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IFRS Developments

IASB releases educational material on COVID-19 related rent concessions applying IFRS 16 *Leases*

What you need to know

- The IASB released a document responding to questions about the application of IFRS 16 to rent concessions granted as a result of the COVID-19 pandemic.
- The document is for educational purposes, highlighting the requirements within IFRS 16 and other IFRS standards.
- The document does not change, remove, nor add to, the requirements in IFRS standards.

Summary

On 10 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.

The document explains how an entity evaluates whether a rent concession constitutes a lease modification, which is defined under 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 assessing whether there has been a change in the scope of a lease or the consideration for a lease, an entity considers whether there has been a change in the right of use conveyed to the lessee by the contract and the overall effect of any change in the lease payments. If there has been a change in either the scope of, or the consideration for, the lease, an entity next considers whether that change was part of the original terms and conditions of the lease, taking into account both the terms and conditions of the contract and all relevant facts and circumstances including contract, statutory or other law or regulation applicable to lease contracts. If a change in lease payments does not result from a lease modification, that change would generally be accounted for as a variable lease payment. In this case, a lessee generally recognises the effect of the rent concession in profit or loss. A lessor recognises the effect of the rent concession in an operating lease by recognising lower income from leases.

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Lease modifications

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. Both lessees and lessors apply the same definition of a lease modification.

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 rent holiday or rent reduction alone is not 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, if a lessee does not make lease payments for a three-month period, the lease payments for periods thereafter may be increased proportionally in a way that means that the consideration for the lease is unchanged.

A change that was not part of the original terms and conditions of the lease

If there has been a change in either the scope of, or the consideration for, the lease, an entity next considers whether that change was part of the original terms and conditions of the lease. As specified in paragraph 2 of IFRS 16, an entity is required to consider the terms and conditions of contracts and all relevant facts and circumstances when applying the standard. Relevant facts and circumstances may include contract, statutory or other law or regulation applicable to lease contracts.

The applicable law or regulations are part of the original terms and conditions of the lease, even if the effect of those clauses (arising from an event such as the COVID-19 pandemic) was not previously contemplated. In such a case, there is no lease modification for the purposes of IFRS 16.

For example, lease contracts or applicable law or regulation may contain clauses that result in changes to payments if particular events occur or circumstances arise. Government action (for example, requiring the closure of retail stores for a period of time because of COVID-19 pandemic) might be relevant to the legal interpretation of clauses, such as *force majeure*, that were in the original contract or in applicable law or regulation. Changes in lease payments that result from clauses in the original contract or in applicable law or regulation are part of the original terms and conditions of the lease, even if the effect of those clauses (arising from an event such as the COVID-19 pandemic) was not previously contemplated. In such a case, there is no lease modification for the purposes of IFRS 16.

Accounting for a change in lease payments

IFRS 16 provides specific guidance for both lessors and lessees if a change in lease payments constitutes a lease modification. If a change in lease payments does not constitute a lease modification, that change would generally be accounted for as a variable lease payment. In this case, a lessee generally recognises the effect of the rent concession in profit or loss in the period in which the event or condition that triggers the rent concession occurs. A lessor recognises the effect of the rent concession in an operating lease by recognising lower income from leases.

If a change in lease payments results in the (partial) extinguishment of a lessee's obligation specified in the contract (for example, a lessee is legally released from its obligation to make specifically identified payments), the lessee would consider whether the requirements for derecognition of (part of) the lease liability are met applying paragraph 3.3.1 of IFRS 9 *Financial Instruments*.

Impairment of assets

Entities are required to apply IAS 36 *Impairment of Assets* in determining whether right-of-use assets (for lessees) and intangibles and items of property, plant and equipment subject to an operating lease (for lessors) are impaired. The circumstances that give rise to rent concessions as a result of the COVID-19 pandemic are likely to indicate that assets may be impaired. For example, loss of earnings during the period covered by a rent concession may be an indicator of impairment of the related right-of-use asset. Similarly, longer-term effects of the COVID-19 pandemic could affect the expected ongoing economic performance of right-of-use assets. Lessors will also need to consider the applicable requirements of IFRS 9, for example, when accounting for any impairment of lease receivables.

Disclosure

Entities are required to apply the disclosure requirements of IFRS 16 and other IFRS standards, such as IAS 1 *Presentation of Financial Statements*. For example, IFRS 16 requires both lessees and 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. The information disclosed will need to be sufficient to enable users of financial statements to understand the impact of changes in lease payments arising from the COVID-19 pandemic on the entity's financial position and financial performance (paragraph 31 of IAS 1).

How we see it

The document provides high level guidance to both lessees and lessors on some of the practical issues related to rent concessions granted as a result of the COVID-19 pandemic. Entities will need to evaluate the accounting impact of a rent concession by carefully examining the specific terms and conditions of the lease contract as well as the applicable law and regulations.

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