CU 7,500). At the same time, Entity A enters into a contract with Entity B for the right-of-use of that asset for 5 years. The present value of the lease payments Is CU 9,000.

Journal

Entity A

	Dr	Cr
Cash	CU 11,250	
Right-of-use asset [Retained]	CU 6,000 (80%* of 7,500)	
Property, plant and equipment		CU 7,500
Lease liability		CU 9,000 (80%* of 11,250)
Gain on rights transferred (PL)		CU 750 [(11,250 – 9,000) – (7,500 – 6,000)]

* *If lease liability is 80% of the fair value of PPE, ROU asset is 80% of carrying amount of PPE.*

Entity B

Property, plant and equipment	CU 11,250	
Cash		CU 11,250

Scenario 2

The same facts as in Scenario 1 except the following –
Consideration at fair value of PPE: CU 8,000; Carrying amount of PPE: CU 10,000; Present value of lease payments: CU 6,000.

Journal

Entity A

Cash	CU 8,000	
Right-of-use asset [Retained]	CU 7,500 (75% of 10,000)	
Loss on rights transferred (PL)	CU 500 [(10,000 – 7,500) – (8,000 – 6,000)]	
Property, plant and equipment		CU 10,000
Lease liability		CU 6,000 (75% of 8,000)

Entity B

Property, plant and equipment	CU 8,000	
Cash		CU 8,000

EXAMPLE 2

If the fair value of the consideration for the sale of asset does not equal the fair value of the asset, the entity shall measure the difference between the fair value of the consideration for the sale and fair value of the asset.

- Any above-market terms is accounted for as financing.
- Any below-market terms shall be accounted for as a prepayment of lease payments.

Scenario 1

Entity A (seller-lessee) sells a building to Entity B (buyer-lessor) for cash of CU 16,500. Immediately before the transaction, the carrying amount of the building is CU 10,000. At the same time, Entity A enters into a contract with Entity B for the right to use the building for 15 years, with annual payments of CU 1,200 payable at the end of each year. The interest rate implicit in the lease results in a present value of the annual payments of CU 13,500. The transfer of the building to Entity B has been assessed as meeting the requirements under Ind AS 115.

At the date of sale, the fair value of the building is CU 15,000. Since the consideration (CU 16,500) exceeds the fair value (CU 15,000) of the building the agreement contains a financing transaction, ie, an additional financing [CU 1,500 (CU 16,500 – CU 15,000)] provided by Entity B to Entity A. The lease liability is, therefore, CU 12,000 (CU 13,500 – CU 1,500). Entity B classifies the lease of the building as an operating lease.

Entity A

If the transfer of an asset by the seller-lessee satisfies the requirements of Ind AS 115 to be accounted for as a sale of the asset, the seller-lessee shall measure the right-of-use asset from the leaseback at the ***proportion*** of the previous carrying amount of the asset that relates to the right-of-use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

Since this standard does not prescribe a particular method for determining that procedure, a seller-lessee may determine the proportion of the asset transferred to buyer-lessor that relates to the right of use it retains as, eg, in this example 80% – based on the amount of lease liability as a proportion of fair value of the asset.

Entity A initially recognises a right-of-use asset as the proportion of the previous carrying amount (CU 10,000) that reflects the right to use retained. The proportion is calculated by dividing the present value of the lease payments by the fair value of the building (CU 15,000).

CU 12,000 ÷ CU 15,000 x CU 10,000 = CU 8,000.

The gain on rights transferred is calculated as under –

(Fair value – Carrying amount) – (Lease liability – Right-of-use asset)

(CU 15,000 – CU 10,000) – (CU 12,000 – CU 8,000) **= CU 1,000.**

Journal

Cash	CU 16,500	
Right-of-use asset [Retained]	CU 8,000	
Property, plant and equipment		CU 10,000
Lease liability		CU 12,000
Financial liability		CU 1,500
Gain on rights transferred (PL)		CU 1,000

Entity B

If the transfer of an asset by the seller-lessee satisfies the requirements of Ind AS 115 to be accounted for as a sale of the asset, 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.

