

Applying IFRS

Accounting for COVID-19 related rent concessions

Updated July 2020

A man with short, light-colored hair and a beard, wearing glasses, a white button-down shirt, and a dark blue blazer. He is holding a tablet computer with both hands and looking off to the side with a thoughtful expression. The background is a blurred indoor setting, possibly a cafe or office, with warm lighting.

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What you need to know

- ▶ The covid-19 pandemic has resulted in a number of lessors granting rent concessions to lessees. Applying the requirements of IFRS 16 *Leases* in the current environment raises a number of practical issues.
- ▶ The IASB issued *Covid-19-Related Rent Concessions - Amendment to IFRS 16 Leases* which allows a lessee, as a practical expedient, not to assess whether a covid-19 related rent concession is a lease modification.
- ▶ The IASB also issued an educational document providing guidance on accounting for rent concessions and assessing whether a change in payments is a lease modification.
- ▶ Lessor accounting for rent concessions is based on the current guidance in IFRS 16 and the clarifications provided by the IASB in its educational document.

A large number of lessees have obtained, or are expecting to obtain, some form of rent concession from lessors.

Overview

In the context of the ongoing covid-19 pandemic, and the significant measures taken by governments worldwide to mitigate its effects, a large number of lessees have obtained, or are expecting to obtain, some form of rent concessions from lessors.

Rent concessions granted by a lessor can take many forms. For example, a rent concession might include, but is not limited to the following (including a combination of the following): a rent payment holiday; a reduction in lease payments for a period of time; and a deferral of payments to a later date. A concession might also include a change to the lease term.

IFRS 16 *Leases* contains certain guidance on accounting for changes in lease payments for both lessees and lessors. However, it could be difficult in practical terms, for entities to apply the requirements in IFRS 16 for changes to lease payments. In particular, to assess whether the rent concessions are lease modifications, and then apply the required accounting, could be difficult due to the large volume of leases and disruption caused to many businesses by the covid-19 pandemic.

In April 2020, the International Accounting Standards Board (IASB or the Board) [released a document](#), prepared for educational purposes, highlighting requirements within IFRS 16 and other IFRS standards that are relevant for entities considering how to account for rent concessions granted as a result of the covid-19 pandemic. The document does not change, remove, nor add to, the requirements in IFRS standards and the intention is to support the consistent and robust application of IFRS 16.

In May 2020, the IASB issued *Covid-19-Related Rent Concessions - Amendment to IFRS 16 Leases* (the amendment). The Board amended the standard to provide an optional relief to lessees from applying IFRS 16's guidance on lease modification accounting for rent concessions arising as a direct consequence of the covid-19 pandemic.

The objective of the amendment is to provide lessees that have been granted covid-19 related rent concessions by lessors with practical relief, while still providing useful information about leases to users of the financial statements.

This publication discusses how IFRS 16, including the recently issued amendments to IFRS 16's lessee guidance, is applied to rent concessions and is intended to help entities consider the effects of applying it:

- ▶ Section 1 discusses the assessment of whether a rent concession is a lease modification.
- ▶ Section 2 discusses how a lessee accounts for a rent concession that is a lease modification; whether a lessee can apply the amendment to IFRS 16 for covid-19 related rent concessions; and how to account for rent concessions that are not accounted for as lease modifications (i.e., when a lessee elects to apply the option or when the concession is not a lease modification).
- ▶ Section 3 discusses how a lessor accounts for rent concessions.

This publication, updated in July 2020, includes additional discussion on lessee accounting for rent concessions as lease modifications and lessor accounting for the forgiveness of past lease payments that are recognised as a lease receivable. We encourage preparers and users of financial statements to read this publication carefully and consider the potential effects on their financial statements of any rent concessions received.

The views we express in this publication represent our perspectives as of June 2020. We may identify additional issues as we continue to analyse IFRS 16, the amendment, and as entities interpret it. As such, our views may evolve during that process.

A lease modification is a change to the scope or consideration that was not part of the original terms and conditions of the lease.

1. Assessing whether a rent concession is a lease modification

A lease modification is defined in IFRS 16 as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. In April 2020, the IASB issued an educational document explaining how an entity evaluates whether a rent concession constitutes a lease modification.

The *Covid-19-Related Rent Concessions - Amendment to IFRS 16 Leases*, which provides lessees with an optional practical expedient, not to assess whether a covid-19 related rent concession is a lease modification, is not addressed in this section, but is considered in sections 2.2 and 2.3 below.

In this section, we consider how the definition of a lease modification is applied to rent concessions. Specifically, what is a change in scope and consideration for a lease.

A change in the scope of a lease

In assessing whether there has been a change in the scope of a lease, an entity considers whether there has been a change in the right of use conveyed to the lessee by the contract. A change in the scope of a lease includes adding or terminating the right to use one or more underlying assets or extending or shortening the contractual lease term. A lease payment deferral, lease payment holiday or lease payment reduction alone is a change in consideration for a lease and is not, in isolation, a change in the scope of a lease.

