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Hans Hoogervorst
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Mr Hoogervorst

ED/2021/2 Covid-19-Related Rent Concessions beyond 30 June 2021

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the IASB's') exposure draft Covid-19-Related Rent Concessions beyond 30 June 2021 ('the ED').

We support the extension of the availability of the practical expedient in IFRS 16:46A so that it applies to rent concessions that affect payments originally due on or before 30 June 2022 instead of 30 June 2021, for the reasons stated in the Basis of Conclusions on the ED. We also agree with the proposed effective date and transition provisions.

We would like to take this opportunity to bring to the attention of the Board the fact that we have become aware of diversity in views on recognition of operating lease income by a lessor when collectability of lease payments is not probable and other related issues. Determining the appropriate accounting becomes even more complex when these lease agreements, as they often do, contain non-lease components in the scope of IFRS 15. Whilst these issues are not specific to the economic uncertainties brought by the Covid-19 pandemic, the current situation has brought to light the diversity of views. More details are provided in appendix to this letter. We note that because IFRS 16 provides very limited guidance on the requirements applicable to a lessor in an operating lease, it does not appear that these issues could be addressed by the IFRS Interpretations Committee through an agenda decision. We suggest that the Board should consider what standard-setting activity should be undertaken to reconsider broadly the accounting requirements applicable by a lessor or to address the more specific issues raised in the appendix. This should not however delay the finalisation and issuance of the amendment to IFRS 16, which extends the availability of the practical expedient.

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If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix

Impact of collectability on recognition of income/revenue in IFRS 16 vs IFRS 15

IFRS 16.81 requires a lessor to recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. IFRS 16 is silent on whether a lessor recognises lease income from an operating lease only if it is probable that the income will be collected. In fact, the absence of a probability of collection threshold can be read as indicating that applying IFRS 16.81, a lessor must continue to recognise income from an operating lease on a straight-line basis or another systematic basis even when it is highly improbable that the lessor will collect the amounts due. Instead, having recognised lease income, the lessor would apply the impairment and derecognition requirements of IFRS 9 to the related operating lease receivable. In many (but not all) situations, the impact of applying the credit loss requirements in IFRS 9 to the recognised lease receivables may result in a net profit for the period that is the same as if income had not been recognised in the first place. Nevertheless, it is questionable whether this provides useful information particularly since it can be viewed as resulting in overstatement of "lease income" which may be a key metric.

In contrast, under IFRS 15 Revenue from Contracts with Customers, revenue is recognised when it is probable that the entity will collect the consideration to which it is entitled, and if there is indication of a significant change in facts and circumstances, for example the ability to pay deteriorates significantly, that criteria is reassessed before revenue is recognised.

Many lease contracts contain lease components, accounted for applying IFRS 16, and non-lease components accounted for applying IFRS 15. The potential difference in principles between the two standards adds to the complexity and potential diversity of application. It appears counterintuitive that a low probability of collection of the amounts due under a single operating lease contract would not affect recognition of lease income under IFRS 16 but would prevent recognition of revenue ancillary services under IFRS 15.

We note that the current requirements on lessor accounting in IFRS 16 have been carried forward with limited changes from IAS 17. However, until the recent amendments to the Conceptual Framework, the probability of future economic benefits was an underlying condition supporting recognition of income. In particular paragraph 4.38 of the previous Conceptual Framework indicated that "[a]n item that meets the definition of an element should be recognised if: a) it is probable that any future economic benefit associated with the item will flow to or from the entity". Hence while it may have previously been possible to refer to the recognition principle in the conceptual framework to limit recognition of income to circumstances in which it was probable that the lessor would collect the amount due, this does not seem possible under the current conceptual framework.

We also note that paragraph 2.4 of the Conceptual Framework defines useful information as information that "is relevant and faithfully represents what it purports to represent". Recognition of lease income on a straight-line basis (or another systematic basis) without any consideration of the probability of collection of the lease payments does not appear to provide useful information.

Other issues related to lessor accounting that are not clearly addressed in IFRS 16

We also take this opportunity bring to the attention of the Board other issues relating to lessor accounting that have highlighted because of the current economic situation.

- In some cases, lease payments are invoiced and due in advance. Many consider that this results in recognition of a lease receivable and deferred income. However, some note that unlike IFRS 15, IFRS 16 does not provide guidance on recognition of, and subsequent accounting for, deferred income (contract liability) nor does it specify when an amount initially recognised applying IFRS 16 becomes subject to another standard (e.g. IFRS 9). This leads to a lack of clarity in practice on whether deferred income should be recognised in the first place, and if so how it should be accounted for subsequently. For example, if it is assessed that it is no longer probable that the lessor will collect the consideration to which it would be entitled for the future use of the underlying asset in an operating lease, should the deferred income balance be derecognised against the lease receivable or should deferred income continue to be amortised as lease income on straight-line basis and the lease receivable impaired under IFRS 9. We note that the net impact on profit or loss in a given reporting period is likely to be different depending on the approach adopted.
- If a lessee is not paying the amount due (and recognised by the lessor as a lease receivable in an operating lease), this may be because the lessee expects the lessor to grant a relief as part of a modification of the lease contract. Some may consider that a credit loss allowance is not required because the non-payment does not reflect a credit loss but rather reflects an expectation of forgiveness as part of a lease modification. Others may consider that the reason for non-payment (credit loss or pending renegotiation) is not relevant in measuring expected credit loss. While this situation may not be specific to operating lease receivables and could also arise in respect of other financial assets, it is likely more prevalent with operating lease receivables. This is because in many jurisdictions the applicable laws (including those introduced in response to COVID-19) restrict the ability of a lessor to readily evict a defaulting lessee.
- If a lessor in an operating lease forgives past due lease payments (possibly without any modifications to the future lease payments or to any other terms of the contract), it is not clear whether the forgiveness should be accounted for as the modification of an operating lease under IFRS 16.87 (in effect reducing future lease income) or a loan forgiveness under IFRS 9 (with a loss recognised in profit or loss at the date of forgiveness).

While the diversity in practice on these issues has been highlighted by the economic uncertainties brought by Covid-19, the issues will continue to exist beyond the current situation.