

Potential Impact on Lease Accounting

What you need to know (July 2020)

What's the issue?

1. The COVID-19 pandemic is affecting the ability of organizations to collect and pay rent and meet other lease obligations. Therefore, companies should use professional judgment and consider the potential implications that COVID-19 could have relating to the accounting for leases under IFRS 16 Leases.

What if a lessee receives rent concessions?

2. Lessees may receive rent assistance from lessors in the form of reduced rent or rent-payment deferral. Generally, the accounting treatment for these rent concessions will depend on whether:
 - (a) the lessee was entitled to the economic relief based on contractual or legal rights; or
 - (b) the relief was given or negotiated outside the original lease agreement.
3. If the economic relief was based on contractual or legal rights, in accordance with IFRS 16:
 - (a) treat as variable rent (i.e., negative variable rent) in the period incurred; and
 - (b) recognize variable lease payments in profit or loss when the variability or conditionality is resolved. ([IFRS 16.38](#))
4. If the economic relief was given or negotiated outside the original lease agreement, in accordance with IFRS 16:
 - (a) treat as a lease modification:
 - (i) remeasure the lease liability by discounting the revised lease payments using a revised discount rate; and
 - (ii) make a corresponding adjustment to the right-of-use (ROU) asset. ([IFRS 16.44-46](#)); or

- (b) apply the practical expedient that was added to IFRS 16 in June 2020 as described in paragraph 7 below:
 - (i) permits lessees not to assess whether certain rent concessions that occur as a direct consequence of the COVID-19 pandemic and are due on or before June 30, 2021 are lease modifications; and
 - (ii) account for rent concessions related to applying the practical expedient as if they were not lease modifications (i.e. based on contractual or legal rights) ([IFRS 16.46A-B](#)).
- 5. Lessees and lessors may also receive economic relief in the form of government subsidies.
 - (a) If a lessee receives relief directly from the government, or indirectly from the government (i.e., the lessor acts as an agent and passes the government subsidy to the lessee), in accordance with IFRS 16:
 - (i) treat as a government grant (apply IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*).
 - (b) If a lessor receives government relief and gives all or a portion of it directly to the lessee, in accordance with IFRS 16:
 - (i) the relief is considered economic relief given by the lessor outside the original lease agreement; and
 - (ii) treat as a lease modification ([IFRS 16.44-46](#)).
- 6. The U.S Financial Accounting Standards Board (FASB) staff received feedback from stakeholders on the challenges in determining whether rent concessions are lease modifications. In response to this, the FASB staff issued a [question-and-answer \(Q&A\) document](#) that includes interpretative guidance on the application of Topic 842, *Leases* to Covid-19 related rent concessions. The FASB staff Q&A indicates that entities can elect to not apply the lease modification guidance in Topic 842 and, instead, treat the relief as if it was based on contractual or legal rights.
- 7. Furthermore, the International Accounting Standards Board (IASB) issued an Exposure Draft (ED) in April 2020 and, based on the feedback received, amended IFRS 16, as discussed in paragraph 4 above, to include an exemption for lessees to account for COVID-19 related rent concessions as if they were not lease modifications (i.e., as if the relief was based on contractual or legal rights). The Accounting Standards Board incorporated the amendment to IFRS 16 into Part I of the CPA Canada Handbook – Accounting on July 1, 2020. The amendment is effective for annual reporting periods beginning on or after June 1, 2020. Earlier application is permitted, including in financial statements not authorized for issue at May 28, 2020.

What about reassessment of lease options or lease terms?

- 8. Lessees may request renegotiation of an existing lease contract or early cancellation of a lease which requires consideration of the need to:
 - (a) account for lease termination penalties; and
 - (b) assess whether the lease term needs revising and consider whether the lessee will exercise option to extend or terminate the lease. ([IFRS 16.20-21](#))

9. Subsequent remeasurement of the lease liability is needed if:
- (a) lease terms are revised;
 - (b) lease options are reassessed;
 - (c) lease payments are not being made (this reduces the carrying amount); or
 - (d) the lessee's incremental borrowing rate changed. ([IFRS 16.40-43](#))

How could interest rate changes affect me?

10. A drop in interest rates likely will affect a lessee's incremental borrowing rate. This will increase the amount of a lessee's calculated ROU assets and lease liabilities, which affects the balance sheet when a lessee has new leases or remeasures its leases. ([IFRS 16.42-43](#))

Should I consider impairments to my ROU assets?

11. Lessees need to assess whether ROU assets are impaired. Impairments to ROU assets could occur as a result of business closures, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from using the underlying asset. Apply IAS 36 *Impairment of Assets* ([IFRS 16.33](#))
12. Lessors need to consider any impairments of lease receivables. Apply IFRS 9 *Financial Instruments* ([IFRS 16.77](#))

How will financial statement disclosures be affected?