A change in the consideration for a lease

In assessing whether there has been a change in the consideration for a lease, an entity considers the overall effect of any change in the lease payments. For example, a lessor-granted concession may allow a lessee not to make lease payments for a three-month period, but the lease payments for periods thereafter are increased proportionally in a way that means that the consideration for the lease is unchanged. Such a lease payment deferral, with no change in the total consideration for the lease, or the scope of the lease, would not be a lease modification. We believe that increases to subsequent lease payments to take account solely of the time value of money would not be a substantive change in the consideration for the lease. For example, if a lessor deferred a lease payment for June 2020 and required it to be paid in January 2021 plus an interest charge at a rate to reasonably compensate the lessor for the time value of money, that would not be a substantive change in the consideration for the lease. However, other changes in the consideration for a lease (e.g., a substantive forgiveness of rents payable/receivable) would be a change in the consideration for a lease.

Illustration 1 – Deferral of lease payments

Fact pattern

Restaurant A leases space in a shopping mall from Lessor B. Lessor B classifies the lease as an operating lease.

Under the terms of the lease, Restaurant A makes fixed lease payments of CU 100 to Lessor B at the beginning of each month. The non-cancellable lease term ends on 28 February 2022. The contract does not include any extension, termination or purchase options. For simplicity, the discount rate is assumed to be 0% at the commencement date and thus the lease liability at 30 June 2020 for the remaining 20 monthly lease payments is CU 2,000.

Assume that Restaurant A's right-of-use asset is not impaired before or during the periods described.

On 1 July 2020, Lessor B agrees to defer the three months of lease payments originally due in July, August and September 2020 to 1 January 2021. There are no non-lease components to the contract and there are no other changes to the terms and conditions of the lease.

Analysis

Under IFRS 16, a lease modification is defined as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. Given that the only change is the timing of the cash outflows, there is no change in the scope of the lease. Restaurant A next considers whether there is a change in the consideration for the lease by reference to the overall effect of any change in the lease payments. In this fact pattern, Restaurant A does not make lease payments for a period of three months from July 2020 and will increase the lease payment due on 1 January 2021 by the same amount as the deferral. Therefore, the consideration for the lease remains substantively unchanged and the rent concession does not constitute a lease modification. The accounting consequences of this are considered in section 2.3 below.

An entity considers all relevant facts and circumstances to evaluate whether a change is a lease modification .

A change that is, or is not, part of the original terms and conditions of the lease

When evaluating if there has been a change in either the scope of, or the consideration for, the lease, an entity is required to consider the terms and conditions of contracts and all relevant facts and circumstances, including the applicable law governing such contracts. When a lessee and lessor agree to a change to a lease that is not contemplated by the original terms and conditions of the lease, the change is accounted for as a lease modification. In this case, lessees would follow paragraphs 44 to 46 of IFRS 16 (if the amendment discussed in section 2.2 below is not applied) and lessors would consider the guidance in paragraphs 79 and 80 of IFRS 16 (for finance leases) or paragraph 87 of IFRS 16 (for operating leases).

However, if a change is limited solely to the changes contemplated in the existing terms and conditions of the lease, there is no lease modification for the purposes of IFRS 16.

Entities should carefully consider terms in their contracts as they may contain clauses (e.g., a *force majeure* clause) that result in changes to lease payments if particular events occur or circumstances arise. For example, a contract may

include a clause providing the lessee with a right to reduced lease payments upon government action requiring the closure of retail stores for a period of time. Changes in lease payments that result from clauses in the original contract (or in applicable law) would not be lease modifications for the purposes of IFRS 16. The accounting consequences of this are considered in section 2.3 below. Section 1.2.1 below further discusses the effects of changes to relevant laws and regulations.

1.1 Rent concessions that change the consideration in the contract

Some forms of rent concessions may change the consideration of the lease beyond what was contemplated in the original terms and conditions of the lease and, thus, require lease modification accounting to be applied (unless the amendment to IFRS 16 is applied, as discussed in section 2.2 below). The accounting for lease modifications is discussed in section 2.1 below.

Illustration 2 – Change of lease payments from fixed to partially variable

Fact pattern

Assume the same fact pattern in Illustration 1, except for the following:

On 1 July 2020, Lessor B agrees to change the terms and conditions of the lease contract with Restaurant A, such that fixed lease payments are reduced to CU 25 per month, plus an additional variable lease payment based on 3% of the monthly turnover of Restaurant A at that shopping mall.

There are no other changes to the terms and conditions of the lease.

Analysis

In this fact pattern, the consideration for the lease has changed from solely fixed lease payments to a combination of fixed and variable lease payments, which were not part of the original terms and conditions of the contract. Therefore, the change constitutes a lease modification.

1.2 Terms and conditions of a contract

As specified above and in paragraph 2 of IFRS 16, an entity is required to consider the terms and conditions of a contract and all relevant facts and circumstances when applying the standard.

How we see it

- ▶ Existing contracts may not specifically contemplate the effect of a global pandemic such as covid-19 and, as such, there could be legal ambiguities when evaluating lease contracts. Therefore, to determine the appropriate accounting for a lease concession, it is important to carefully identify and consider the rights and obligations of the lessee and lessor, taking into account the terms and conditions of the contract and the applicable legal framework.
- ▶ However, for lessees, the amendments to IFRS 16 discussed below are intended to mitigate the operational difficulties of evaluating every contract impacted by a concession granted by a lessor.

