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Dear Sir

Exposure Draft ED/2020/2: COVID-19 Related Rent Concessions, Proposed amendments to IFRS 16

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network¹, this letter summarises views of member firms that provided comments on the ED.

We strongly support the amendments proposed by the IASB as they provide significant operational relief to lessees. However, we believe that the practical expedients should be made available to lessors as well as lessees. We have included draft text in our detailed comments for how this could be achieved in a simple and straightforward way. We have also suggested a number of other amendments and clarifications to the proposals in the ED.

Our responses to the questions in the ED are set out in the attached Appendix A.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Global Head of IFRS

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Appendix A

Question 1 - Paragraph 46A of the draft amendment to IFRS 16 proposes, as a practical expedient, that a lessee may elect not to assess whether a covid-19-related rent concession is a lease modification. A lessee that makes this election would account for any change in lease payments resulting from the covid-19-related rent concession the same way it would account for the change applying IFRS 16 if the change were not a lease modification.

Paragraph 46B of the draft amendment to IFRS 16 proposes that the practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of the following conditions are met:

- (a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;*
- (b) any reduction in lease payments affects only payments originally due in 2020; and*
- (c) there is no substantive change to other terms and conditions of the lease.*

Do you agree that this practical expedient would provide lessees with practical relief while enabling them to continue providing useful information about their leases to users of financial statements? Why or why not? If you disagree with the proposal, please explain what you propose and why.

We agree that the practical expedient proposed by the exposure draft would provide significant operational relief to lessees. Many lessees have a significant number of lease contracts, and if they were required to assess each individually to determine if a rent concession met the definition of a lease modification in IFRS 16, the work effort required would, in many cases, be onerous.

We also believe that the accounting that would result from the practical expedient would provide useful information to users of financial statements. Application of the requirements in IFRS 16 to lease modifications results in an adjustment to the lease liability using an updated discount rate, with an associated adjustment being made to the related right-of-use asset. This means that the effect of a lease modification is reflected over the remaining term of the lease in adjustments to the amount of future depreciation of right-of-use assets and finance expense accruing in relation to the lease liability. Consequently, if covid-19 related rent concessions were accounted for as giving rise to lease modifications, the lessee's benefit would be spread over the remaining lease term, and would not be recognised within the period to which the concessions relate, which we believe is not appropriate.

Accounting for rent concessions applying the other requirements of IFRS 16 will often result in concessions being accounted for as negative variable lease payments (IFRS 16.38(b)), which results in the concessions being recognised in profit or loss within the period to which the concession relates. In the case of many rent concessions offered to lessees as a direct consequence of COVID-19 (e.g. rent holidays or partial forgiveness of rent), we believe that recognising them in profit or loss in this way is a more faithful representation of the economics of such concessions because they are often provided to lessees on an urgent basis and they clearly relate to adverse conditions (and related effects on reported financial performance) experienced by the lessee in a specific period of time.

While we are supportive of the proposed amendments, we believe the IASB should make two substantive changes to the proposed amendments. We also have three suggestions where we believe that the proposed amendments should be clarified.

Scope of the practical expedient - lessors

We acknowledge that the IASB has considered whether the practical expedient should be provided to lessors, and has tentatively concluded that it should not. The reasons for this tentative decision are noted in paragraph BC3 of the exposure draft. Our concerns relate primarily to leases classified as operating leases by the lessor, which is the predominant type of lease contract for real estate.

Despite the fact that IFRS 16 did not significantly alter the accounting requirements for lessors as compared to IAS 17, lessors will experience significant operational difficulties in applying the requirements of IFRS 16. Although IFRS 16 does not require amounts recognised in the statement of financial position to be remeasured, lessors must nonetheless:

- Identify all leases affected by covid-19 related rent concessions;
- Assess whether each rent concession meets the definition of a lease modification; and
- If the rent concession is a lease modification, account for the modification as a new lease from the effective date of the modification (IFRS 16.87). This will involve recalculating the total amount of lease payments in the new lease while also considering any prepaid or accrued lease payments relating to the original lease, the operating lease income then being recognised over the term of the new lease.