Journal

Property, plant and equipment	CU 15,000	
Financial asset	CU 1,500*	
Cash		CU 16,500

* *The present value of the annual payments amounts to CU 13,500, of which CU 1,500 relates to additional financing (as already stated) and CU 12,000 relates to the lease corresponding to 15 annual payments of CU 133 (CU 1,500 ÷ CU 13,500 x CU 1,200) and CU 1,067 (CU 1,200 – CU 133). After the commencement date, Entity B accounts for the lease by treating CU 1,067 of the annual payments of CU 1,200 as lease payments. The remaining CU 133 of annual payments received from Entity A are accounted for as (i) payments received to settle the financial asset of CU 1,500 and (ii) interest revenue.*

Scenario 2

Entity A (seller-lessee) sells an item of property, plant and equipment to Entity B (buyer-lessor) at CU 12,000. The carrying amount and fair value of the asset are CU 10,000 and CU 15,000 respectively. The present value of lease payments is CU 10,500.

Journal

Entity A

Cash	CU 12,000	
Right-of-use asset [Retained]	CU 7,000 (70% of 10,000)	
Prepaid lease liability	CU 3,000 (15,000 – 12,000)	
Property, plant and equipment		CU 10,000
Lease liability		CU 10,500 (70% of 15,000)
Gain on rights transferred (PL)		CU 1,500 [(15,000 – 10,500) – (10,000 – 7,000)]

Entity B

Property, plant and equipment	CU 15,000	
Cash		CU 12,000
Prepaid lease receivable		CU 3,000

As per the amendment (stated earlier), after the commencement date, 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.

EXAMPLE 3

Entity A (seller-lessee) sells a building to Entity B (buyer-lessor) at its fair value of CU 15,000 (carrying amount CU 10,000). At the same time, Entity A enters into a contract with Entity B for the right to use the building for 5 years, with annual payments of CU 2,772 payable at the end of each year. Entity A's incremental borrowing rate is 5% p.a. Entity A expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates right-of-use asset on a straight-line basis.

Entity A

Entity A shall measure the right-of-use asset from the leaseback at the ***proportion*** of the previous carrying amount of the asset that relates to the right-of-use retained by it. Accordingly, Entity A shall recognise only the amount of any gain or loss that relates to the rights transferred to Entity B. Since this standard does not prescribe a particular method for determining that procedure, Entity A determines the proportion of the building transferred to Entity B that relates to the right-of-use it retains as 80% – based on the amount of lease liability as a proportion of fair value of the asset.

The present value of annual lease payments CU 2,772, discounted using the incremental borrowing rate of 5% is CU 12,000. This is the lease liability at the commencement date. In other words, seller-lessee determines *lease payments* to reflect equal periodic payments over the lease term that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability, at the commencement date, of CU 12,000.

Journal

Cash [FV of PPE]	CU 15,000	
Right-of-use asset [Retained]	CU 8,000 (80% of 10,000)	
Property, plant and equipment [CA]		CU 10,000
Lease liability		CU 12,000 (80% of 15,000)
Gain on rights transferred [PL]		CU 1,000 [(15,000 – 12,000) – (10,000 – 8,000)]

Gain on rights transferred:
[PPE(FV – CA)] x 20%] = [(CU 15,000 – CU 10,000) x 20%] = **CU 1,000**

No gain or loss on right-of-use asset retained:

- **Gain** = [PPE(FV – CA)] x 80% = [(CU 15,000 – CU 10,000) x 80%] = **CU 4,000**
- **Loss** = (Lease liability – ROU asset) = CU 12,000 – CU 8,000 = **CU 4,000**

Lease liability

Year	Opening Balance (CU)	Interest @ 5% p.a. (CU)	Lease payment (CU)	Closing Balance (CU)
1	12,000	600	(2,772)	9,828
2	9,828	491	(2,772)	7,547
3	7,547	377	(2,772)	5,152
4	5,152	258	(2,772)	2,638
5	2,638	134	(2,772)	–

The seller-lessee shall recognise in profit and loss the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if seller-lessee pays CU 3,000 for the use of the asset in Year 1, it recognises CU 228 (CU 3,000 – CU 2,772) in profit and loss as variable lease payments not included in the measurement of the lease liability.

Right-of-use asset

Year	Opening Balance (CU)	Depreciation (CU)	Closing Balance (CU)
1	12,000	(2,400)	9,600
2	9,600	(2,400)	7,200
3	7,200	(2,400)	4,800
4	4,800	(2,400)	2,400
5	2,400	(2,400)	–

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