1.2.1 Rent concessions mandated by changes to applicable law or regulation

As a response to the economic impact of the covid-19 pandemic, governments in certain jurisdictions have introduced new laws mandating certain rent concessions, such as requiring lessors to provide lessees with lease payment holidays or lease payment reductions. Questions have been asked as to whether these lease concessions mandated by changes to applicable law constitute a lease modification. Some stakeholders believe that, in these cases, there is a change in the consideration for the lease which was not part of the original terms and conditions of the lease and, thus, modification accounting is required. However, other stakeholders believe that when the lessee and lessor agree to a lease contract, subject to the law of a jurisdiction, the parties have also agreed to be bound by any future changes in the applicable law. Thus, any changes made to comply with a change in law are contemplated in the contract and should not be considered to constitute a lease modification. Given that IFRS 16 does not specifically address this circumstance, we believe there is likely to be diversity in practice and both approaches are acceptable. However, and as discussed below, entities should consider the disclosure objectives in IFRS 16 and disclose their policies and the effect of such policies related to lease concessions. Refer to section 2.4 below.

1.3 Subsequent event consideration

A rent concession granted after the reporting period is a non-adjusting event, as defined in IAS 10 *Events after the Reporting Period*, which is subject to disclosure in the financial statements for the current reporting period, if material.

2. Lessee accounting

Prior to the May 2020 amendments to IFRS 16, when a rent concession is granted by a lessor, the lessee would assess whether the rent concession represents a lease modification (as discussed in section 1 above). If the concession meets the definition of a lease modification, it would apply the requirements for accounting for lease modifications, as discussed in section 2.1 below.

However, if a covid-19 related rent concession granted by a lessor meets the conditions of the amendment to IFRS 16, a lessee may elect not to assess whether the covid-19 rent concession is a lease modification and, therefore, account for the concession as if it were not a lease modification.

Lessees generally account for rent concessions as a lease modification when the definition of a lease modification is met and the amendment to IFRS 16 is not applied. However, in circumstances involving a voluntary forgiveness of a lease liability granted by the lessor without other changes to the lease, it might also be reasonable for the lessee to account for such rent concession as a (partial) derecognition of a lease liability applying paragraph 3.3.1 of IFRS 9 *Financial Instruments* with a credit to profit or loss (i.e., rather than applying the IFRS 16 amendments or the IFRS 16 lease modification guidance). Therefore, diversity in practice may exist in this situation and it is important to consider the perspective of the local regulator. Lessees should apply their policy (i.e., to apply IFRS 16 or IFRS 9) consistently to contracts with similar characteristics and in similar circumstances.

The conditions for applying the amendment, and the accounting for rent concessions that are not accounted for as lease modifications, are discussed in sections 2.2 and 2.3 below.

2.1 Lessee accounting for rent concessions as lease modifications (amendment to IFRS 16 is not applied)

A lease modification that increases the scope of the lease and increases the consideration by an amount commensurate with the stand-alone price is accounted for as a separate lease. This is discussed further in our publication, [Applying IFRS: A closer look at IFRS 16 Leases](#).

For a lease modification that is not accounted for as a separate lease, a lessee applies modification accounting at the effective date of the lease modification.¹ In such a case, a lessee allocates the consideration in the modified contract to the lease and non-lease components (where applicable), determines the lease term of the modified lease and remeasures the lease liability by discounting the revised lease payments using a revised discount rate determined on that date. The revised discount rate is the rate of interest implicit in the lease for the remainder of the lease term, or if that rate cannot be readily determined, the lessee's incremental borrowing rate.

If the modification decreases the scope of the lease (e.g., a change that reduces total leased space or shortens the lease term), the lessee remeasures the lease liability and reduces the right-of-use asset to reflect the partial or full

¹ Under IFRS 16, the effective date of modification is defined as the date when both parties agree to a lease modification.

termination of the lease (e.g., a 50% reduction in leased space would reduce the right-of-use asset by 50%). Any difference between those two adjustments is recognised in profit or loss at the effective date of the modification. For all other modifications, the lessee recognises the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset, without affecting profit or loss. For additional examples of accounting for lease modifications by a lessee, see [Applying IFRS: A closer look at IFRS 16 Leases](#).

Illustration 3 – Lessee accounting for covid-19 related rent concessions that are a lease modification and the lessee does not apply the amendment to IFRS 16

Scenario 1 - Forgiveness of lease payments and extension of the lease term

Fact pattern

Restaurant A leases space in a shopping mall from Lessor B. Lessor B classifies the lease as an operating lease.

Under the terms of the lease, Restaurant A makes fixed lease payments of CU 100 to Lessor B at the beginning of each month. The non-cancellable lease term ends on 28 February 2022. The contract does not include any extension, termination or purchase options. For simplicity, the discount rate is assumed to be 0% at the commencement date and thus the lease liability at 30 June 2020 for the remaining 20 monthly lease payments is CU 2,000.

Assume that Restaurant A's right-of-use asset is not impaired before or during the periods described.

On 1 July 2020, Lessor B agrees to forgive the three months of lease payments originally due in July, August and September 2020. There are no non-lease components to the contract and there are no other changes to the terms and conditions of the lease.

Assume the parties agree to extend the lease term by three months at the same monthly lease payment of CU 100 per month. The lease term will now end on 31 May 2022.

Restaurant A does not apply the amendment to IFRS 16 not to assess whether a rent concession is a lease modification.

