

20 August 2019

Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom
E14 4HD

Dear Ms Lloyd

Tentative agenda decision – Lessee’s incremental borrowing rate (IFRS 16)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee’s publication in the June 2019 IFRIC Update of the tentative decision not to take onto the Committee’s agenda the request for clarification on the determination of a lessee’s incremental borrowing rate.

We do not agree with the Committee’s conclusion that a lessee is not required to determine an incremental borrowing rate that reflects the interest rate in a loan with a similar payment profile to the lease payments. We do not believe that it is appropriate to infer that the reference to “a similar term” should be read as simply meaning over the “lease term” as defined in Appendix A.

The tentative agenda decision observes that “a lessee might often refer as a starting point to a readily observable rate for a loan with a similar payment profile to that of the lease”. We note that in practice a readily observable rate for amortising loans (as this is the typical payment profile of leases) may not always be available and therefore we are concerned that lessees may interpret the lack of observable market data on amortising loans to permit them to default to using the interest rate for a bullet loan. We do not believe that this would be appropriate and there are methods that can be used to estimate the interest rate of amortising loans.

IFRS 16 defines the lessee’s incremental borrowing rate as “the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment”. In determining the rate of interest on any borrowing by a debtor or receivable by a lender, the payment profile (i.e., amount and timing) is always a critical factor. Thus, the reference to what a lessee would have to pay to borrow implicitly encompasses the payment profile of the lease payments. This appears to be consistent with the Board’s objective in specifying the discount rate which was, as noted in BC160, to “specify a rate that reflects how the contract is priced”. For example, the pricing of the contract with a bullet payment on maturity will be different from that of an amortising loan.

We believe that this is also confirmed by the discussion in BC162 that indicates that the definition of the incremental borrowing rate takes into consideration the terms and conditions of the lease. The payment profile is a key term of the lease. Because IFRS 16 is clear that the payment profile is a key term that a lessee must take into consideration to determine its incremental borrowing rate, we believe that the issue could be appropriately addressed through an agenda decision. However, if the Committee does not agree

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte Touche Tohmatsu Limited is a private company limited by guarantee incorporated in England & Wales under company number 07271800, and its registered office is Hill House, 1 Little New Street, London, EC4A, 3TR, United Kingdom.

© 2019 . For information, contact Deloitte Touche Tohmatsu Limited.

with this assessment, we believe that standard setting in the form of an IFRS Interpretation is required. As noted in the staff Agenda Paper 2, “[f]or some leases (and in particular long-term leases), even small changes in the discount rate could result in materially different amounts being recognised as lease liabilities”.

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 blue ink, appearing to read 'V Poole', with a stylized, flowing script.

Veronica Poole
Global IFRS Leader