This may be challenging for many lessors that have hundreds or thousands of leases with many different lessees. In outreach we have performed, multiple jurisdictions have consistently noted that their larger lessor clients do not have standard contracts and do not necessarily have consistent lease management systems for all leases. This is particularly the case for those lessors that have expanded by acquisition and may have inherited leases from their acquirees which have lease management systems which may differ from the acquirer's systems, and which often have leases with different contractual terms.

Apart from the work effort required to apply the existing requirements in IFRS 16, we believe that reflecting a revision in the consideration of an operating lease over the new lease term (IFRS 16.87) does not faithfully represent the economics of many concessions.

Normally when a lessee and a lessor modify the amount of consideration in a lease, adjusting total lease payments over the revised lease term provides useful information. However, in applying this requirement to covid-19 related rent concessions, such as rent holidays or partial forgiveness of rent, we do not believe this is the case. If a lessor provides significant reductions in rent to lessees, applying IFRS 16.87, the effect of that relief will be reflected in future periods, and in some cases, many years after the effects of covid-19 have ceased (i.e. a 'smoothing' of the impact to the lessor). We believe that the information provided to users of financial statements would be improved if reductions in lease payments that are a direct consequence of COVID-19 are included in profit or loss within the period to which they relate. We note that this would then be consistent with the accounting effect of the practical expedient proposed for lessees. This reflects the fact that many lessors are being compelled to provide reductions in rent, either to ensure their lessees remain financially viable or due to government intervention, for a specific period of time.

We believe providing this relief to lessors could be achieved by making minimal changes to the amendments as proposed in the exposure draft. A paragraph could be inserted immediately following IFRS 16.87, which states (edits made to proposed paragraph 46A are underlined):

As a practical expedient, a lessor may elect not to assess whether a covid-19- related rent concession (see paragraph XX) is a lease modification. A lessor that makes this election shall account for any change in lease payments resulting from the covid-19- related rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.

This new paragraph would be followed by another that contains the same criteria as paragraph 46B, modified to relate to lessors.

The practical effect of this modification would be for lessors to account for covid-19 related lease concessions as if they were part of the original lease agreement, and not as lease modifications (i.e. not applying IFRS 16.87). In many cases, such rent concessions would then be accounted for as negative variable lease payments, and included in profit or loss within the period to which they relate.

As noted above, we believe that it would be straightforward to extend relief to lessors. However, if extending the practical expedient to lessors would result in a delay in finalising the amendments for lessees, we believe the IASB should finalise the amendments for lessees and deal with lessor-related amendments separately. We believe that the proposed relief for lessees is urgently needed.

Scope of the practical expedient - reductions in payments

Paragraph 46B(b) of the proposed amendments would permit the application of the practical expedient to only those rent concessions where reductions in lease payments occur solely to those payments originally due in 2020. We acknowledge the IASB's rationale for this ring fencing which is that without a definitive timeframe limiting its application, there is a risk it may be applied too broadly. We agree that is appropriate to limit the application of the proposed amendments.

However, in outreach we have performed, we have received feedback that the scope of the practical expedient as proposed is such that it will provide little to no relief for lessees in a number of jurisdictions, which include, India, Australia and New Zealand. This is because these jurisdictions typically do not have calendar year-ends (annual period ends are typically 31 March for India and New Zealand, and 30 June for Australia). In such jurisdictions, it is already becoming common for lessors to propose the provision of covid-19 related rent concessions that relate to calendar quarter 2 of 2020 by reducing payments for the next fiscal periods which will extend beyond 2020. For example, this can involve reducing monthly payments from July 2020 - June 2021, rather than reducing payments from (say) July 2020 - September 2020 by a larger amount. These concessions are economically similar because the reductions relate to the same period that has been affected by covid-19, with the difference being only in the timing of cash flows. However, due to the former arrangement including reductions in payments beyond 2020, the practical expedient as drafted would not apply.