Analysis

Similar to Illustration 1, there is no overall effect of any change in the lease payments in this scenario. Thus, there is no change in the consideration for the lease. However, the scope of the lease has changed as the lease term has been extended by three months, which was not part of the original terms and conditions of the lease. Therefore, the rent concession in this scenario constitutes a lease modification.

On the effective date of modification (i.e., 1 July 2020), Restaurant A applies lease modification accounting and remeasures the lease liability by discounting the revised lease payments using a revised discount rate, determined at the effective date of the modification. A corresponding adjustment is made to the right-of-use asset.

Depreciation of the right-of-use asset continues over the revised remaining lease term.

Scenario 2 - Forgiveness of lease payments

Fact pattern

Assume the same fact pattern as above, except for the following:

On 1 July 2020, Lessor B agrees to waive the three months of lease payments originally due in July, August and September 2020. There are no other changes to the terms and conditions of the lease.

Restaurant A does not apply the amendment to IFRS 16 not to assess whether a rent concession is a lease modification.

Analysis

In this fact pattern, there is a reduction in the consideration for the lease which was not part of the original terms and conditions of the lease. Therefore, there is a lease modification.

On the effective date of the modification (i.e., 1 July 2020), Restaurant A applies lease modification accounting and remeasures the lease liability by discounting the revised lease payments using a revised discount rate, determined at the effective date of the modification. Restaurant A accounts for the remeasurement of the lease liability by adjusting the carrying amount of the right-of-use asset, as follows (assuming the revised discount rate is 0%):

Dr Lease liability (100 * 3)	CU 300
Cr Right-of-use asset	CU 300

Depreciation of the revised right-of-use asset continues over the remaining lease term.

How we see it

When applying the requirements of IFRS 16 without applying the amendment discussed in section 2.2 below, the modification of the lease often requires the remeasurement of the lease liability using a revised discount rate. Given that the interest rate implicit in the lease is generally not readily determinable by the lessee, it is often necessary for the lessee to determine a revised incremental borrowing rate, which may be practically difficult particularly when an entity has been granted many lease concessions by various lessors across many jurisdictions.

2.2 Amendment to IFRS 16 for covid-19 related rent concessions

On 28 May 2020, the IASB issued *Covid-19-Related Rent Concessions - Amendment to IFRS 16 Leases* (the amendment). The Board amended the standard to provide optional relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the covid-19 pandemic. The amendments do not apply to lessors.

In providing the relief, the Board acknowledged that "... lessees could find it challenging to assess whether a potentially large volume of covid-19 related rent concessions are lease modifications and, for those that are, to apply the required accounting in IFRS 16, especially in the light of the many challenges lessees face during the pandemic."²

The objective of the amendment is to provide lessees that have been granted covid-19 related rent concessions with practical relief, while still providing useful information about leases to users of the financial statements.

As a practical expedient, a lessee may elect not to assess whether a covid-19 related lease concession from a lessor is a lease modification.

2.2.1 Practical expedient

As a practical expedient, a lessee may elect not to assess whether a covid-19 related lease concession from a lessor is a lease modification. A lessee that makes this election accounts for any qualifying change in lease payments resulting from the covid-19 related rent concession the same way it would account for the change under IFRS 16 if the change were not a lease modification. A lessee may elect to apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances, as specified in paragraph 2 of IFRS 16.

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 described in IFRS 16 paragraph 46B are met:

- ▶ 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.
- ▶ Any reduction in lease payments affects only payments originally due on or before 30 June 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments before 30 June 2021 and increased lease payments that extend beyond 30 June 2021).
- ▶ There is no substantive change to other terms and conditions of the lease.

In the Basis for Conclusions to the amendment, paragraph BC205D(a) states that "The Board was of the view that a rent concession that increases total payments for the lease should not be considered a direct consequence of the covid-19 pandemic, except to the extent the increase reflects only the time value of money." Therefore, a rent concession that defers payments to a future date and increases those payments to reflect the time value of money would be in the scope of the practical relief, provided all the other conditions were met.

² IFRS 16.BC 205B

The IASB further explained³ that qualitative and quantitative factors are considered in assessing whether there are no substantive changes to other terms and conditions of the lease. Other substantive changes beyond providing a covid-19 related rent concession, such as introducing or withdrawing extension, termination or purchase options, would make the entire modification to the lease ineligible to qualify for the relief provided by the practical expedient. Conversely, under the amendment, a change in the lease term, such as a three-month rent holiday before 30 June 2021 followed by three additional months of substantially equivalent payments at the end of the lease, would not constitute a substantive change to other terms and conditions of the lease.

2.3 Accounting for rent concessions that are not accounted for as lease modifications

The amendment to IFRS 16 does not provide explicit guidance about how a lessee accounts for a rent concession when applying the practical expedient. It states that a lessee making the election accounts for any change in lease payments resulting from the covid-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

There are several potential approaches for accounting for a rent concession that is not accounted for as a lease modification.