13. Lessees and lessors need to consider the need for expanded disclosures on how COVID-19 affects the accounting for leases. The information disclosed needs to help financial statement users understand how COVID-19 affects changes in lease payments on the entity's financial position and financial performance. ([IAS 1.31](#))
14. For lessees that applied the practical expedient added to IFRS 16, the lessee needs to disclose:
- (i) that it applied the practical expedient; and
 - (ii) the amount recognized in profit or loss to reflect the changes in lease payments arising from applying the practical expedient. ([IFRS 16.60A](#))

Has the IFRS® Discussion Group talked about this topic?

15. The Group has had several conversations on leases. The discussions listed may be helpful as you think how COVID-19 could affect the accounting for leases:

Meeting Date	Topic	Meeting Report
May 27, 2020	IFRS 16: Accounting for COVID-19 Related Rent Concessions	View Document
June 20, 2019	Determining Lease Payments	View Document
October 16, 2018	Lessee's Discount Rate	View Document
January 10, 2018	Future Lease Payments	View Document
January 10, 2018	Lessee's Discount Rate	View Document
October 5, 2017	Lease Term	View Document

What other resources are available?

16. Do you need more information? The following publications may provide more insight:

Resources (IFRS® Standards)

IASB, "[IFRS 16 and Covid-19](#)," IFRS Foundation, April 10, 2020.

BDO, "[IASB Issues Amendments to IFRS 16: Covid-19 Related Rent Concessions](#)," May 28, 2020.

Grant Thornton, "[COVID 19: Accounting for lease modifications](#)," June 4, 2020.

KPMG, "[Rent concessions – Practical relief for lessees](#)," June 23, 2020.

Resources (U.S. GAAP)

FASB Staff Q&A, "[Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic](#)".

BDO, "[Insights: FASB Votes to Defer the Effective Date of ASC 842](#)," April 2020.

KPMG, "[Lease Accounting Impacts of COVID-19](#)," March 16, 2020.

Matt Waters, "[How Lease Accounting Will Be Affected by Coronavirus](#)," FEI Daily, March 31, 2020.

Extracts from relevant IFRS Standards

Standard	Guidance
IAS 1	<p>31 Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.</p>
IFRS 16	<p>20 A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:</p> <ul style="list-style-type: none"> (a) is within the control of the lessee; and (b) affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph B41). <p>21 An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:</p> <ul style="list-style-type: none"> (a) the lessee exercises an option not previously included in the entity's determination of the lease term; (b) the lessee does not exercise an option previously included in the entity's determination of the lease term; (c) an event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term; or (d) an event occurs that contractually prohibits the lessee from exercising an option previously included in the entity's determination of the lease term. <p>33 A lessee shall apply IAS 36 <i>Impairment of Assets</i> to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.</p> <p>38 After the commencement date, a lessee shall recognise in profit or loss, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:</p> <ul style="list-style-type: none"> (a) interest on the lease liability; and (b) variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.
	<p>40 A lessee shall remeasure the lease liability by discounting the revised lease</p>

Standard	Guidance
	<p>payments using a revised discount rate, if either:</p> <ul style="list-style-type: none"> (a) there is a change in the lease term, as described in paragraphs 20-21. A lessee shall determine the revised lease payments on the basis of the revised lease term; or (b) there is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 20-21 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option. <p>41 In applying paragraph 40, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee’s incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.</p> <p>42 A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:</p> <ul style="list-style-type: none"> (a) there is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee. (b) there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments. <p>43 In applying paragraph 42, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.</p> <p>44 A lessee shall account for a lease modification as a separate lease if both:</p> <ul style="list-style-type: none"> (a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and (b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract. <p>45 For a lease modification that is not accounted for as a separate lease, at the <i>effective date of the lease modification</i> a lessee shall:</p>

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	<ul style="list-style-type: none"> (a) allocate the consideration in the modified contract applying paragraphs 13-16; (b) determine the lease term of the modified lease applying paragraphs 18-19; and (c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
46	<p>For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:</p> <ul style="list-style-type: none"> (a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognise in profit or loss any gain or loss relating to the partial or full termination of the lease. (b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.
46A	<p>As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 46B is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.</p>
46B	<p>The practical expedient in paragraph 46A 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:</p> <ul style="list-style-type: none"> (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 on or before 30 June 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and (c) there is no substantive change to other terms and conditions of the lease.
60A	<p>If a lessee applies the practical expedient in paragraph 46A, the lessee shall disclose:</p> <ul style="list-style-type: none"> (a) that it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 46B or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see paragraph 2); and (b) the amount recognised in profit or loss for the reporting period to reflect

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	<p>changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 46A.</p> <p>77 A lessor shall apply the derecognition and impairment requirements in IFRS 9 to the net investment in the lease. A lessor shall review regularly estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.</p>