Any fixed period to which the practical expedient may be limited is inherently arbitrary, and the criterion was proposed to avoid potential over application of the practical expedient to other types of notional lease modifications. We agree that it is appropriate to include a limitation on the application of the practical expedient. However, instead of limiting the timeframe to which reductions in payments may apply, we suggest the following modifications are made to focus the analysis on the period to which a concession relates (edits made to proposed paragraph 46B(b) are underlined):

any reduction in lease payments affects relates only to payments originally due in 2020 (for example, a rent concession would meet this condition if it results in reduced lease payments in 2020 and increased lease payments that extend beyond 2020; the condition would also be met if a rent concession was in respect of lease payments for the period April to June 2020 which are not reduced or waived, with the reduction in payments from the lessee to the lessor instead being allocated to rent payments falling due in the period from July 2020 to June 2021);

Paragraph 46B already establishes that a rent concession must occur as a ‘direct consequence’ of covid-19. The amendments to paragraph 46B(b) which we have suggested would result in similar lease concessions being accounted for in a similar manner, while still requiring that preparers demonstrate a direct link between the rent concession and the effects of covid-19. We believe the benefits of modifying this criterion outweigh the potential risk of its misapplication.

Suggestions for clarification

We suggest the following clarifications are made to amendments proposed in the exposure draft.

<i>Paragraph</i>	<i>Comment</i>	<i>Proposed amendment</i>
46A	The scoping of the practical expedient does not establish the unit of account to which the criteria should be applied. For example, it is unclear whether each legal amendment to the lease contract is assessed individually under the criteria in 46B.	Amend paragraph 46 to require that multiple rent concessions entered into at or around the same time for the same underlying asset/assets should apply the criteria in paragraph 46B as a single unit of account. It may be appropriate to incorporate requirements similar to those in IFRS 9.IG.B.6.
BC5(c)	BC5(c) ends by stating ‘(although, for example, a three-month rent holiday in 2020 followed by three additional months of substantially equivalent payments at the end of the lease would not prevent a rent concession from being within the scope of the practical expedient).’ As drafted it is unclear whether, in the example, the original lease term is unchanged	Clarify whether a rent concession is precluded from being within the scope of the proposed amendments if that rent concession is a payment holiday for a specified period of time during 2020, with a period equal to the payment holiday being added to the lease term, provided that the

	<p>with the deferred payments for the three month period being settled in one overall payment, or whether there is an equivalent three month extension to the lease with the deferred payments being made during this period.</p> <p>If the lease term was extended by the same period as the rent holiday, it might be concluded that the requirement of proposed paragraph 46B(c) would not be met, as an extension to the lease term could be viewed as an additional substantive change to other terms of the lease. Additionally, if the lease term is modified, a revised discount rate is required to be used in discounting the revised cash flows (IFRS 16.40(a)).</p>	<p>change in lease payments results in remaining consideration for the lease is substantially the same or less than the consideration immediately preceding the change.</p>
BC7(b)	<p>BC7(b) states that ‘A change in lease payments that reduces payments in one period but proportionally increases payments in another does not extinguish the lessee’s lease liability or change the consideration for the lease...’</p> <p>It is unclear what ‘proportionally’ means in this context, particularly, whether this is meant in the context of nominal or discounted cash flows. The meaning has wider implications, because if a change in consideration for a lease is assessed only based on nominal cash flows, then it is possible that an arrangement under which rental payments were deferred and increased for the time value of money would fail the requirements of proposed paragraph 46B(a).</p>	<p>Clarify whether, when determining whether a rent concession gives rise to a lease concession within the scope of the proposed amendments, a lessee is permitted or required to consider the nominal amount, or the present value, of revised lease payments.</p>

Question 2 - Paragraphs C1A and C20A of the draft amendment to IFRS 16 propose that a lessee would apply the amendment:

- (a) for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at the date the amendment is issued; and*
- (b) retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.*

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.

We agree with this proposal. We believe that permitting entities to apply the amendments as soon as they are issued will be useful for entities that are significantly impacted by covid-19 related rent concessions.