We believe there are several potential approaches for accounting for a rent concession which is not accounted for as a lease modification, including:

- ▶ Accounting for a concession in the form of forgiveness or deferral of lease payments, as a negative variable lease payment (Approach 1)
- ▶ Accounting for a concession in the form of forgiveness or deferral of lease payments, as a resolution of a contingency that fixes previously variable lease payments (Approach 2)
- ▶ Accounting for a concession in the form of a deferral of payments as if the lease is unchanged (Approach 3)

2.3.1 Accounting for a concession, in the form of forgiveness or deferral of lease payments, as a negative variable lease payment (Approach 1)

When a lessor grants a concession that contractually releases a lessee from certain lease payments or defers lease payments, we believe a lessee may account for the concession as a negative variable lease payment. In this case, the lessee would remeasure the remaining consideration in the contract and, if the contract contains multiple lease and non-lease components, reallocate the consideration to the lease and non-lease components (using unchanged allocation percentages). The lessee would also not update the discount rate used to measure the lease liability. In this case, the lessee would recognise the allocated portion of the forgiven payments as a negative variable lease expense in the period when changes in facts and circumstances on which the variable lease payments are based occur. This approach is similar to that used by the lessor to recognise variable lease income.

³ IFRS 16.BC 205D(c)

2.3.2 Accounting for a concession in the form of forgiveness or deferral of lease payments as a resolution of a contingency that fixes previously variable lease payments (Approach 2)

We believe that a lessee may account for a rent concession in the same manner as it would account for a resolution of a contingency that fixes previously variable lease payments. In this case, the lessee would remeasure the remaining consideration in the contract and, if the contract contains multiple lease and non-lease components, reallocate the consideration to the lease and non-lease components (using unchanged allocation percentages). The lessee would also not update the discount rate used to measure the lease liability. Therefore, the lessee would remeasure its lease liability, using the remeasured consideration (e.g., reflecting the lease payment reduction or lease payment deferral provided by the lessor), with a corresponding adjustment to the right-of-use asset.

2.3.3 Accounting for a concession in the form of a deferral of lease payments as if the lease is unchanged (Approach 3)

When a lessor permits a lessee to defer a lease payment, we believe the lessee may account for the concession by continuing to account for the lease liability and right-of-use asset using the rights and obligations of the existing lease and recognising a separate lease payable (that generally does not accrue interest) in the period that the allocated lease cash payment is due. In this case, the lessee would reduce the lease payable when it makes the lease payment at the revised payment date.

This approach of recording a lease payable for the future payment would allow the lease liability to be accreted using the original incremental borrowing rate and would result in a lease liability balance of zero at the end of the lease term (i.e., the lessee would not need to revisit the accretion of its lease liability based on the revised timing of payments). In many cases, this will allow a lessee to use its existing systems to account for the lease liability using the existing payment schedule and discount rate.

The following examples in Illustration 4 illustrate how a lessee may account for lease payment forgiveness following Approaches 1 and 2 described above.

Illustration 4 – Lessee accounting for covid-19 related rent concessions on a forgiveness of lease payments applying the amendment to IFRS 16

Fact pattern

Restaurant A leases space in a shopping mall from Lessor B. Lessor B classifies the lease as an operating lease.

Under the terms of the lease, Restaurant A makes fixed lease payments of CU 100 to Lessor B at the beginning of each month. The non-cancellable lease term ends on 28 February 2022. The contract does not include any non-lease components, extension, termination or purchase options. For simplicity, the discount rate is assumed to be 0% at the commencement date and thus the lease liability at 30 June 2020 for the remaining 20 monthly lease payments is CU 2,000.

Assume that Restaurant A's right-of-use asset is not impaired before or during the periods described.

Due to reduced customer traffic arising from covid-19, on 1 July 2020, Lessor B agrees to waive the three months of lease payments originally due in July, August and September 2020. There are no other changes to the terms and conditions of the lease.

Analysis

Restaurant A first assesses whether the rent concession qualifies for the practical relief provided by IFRS 16. The change in lease payments, granted as a direct consequence of the covid-19 pandemic, results in revised consideration for the lease that is less than the consideration for the lease immediately preceding the change. The reduction in lease payments affects only payments originally due on or before 30 June 2021. As there are no other changes to the terms and conditions of the contract, Restaurant A concludes that the conditions of paragraph 46B are met (and described in section 2.2.1 *Practical expedient*).

Approach 1 - account for the forgiveness as a negative variable lease payment

On 1 July 2020, Restaurant A treats the concession as an event or condition which triggers a negative variable payment. Restaurant A accounts for the reduction in future lease payments by derecognising the part of the lease liability which has been forgiven and recognising the adjustment in profit or loss.

Dr Lease liability (100 * 3)	CU 300
Cr Profit or loss	CU 300

Depreciation of the right-of-use asset continues over the remaining lease term.

Approach 2 - account for the forgiveness as a resolution of a contingency that fixes previously variable lease payments

On 1 July 2020, Restaurant A treats the concession as an event or condition which resolves uncertainty or conditionality on the previous lease payments. Restaurant A accounts for the reduction in future lease payments by derecognising the part of the lease liability which has been forgiven and adjusting the right-of-use asset.

Dr Lease liability (100 * 3)	CU 300
Cr Right-of-use asset	CU 300

To record the reduction in lease liability arising from the rent concession

Depreciation of the revised right-of-use asset continues over the remaining lease term.

Note that if the fact pattern were changed such that the lessee is entitled to a reduction in lease payments for August and September on a month-by-month basis (i.e., if conditions related to covid-19 continue to be present the monthly lease liability is contractually forgiven), the reduction in the lease obligation would also be recognised monthly. The corresponding credit to profit and loss or the right-of-use asset would depend on whether Approach 1 or Approach 2 is taken.

