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Mr Bruce Mackenzie
International Accounting Standards Board
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Our ref RD/288

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Dear Mr Mackenzie

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

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (Committee) tentative agenda decision: *Lessor Forgiveness of Lease Payments (IFRS 9 and IFRS 16)*. We have consulted with, and this letter represents the views of, the KPMG network.

The Committee discussed how a lessee and lessor should account for a specific form of rent concession. The Committee recommended that the Board undertake narrow-scope standard-setting on lessee accounting and issued a tentative agenda decision addressing lessor accounting. We disagree with aspects of the tentative agenda decision on lessor accounting and do not believe that the Committee should finalise it. We recommend instead that the Board addresses both lessee and lessor accounting for this form of rent concession. Our detailed comments on the tentative agenda decision are attached.

Please contact Reinhard Dotzlaw (rdotzlaw@kpmg.ca) or Kimber Bascom (kbascom@kpmg.com) if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix – Detailed comments on the tentative agenda decision

Applying the expected credit loss model in IFRS 9 to the operating lease receivable

The tentative agenda decision does not specify that the lessee is in financial difficulties. Indeed, in the Committee meeting, the staff specifically rejected calls from Committee members that the conclusion specify that the lessee is in financial difficulties. We believe that if a modification does not relate to the lessee's financial difficulties, then expected modifications should not be considered in the determination of the expected cash flows for the purposes of IFRS 9.

We do not believe that the analysis in the tentative agenda decision accurately reflects the definition of 'credit loss' in Appendix A of IFRS 9. That definition states that '*An entity shall estimate cash flows by considering all contractual terms of the financial instrument…*'. We do not think that the definition requires an entity to anticipate the future cash flows of modifications (in the absence of forbearance events) in the measurement of the expected credit loss, because contractual terms arising from a yet to occur modification are not part of the contractual terms of the instrument at the measurement date.

Lessor accounting for the rent concession

The agenda decision is inconsistent with the income recognition principle in IFRS 16

The effect of the tentative agenda decision is that the lessor does not adjust operating lease income if it modifies a lease contract to forgive specified lease payments that are included in an operating lease receivable at the date of the lease modification. We believe that this conclusion is inconsistent with the core requirement in IFRS 16.81 that 'a lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis'.

For example, if a lease agreement requires a lessee to pay a premium at lease commencement and the lessor subsequently forgives that premium before it is paid, the tentative agenda decision appears to require the lessor to continue to recognise the lease premium as income over the remaining lease term, even though it is no longer a lease payment under the contract.

The proposed accounting does not provide useful information to users

We believe that it does not provide useful information to users for a lessor to continue to recognise as income an amount to which the lessor has waived its contractual rights.

Elaborating on the above example, suppose a lease agreement required a lessee to pay an upfront lease payment of 200 to a lessor on lease commencement on 1 January 2020. The lessor records a receivable of 200 and deferred operating lease income of 200 on lease commencement. The lease term is 10 years. Shortly after lease commencement, the lessor modifies the lease agreement to forgive the upfront lease payment. The tentative agenda decision would appear to require the lessor to derecognise the receivable via profit or loss immediately and continue to recognise the deferred operating lease income in profit or loss over the remaining lease term – i.e. to recognise 20 per year for the next 10 years.

In this example, what does the operating lease income of 20 to be recognised in, say, 2022 represent? It does not represent a right to receive cash in the future, nor does it represent cash that has been received in the past that has been deferred to be recognised as income in 2022. It does not reflect any kind of right in the contract that exists in 2022. Instead, it represents an historical contractual right that was waived in 2020.

Finalising the agenda decision will not improve consistency…

Basing lessor income recognition on whether an amount is recognised as a receivable on the effective date of the lease modification will not enhance consistency, as there is diversity in when lease payments are recognised as receivables. In particular, we note that:

— there is no guidance in IFRS 16 on when a lessor recognises a receivable, in contrast to IFRS 15;

— there is no linkage between performance by the lessor and recognition of a receivable, as illustrated by the above example. In other cases, recognition of an operating lease receivable lags performance by the lessor – e.g. when the lessor offers upfront lease incentives such as rent-free periods; and

— there appears to be no restriction in IFRS 16 that prevents a lessor recognising income that it knows to be uncollectable.

… and would create additional structuring opportunities

Introducing a 'bright-line' difference in income recognition depending on whether an amount is recognised as a receivable at the date of the rent concession will require economically similar agreements to be accounted for differently. This will increase the risk of structuring opportunities.

For example, consider a lease contract under which the lessee is required to pay to the lessor lease payments of 100 on the first day of each month. On 31 March, the lessee has not yet paid the amount due on 1 March. The lessor agrees to forgive 100 of lease payments on 31 March. If the lessor specifies that the amount forgiven is the lease payment due on 1 March that is recognised as a receivable, this will not reduce future operating lease income. If, however, the lessor specifies that the amount forgiven is the lease payment that will become due on 1 April that is not yet recognised as a receivable, then this will reduce future operating lease income.

There is a simple alternative analysis that could be applied

If the forgiveness of the lease payments were treated as a lease incentive, then many of the concerns outlined above would be addressed.

The agenda paper asserts that the forgiveness does not meet the definition of a lease incentive but no arguments for this are presented. The tentative agenda decision itself is silent on this point.

— If the Committee's view is that the forgiveness of specified lease payments does not meet the definition of a lease incentive because it is not a "payment", then we disagree. In our experience, lease incentives may be monetary or non-monetary – transfers of value from a lessor to a lessee in connection with leases generally reduce operating lease income.

— Economically, the purpose of the forgiveness could be to incentivise the lessee to remain in the lease – e.g. to make it more likely that the lessee will exercise a renewal option, or less likely to exercise a termination option. As noted under our comments regarding the application of IFRS 9 above, the tentative agenda decision does not specify that the lessee is in financial difficulties.

However, the Committee process has identified diversity of practice and of view.

Recommendation

Given the diversity identified, we support standard-setting to clarify the interaction of IFRS 9 and IFRS 16 for both lessors and lessees. We believe that a possible course of action to address lessor accounting would be to amend the definition of a lease incentive, or IFRS 16.77, specifying that the amount that adjusts operating lease income is the amount specified in IFRS 9.3.2.12.