

IFRS in Focus

IASB proposes to amend IFRS 16 *Leases* regarding COVID-19-related rent concessions

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This *IFRS in Focus* addresses the proposed amendment to IFRS 16 *Leases* set out in Exposure Draft ED/2020/2 *Covid-19-Related Rent Concessions (Proposed amendment to IFRS 16)* (the 'ED') published by the International Accounting Standards Board (IASB) in April 2020.

- The changes proposed in the ED would amend IFRS 16 to:
 - provide lessees with a practical expedient that relieves a lessee from assessing whether a COVID-19-related rent concession is a lease modification;
 - require lessees that apply the practical expedient to account for COVID-19-related rent concessions as if they were not lease modifications;
 - require lessees that apply the practical expedient to disclose that fact; and
 - require lessees to apply the practical expedient retrospectively in accordance with IAS 8, but not require them to restate prior period figures.
- No changes are proposed to lessor accounting.
- The proposed amendment would be effective for annual reporting periods beginning on or after 1 June 2020. Earlier application is proposed to be permitted, including in financial statements not yet authorised for issue at the date the amendment is published.
- Comments on the proposals are requested by 8 May 2020.

Background

COVID-19 has led many lessors to provide relief to lessees by deferring or relieving them of amounts that would otherwise be payable. In some cases this is through negotiation between the parties, but can be as a consequence of a government encouraging or requiring that the relief be provided.

IFRS 16 requires lessees to assess whether changes to lease contracts are lease modifications as this term is defined in the Standard and, if so, the lessee must remeasure the lease liability using a revised discount rate. The IASB has been advised that lessees would face significant practical challenges in identifying which COVID-19-related lease concessions meet the definition of lease modifications and, for those that are, in applying the required accounting.

The proposed amendment is intended to provide practical relief to lessees in accounting for rent concessions arising as a result of COVID-19.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Observation

The IASB is not proposing changes to lessor accounting because it does not expect lessors to face the same practical challenges as lessees in accounting for COVID-19-related rent concessions. In reaching this conclusion, the IASB considered that:

- For many lessors with a large volume of leases, leasing is a core part of their business.
- Unlike lessees, lessors have not recently implemented a new accounting model for their leases.
- Many of the real estate leases for which COVID-19-related rent concessions are being provided would be operating leases for the lessor. Lessor accounting for modifications to operating leases requires no remeasurement of amounts recognised in a lessor's statement of financial position.
- In the case of a finance lease, lessors apply the requirements in IFRS 9 *Financial Instruments* to modifications. The information this accounting provides is considered useful for users of a lessor's financial statements and is consistent with the required accounting for other financial instruments in the scope of IFRS 9.

The proposed amendment

Practical expedient

The IASB proposes that IFRS 16 be amended, by adding the following practical expedient:

A lessee may elect not to assess whether a COVID-19-related rent concession is a lease modification. A lessee 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 IFRS 16 if the change were not a lease modification.

The practical expedient would apply only to rent concessions occurring as a direct consequence of COVID-19 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 (a rent concession would meet this condition if it results in reduced lease payments in 2020 and increased lease payments that extend beyond 2020); and
- (c) There is no substantive change to other terms and conditions of the lease.

Lessees that apply the exemption would be required to disclose that fact.

Observation

The IASB was mindful of the risk of the practical expedient being applied too broadly, which could result in unintended consequences. Therefore, the IASB is proposing to limit the scope of the practical expedient so that it applies only to rent concessions that occur as a direct consequence of COVID-19.

The practical expedient is a departure from the requirements in IFRS 16 and is proposed only to provide lessees with practical relief during COVID-19. The IASB decided that lessees should not be *required* to depart from the requirements in IFRS 16—some lessees (for example, those with systems to address changes in lease payments) may prefer to apply the existing requirements to all changes in lease contracts throughout COVID-19. The IASB therefore proposes to permit, but not require, a lessee to apply the practical expedient.

If a lessee chooses to apply the practical expedient, it would apply the practical expedient consistently to all lease contracts with similar characteristics and in similar circumstances.

Accounting for changes in lease payments applying the exemption

A lessee that applies the practical expedient would generally account for:

- A reduction in lease payments as a negative variable lease payment. This means a lessee would generally recognise the variable payment in profit or loss in the period in which the event or condition occurs. The lessee would also derecognise that part of the lease liability that has been extinguished by the forgiveness of lease payments. This is consistent with IFRS 9:3.3.1, which requires an entity to remove a part of a financial liability from its balance sheet when, and only when, it is extinguished.
- A change in lease payments that reduces payments in one period but proportionally increases payments in another (such that there is no change to the overall consideration, only the timing of individual payments changes), by continuing to reduce the lease liability for payments made to the lessor.

If the lease payments are reduced in one period but increased by a lower amount in a later period (hence the total consideration is lower) the change in lease payments incorporates both a forgiveness of payments and deferred lease payments.

The lease liability recognised by a lessee applying the practical expedient would represent the present value of future lease payments owing to the lessor.

Transitional provisions, effective date and comment period

It is proposed that lessees are required to apply the amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but not require them to restate prior period figures. Instead, a lessee would recognise any difference arising on initial application of the amendment in 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.

A lessee shall apply the amendment 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 when the amendment is published.

Comments on the proposals are requested by 8 May 2020.

Further information

If you have any questions about the amendment to IFRS 16 please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

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