The example in Illustration 5 below illustrates how a lessee may account for a lease payment deferral following Approaches 1 to 3 described above.

Illustration 5 – Lessee accounting for covid-19 related rent concessions on a deferral of lease payments applying the amendment to IFRS 16

Fact pattern

Restaurant Y leases space in a shopping mall from Lessor Z.

Under the terms of the lease, Restaurant Y makes fixed lease payments to Lessor Z of CU 600 semi-annually in arrears. The non-cancellable lease term starts on 1 January 2020 and ends on 30 June 2021. The contract does not include any non-lease components, extension, termination or purchase options. The discount rate is 5% at the commencement date.

As a direct consequence of the covid-19 pandemic, on 1 July 2020, Lessor Z agrees to defer the lease payment originally due on 31 December 2020 to 30 June 2021. There are no other changes to the terms and conditions of the lease.

Assume that Restaurant Y's right-of-use asset is not impaired before or during the periods described.

Analysis

Restaurant Y first assesses whether the rent concession qualifies for the practical relief provided by IFRS 16. The rent concession is granted as a direct consequence of the covid-19 pandemic and results in no substantive change in the lease payments for the lease. The reduction in lease payments affects only payments originally due on or before 30 June 2021. As there are no other changes to the terms and conditions of the contract, Restaurant Y concludes that the conditions of paragraph 46B are met (and described in section 2.2.1 *Practical expedient*).

Approach 1 - account for the deferral as a negative variable lease payment

On 1 July 2020, Restaurant Y treats the concession as an event or condition which triggers a negative variable payment. Restaurant Y derecognises the part of the lease liability which is the time value of money of the lease payment deferred using the unchanged discount rate with the adjustment in profit or loss.

Lease liability immediately before the rent concession:

Present value of lease payments discounted at 5% = CU 1,157 ($600/(1.05)^{1/2} + 600/1.05$)

Lease liability immediately after the rent concession:

Present value of lease payments discounted at 5% = CU 1,143 ($1,200/1.05$)

Dr Lease liability (1,157-1,143)	CU 14
Cr Profit or loss	CU 14

To record the reduction in lease liability arising from the rent concession

Depreciation of the right-of-use asset continues over the remaining lease term.

Approach 2 - account for the deferral as a resolution of a contingency that fixes previously variable lease payments

The accounting under this approach would be the same as under Approach 1 above, except that the credit of CU 14 would be recognised as an adjustment to the right-of-use asset, rather than a credit to profit or loss.

Approach 3 - account for the deferral of lease payments as if the lease is unchanged

In this approach, Restaurant Y continues to account for the lease liability and right-of-use asset using the rights and obligations of the existing lease. The lease payment originally due on 31 December 2020 will remain on the balance sheet until it is settled on 30 June 2021, but the amount will not accrue interest during the deferral period. Hence, the interest expense for the six months up to 30 June 2021 will remain the same as in the original amortisation schedule.

Depreciation of the right-of-use asset continues over the remaining lease term.

2.4 Disclosure

A lessee that applies the practical expedient discloses that it has applied the practical expedient to all rent concessions that meet the conditions for it or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient.

In addition, a lessee discloses the amount recognised in profit or loss to reflect changes in lease payments that arise from such rent concessions to which the lessee has applied the practical expedient. The Basis for Conclusions to the amendment also notes that disclosure of the cash flow effects of rent concessions would be relevant regardless of whether a lessee applies the practical expedient.

2.5 Transition and effective date

Lessees apply the practical expedient 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. In the reporting period in which a lessee first applies the amendment, the lessee is not required to disclose the amount of the adjustment for each financial statement line affected and earnings per share required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

A lessee applies 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 28 May 2020⁴.

A lessee applies 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 28 May 2020.

⁴ This refers to the application date in IFRS 16. Local endorsement requirements may impact when the amendment can be applied in particular jurisdictions.

How we see it

- ▶ There are many different forms of rent concessions obtained by lessees. Therefore, lessees need to evaluate the details of the rent concession granted carefully to determine an appropriate accounting approach. It is possible for more than one approach to be acceptable.
- ▶ As well as providing the specific disclosures required in the amendment, entities should be mindful of the disclosure objectives of IFRS 16 which require lessees to provide adequate disclosure that gives a basis for financial statement users to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. In addition, lessees need to consider the presentation and disclosure requirements in other standards such as those in IAS 1 *Presentation of financial statements* when accounting for rent concessions.

Lessor accounting for rent concessions is based on existing guidance. The May 2020 amendments to IFRS 16, discussed in section 2, do not apply to lessors.

3. Lessor accounting

Lessor accounting for rent concessions is based on existing guidance. The May 2020 amendments to IFRS 16, discussed in section 2 above, do not apply to lessors. However, the clarifications provided by the IASB in its educational document are applicable to lessors.

The IASB states in the Basis for Conclusions⁵ to the amendment that it decided not to provide lessors with practical relief for rent concessions occurring as a direct consequence of the covid-19 pandemic for the following reasons: (i) IFRS 16 does not specify how a lessor accounts for a change in lease payments that is not a lease modification; and (ii) any practical expedient would adversely affect the comparability of, and interaction between, the lessor accounting requirements in IFRS 16 and related requirements in other standards (in particular, IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*).

