

23 May 2022

Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Mr Mackenzie

Tentative agenda decision – Lessor Forgiveness of Lease Payments (IFRS 9 and IFRS 16)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March 2022 IFRIC Update of the tentative agenda decision (TAD) not to take onto the Committee's agenda the request for clarification about a lessor's application of IFRS 9 and IFRS 16 in accounting for a particular rent concession.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda. However, we have concerns that the analysis presented in the TAD may have unintended consequences in a number of areas and suggest that further analysis may be warranted before the TAD is finalised.

Application of the expected credit loss model

We agree that the definition of credit loss in IFRS 9 refers to "all cash shortfalls". Therefore, in the fact pattern presented in the TAD, it appears reasonable that the measurement of expected credit loss should reflect cash shortfalls that result from the expected forgiveness of lease payments recognised as part of the receivable. However, we believe it would be worth considering whether the forgiveness of a lease payment should always be viewed as a cash shortfall, including, for example, when the forgiveness is in fact granted as an incentive for an increase of the scope of a lease contract that the lessor would not obtain in the absence of the forgiveness of the lease payments that are owed (or other economically similar lease incentives). Whilst the TAD is meant to address the specific fact pattern submitted (in which the other terms of the lease contract are not changed), we are concerned that the statements made in the TAD, in particular in the third paragraph in the section addressing the application of the ECL model, leave little room for a different application of the ECL requirements to other fact patterns. We suggest that this topic may be addressed in a more comprehensive manner in the upcoming post-implementation review of the ECL requirements in IFRS 9.

Further, we note that the TAD contemplates that a derecognition loss may need to be recognised in profit or loss upon derecognition of the receivable, despite the fact that the expected forgiveness is reflected in the measurement of the ECL. We suggest that it would be useful if the agenda decision specified that the ECL should be remeasured at the derecognition date, consistent with the discussion of the Transition Resource Group for Impairment of Financial Instruments at its meeting in April 2015. We believe that this

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is important because, as we explain further below, in the case presented, we would expect that, after application of the ECL model, the net carrying amount of the lease receivable at the derecognition date would be nil and no derecognition loss would arise.

Interaction between the derecognition requirements and the recognition of revenue/income

The TAD indicates that “the lessor derecognises the operating lease receivable (and associated expected credit loss allowance) and recognises any difference as a loss in profit or loss”. It also indicates “lease payments ... recognised as an operating lease receivable ... are not accrued lease payments. Consequently, neither those lease payments nor their forgiveness are considered part of the lease payments for the new lease.”

If the lessee is released from its obligation to make the specifically identified contractually due lease payments and no other changes are made to the lease contract, we would expect that, after application of the ECL model, the net carrying amount of the lease receivable at the derecognition date would be nil and no derecognition loss would arise. Hence, in the fact pattern presented, it does not appear realistic that a derecognition loss may need to be recognised as suggested in the TAD.

In other fact patterns, if the net carrying amount of the lease receivable is other than nil immediately before the derecognition event but after measurement of the ECL, this may indicate that the lessor expects to receive some of the cash flows that are being forgiven, albeit at a later date. However, the above extracts from the TAD do not appear to require (or allow) a lessor to consider whether the forgiveness of the receivable is linked to the terms of the new lease. As a result, the analysis proposed in the TAD would yield significantly different accounting results based on the legal form and timing of the modification to the lease payments.

If the lease agreement is legally structured as modified such that lease payments recognised as a receivable are forgiven and future lease payments are increased by the same amount, applying the conclusion in the TAD, an impairment loss and/or a derecognition loss is recognised in profit or loss for the forgiven payments and lease income is recognised for the increased lease payments over the term of the new lease (in effect, double counting the lease income arising from the increased lease payments).

If instead the lease agreement is legally structured as modified to indicate that settlement of the receivable is postponed (but not forgiven), applying IFRS 9, an impairment loss is recognised to reflect the lost time value of money but the receivable may not be derecognised and, post modification, the lease income would not be affected by the change in timing of the lease payments (i.e., the double counting of lease income would not arise).

The importance of the legal form of the lease modification on future lease income is magnified by the fact that the negotiation of such lease modifications can extend over long periods. The longer the time required to negotiate the revised lease term, the greater the “double counting” of lease income.

We further note that trade receivables that result from transactions that are within the scope of IFRS 15 are also subject to the ECL and derecognition requirements in IFRS 9. Hence, we are concerned that the analysis in the TAD may have an effect on trade receivables and inadvertently lead to confusion on the application of IFRS 15, including the requirements in IFRS 15:21(a). Applying IFRS 15:21(a), the consideration promised in the original contract that has been recognised as revenue is excluded from the consideration allocated to future performance obligations. Hence, if a contract is modified such that specifically identified payments from the customer that have already been recognised as revenue are forgiven and replaced by higher payments in later periods, IFRS 15:21(a) would exclude from the future consideration receivable the payments already recognised as revenue. Instead, these amounts would be recognised as a contract asset or a trade receivable. In effect, the impact of the “derecognition” of the

forgiven trade receivable would not be recognised in profit or loss at the point of derecognition – rather, it would be factored into the measurement of future revenue.

It is common for lease arrangements to include a service component that is accounted for applying IFRS 15 by the lessor. Therefore, whilst the TAD addresses the forgiveness of operating lease payments, we believe that it is important to consider that the forgiveness of payments in a lease agreement may in fact relate to payments that are allocated to components accounted for in different IFRS Accounting Standards (either IFRS 15 or IFRS 16) and ensure that the conclusion reached on the application of IFRS 9 to the receivable previously recognised is compatible with both.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'V. Poole', with a stylized flourish at the end.

Veronica Poole
Global IFRS and Corporate Reporting Leader