The definition of a lease modification in IFRS 16 applies equally to lessors as to lessees.

3.1 Collectability

Many lessees may face financial difficulties due to government mandated closure of businesses. This may cause a significant deterioration in collectability of lease payments from certain lessees.

Unlike other standards such as IFRS 15, IFRS 16 does not refer to collectability to determine whether (and when) lease income should be recognised. Therefore, we believe that a lessor may continue to recognise operating lease income even when collectability is not probable. However, other approaches may also be appropriate when there is significant doubt about collectability. Therefore, there could be diversity in practice and it is important to consider the view from the local regulator. Regardless of the approach followed, IFRS 9's guidance on credit losses continues to be applicable to recognised lease receivables.

Illustration 6 – Operating lease income not expected to be fully collectable

Restaurant A leases space in a shopping mall from Lessor B. Lessor B classifies the lease as an operating lease.

Under the terms of the lease, Restaurant A makes fixed lease payments of CU 100 to Lessor B at the beginning of each month. The non-cancellable lease term ends on 28 February 2022. The contract does not include any non-lease components, extension, termination or purchase options. For simplicity, the discount rate is assumed to be 0% at the commencement date.

Due to significant financial difficulties, at the end of June, Restaurant A has indicated that it will only pay 25% of the lease receivable due for the month of July 2020. Up to 31 July 2020, CU 25 has been collected and Lessor B does not expect the remaining amount of CU 75 due in respect of July to be recovered considering Restaurant A's financial condition.

⁵ IFRS 16.BC240(A)

Analysis

Approach 1 - Recognising the full operating lease income

Lessor B recognises the full operating lease income on a straight-line basis of CU 100 per month in accordance with paragraph 81 of IFRS 16.

Lessor B recognises a lease receivable and an impairment loss of CU 75 reflecting the remote likelihood of collection in accordance with IFRS 9.

Under this approach, Lessor B records the following entries:

Dr Lease receivable	CU 100	
Cr Operating lease income		CU 100

To record the operating lease income and lease receivable for July 2020

Dr Cash	CU 25	
Cr Lease receivable		CU 25

To record receipt of CU 25 from the lessee

Dr Impairment loss on lease receivable	CU 75	
Cr Impairment allowance on lease receivable		CU 75

To record an impairment loss against the lease receivable

Approach 2 - Recognition of operating lease income to the extent collectable

Under this approach, Lessor B accounts for the monthly lease income to the extent collectable. This approach reflects the high uncertainty related to the collectability of the full lease payments and Lessor B's concerns about the appropriateness of reporting income when the likelihood of collecting the full amount is considered to be remote.

Under this approach, Lessor B records the following entries:

Dr Lease receivable	CU 25	
Cr Operating lease income		CU 25

To record the operating lease income for July 2020

Dr Cash	CU 25	
Cr Lease receivable		CU 25

To record receipt of CU 25 from the lessee

A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Under IFRS 16, a lessor of a finance lease is required to apply the impairment requirements in IFRS 9 to the net investment in the lease

3.2 Accounting for a modification

Lessor accounting for lease modifications depends on the classification of the lease.

A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

A lease modification to a finance lease that increases the scope of the lease and increases the consideration by an amount commensurate with the stand-alone price, is accounted for as a separate lease. This is discussed further in

[Applying IFRS: A closer look at IFRS 16 Leases](#). For a modification to a finance lease that is not accounted for as a separate lease:

- ▶ If the lease would have been classified as an operating lease, had the modification been in effect at the lease inception date, the lessor accounts for the lease modification as a new lease from the effective date of the modification and measures the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- ▶ Otherwise, the lessor accounts for the net investment in the lease in accordance with IFRS 9.

Illustration 7 – Forgiveness of future lease payments of an operating lease

Assume the same fact pattern in Illustration 6 above, except for the following:

All lease payments due up to 30 June 2020 have been received in a timely manner. On 30 June 2020, in compensation for the closure of the shopping mall. Lessor B agrees to forgive Restaurant A's future lease payments for the months of July, August and September 2020.

Analysis

The rent concession results in a decrease in the total lease payments. Thus, there has been a change in the consideration for a lease that was not part of the original terms and conditions of the contract. Therefore, the rent concession constitutes a lease modification. The modification does not change the classification of the lease as an operating lease.

On the effective date of the modification (i.e., 30 June 2020), Lessor B accounts for the modification as a new lease, as follows:

- ▶ The remaining lease payments under the modified lease comprise CU 1,700 (lease payments of CU 100 per month from October 2020 to February 2022).
- ▶ The remaining lease term is 20 months.
- ▶ The monthly operating lease income to be recognised over the remaining lease term is therefore $CU\ 1,700 / 20\ months = CU\ 85$.

In some cases, a lessor may forgive past lease payments that are recognised as a lease receivable in an operating lease. The rent concession results in a change in the consideration for the lease that was not part of the original terms of the lease and therefore may be viewed as a lease modification. An alternative view may be to consider that the forgiveness of the past lease payments is an extinguishment of the operating lease receivable and the derecognition requirements of IFRS 9 apply. Paragraph 2.1(b)(i) of IFRS 9 clarifies that operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of IFRS 9. When IFRS 9 is applied in these situations, we believe the lessor has an accounting policy choice, to be applied consistently, to either include or exclude the expected forgiveness of lease payments in the ECL assessment of operating lease receivables. The approaches applying IFRS 16 and IFRS 9 are illustrated below.

Illustration 8 – Waiver of lease receivable in an operating lease

Assume the same fact pattern in Illustration 6 above, except for the following:

Due to its financial difficulties, Restaurant A did not pay the lease payment for June 2020. Consequently, Lessor B recognised, in accordance with IFRS 9, an impairment loss of CU 20 on 30 June 2020, which takes into consideration the collateral in the contract.

On 1 July 2020, Lessor B grants a rent concession that waives CU 60 of the outstanding amount for June 2020. The remaining amount (CU40) is paid shortly after.

Analysis

Approach 1- Lease modification under IFRS 16.

The rent concession results in a decrease in the total lease payments and, thus, there has been a change in the consideration for a lease that was not part of the original terms and conditions of the contract. Therefore, the rent concession constitutes a lease modification. Assume the modification does not change the classification of the lease as an operating lease.

Lessor B records the following entries for June 2020:

Dr Lease receivable	CU 100	
Cr Operating lease income		CU 100

To record the operating lease income and lease receivable for June 2020

Dr Impairment loss on lease receivable	CU 20	
Cr Impairment allowance on lease receivable		CU 20

To record an impairment loss against the lease receivable

Paragraph 87 of IFRS 16 requires that a lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Therefore, at the effective date of the modification (i.e., 1 July 2020), Lessor B accounts for the new lease with a lease term that ends in February 2022. The remaining lease payments after taking into account the partial forgiveness of the June lease payment amount to CU 1,940 (CU 2,000 - CU 60).

Lessor B records the following entries for July 2020:

Dr Lease incentive	CU 60	
Cr Lease receivable		CU 60
Dr Impairment allowance on lease receivable	CU 20	
Cr Profit/loss		CU 20

To recognise the lease incentive (forgiveness of CU 60) to enter into the modified lease and reverse the IFRS 9 allowance recognised in June 2020

Dr Cash	CU 40	
Cr Lease receivable		CU 40

To record receipt of partial payment

Dr Lease receivable	CU 100	
Cr Operating lease income		CU 100
Dr Operating lease income	CU 3	
Cr Lease incentive		CU 3

To recognise July 2020 lease income of CU 100 (based on the monthly CU 100 payments) less amortisation of the lease incentive of CU 3 (CU60 divided by 20 months)

Therefore, operating lease income of CU 97 will be recognised each month for the remainder of the new lease term. The IFRS 9 impairment loss of CU 20 is written back to profit or loss when the CU 60 of the receivable is forgiven.

Under this approach, since the remaining CU 40 recognised receivable of the pre-modified lease has already been recognised in income and will be received, it is not carried forward to the new lease.

Approach 2- Derecognition of past lease receivable under IFRS 9

Lessor B records the following entries for June 2020:

Dr Lease receivable	CU 100
Cr Operating lease income	CU 100

To record the operating lease income and lease receivable for June 2020

Dr Impairment loss on lease receivable	CU 20
Cr Impairment allowance on lease receivable	CU 20

To record an impairment loss against the lease receivable

Lessor B records the following entries for July 2020:

Dr Impairment allowance on lease receivable	CU 20
Dr Derecognition loss on lease receivable	CU 40
Cr Lease receivable	CU 60

To derecognise the past lease receivable that is forgiven

Under this approach, the forgiveness of the lease receivables that were previously impaired under IFRS 9 do not impact the lease modification accounting. Therefore, the lessor in this illustration would continue to recognise CU 100 of lease income over the new lease term (i.e., based on the regular payments of CU 100 over the new lease term).

How we see it

- ▶ Lessors need to carefully evaluate the requirements of impairment and derecognition of lease receivables under IFRS 9 and its interaction with IFRS 16 when rent concessions are granted.
- ▶ The amendment to IFRS 16 discussed in section 2.2 applies only to lessees and lessors are required to apply the lease modification accounting requirements to covid-19 related rent concessions where applicable. Therefore, entities that are sublessors may have asymmetry in the accounting treatment of these types of rent concessions between the treatment of the head lease (where the entity is a lessee) and the sublease (where the entity is a lessor).

3.2.1 Recognition of operating lease income after modification

As discussed above, lessors account for a modification to an operating lease as a new lease from the effective date of the modification. If the new lease is classified as an operating lease, the lessor applies paragraph 81 of IFRS 16 and recognises lease payments on a straight-line basis, unless there is another systematic basis which is more representative of the pattern in which benefit from the use of the underlying asset is diminished.

3.3 Accounting for a rent concession that does not constitute a modification

If a change in lease payments does not meet the definition of a lease modification, that change would generally be accounted for as a negative variable lease payment. In the case of an operating lease, a lessor recognises the effect of the rent concession by recognising lower income from leases.

3.4 Disclosure

IFRS 16 requires lessors to disclose information that gives a basis for users of financial statements to assess the effect that leases have on their financial position, financial performance and cash flows. Whilst there are no specific disclosure requirements related to lease modifications, lessors will need to disclose information that is sufficient to enable users of financial statements to understand the impact of covid-19 related changes in lease payments on the entity's financial position and financial performance.

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