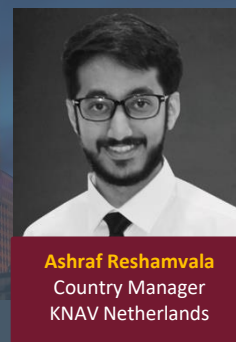




IFRS 16 – LEASES: RENT CONCESSIONS

DECEMBER 2020



Due to the impact of the COVID-19 pandemic on business conditions, many lessees are seeking rent concessions from lessors. Rent concessions may take the form of a one-off reduction in rent, a deferral of rent or a change in the nature of rent – e.g. fixed payments becoming variable.

Under IFRS 16 Leases, rent concessions often meet the definition of a lease modification. The accounting for lease modifications can be complex. For example, the lessee may be required to recalculate lease liabilities using a revised discount rate and adjust right-of-use assets.

In the recent amendments to IFRS 16, a practical expedient has been introduced for lessees – i.e. a lessee is not required to assess whether eligible rent concessions that are a direct consequence of the COVID-19 pandemic are lease modifications. Instead, it accounts for them under other applicable guidance. For example, if the rent concession was in the form of a one-off reduction in rent, then it would be accounted for as a variable lease payment and be recognised in profit or loss.

The amendments were issued swiftly and, for practical purposes, can be applied immediately subject to any local endorsement process. No such relief is provided for lessors. Lessors are required to assess whether rent concessions are lease modifications and, if so, account for them accordingly.

This article provides a practical guidance on how a company identifies rent concessions that qualify for the practical expedient – and how to account for them.

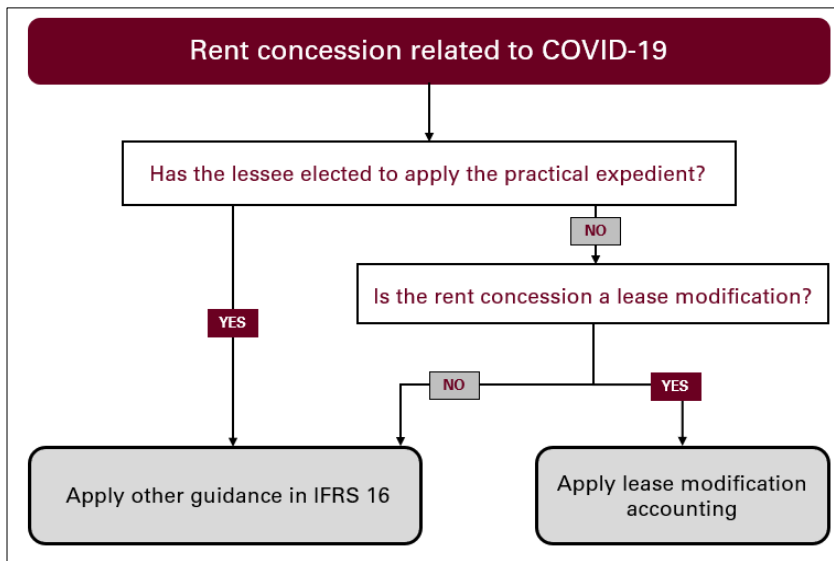
1. The practical expedient applies only to eligible rent concessions; eligibility is strictly time limited. The key conditions for applying the practical expedient are as follows:

Scope of the practical expedient	
Criteria involved	Additional guidance
Is the rent concession a direct consequence of the COVID-19 pandemic?	<p>Factors to consider to determine a direct consequence include, but are not limited to:</p> <ul style="list-style-type: none"> Reason and timing of negotiation between lessor and lessee regarding rent concession Whether reason is explicitly stated in a supplementary agreement Relevant laws and regulations in specific jurisdictions <p>The commencement of a lockdown in a country may not be a determinative evidence of a direct consequence of COVID-19 as many businesses have experienced disruption to trading activities both before and after the official lockdown periods.</p>
Is the revised consideration for the lease substantially the same as, or less than, the consideration immediately preceding the change?	<ul style="list-style-type: none"> If the lease payments are deferred during the COVID-19 pandemic and the deferred payments are increased to compensate the lessor for the time value of money relating to the deferred payments, then these increases do not disqualify the concession from the practical expedient. The practical expedient applies only to agreed rent concessions and not to payment shortfalls.

Does the rent concession reduce lease payments originally due on or before 30 June 2021?	<ul style="list-style-type: none"> • Not having a definitive timeframe could lead to companies applying the practical expedient to future changes to the lease contract that are unrelated to the COVID-19 pandemic merely because its economic effects are long-lasting.
Are there other substantive changes to terms and conditions of the lease?	<ul style="list-style-type: none"> • A company assesses whether there are changes to other terms and conditions in the lease contract that are not a direct consequence of the COVID-19 pandemic – i.e. those for which the practical expedient does not apply. • In all cases, a lessee is expected to make the judgement about whether other changes are substantive based on its understanding of those changes.

2. Applying the practical expedient

The amendments permit lessees, as a practical expedient, not to assess whether rent concessions relating to the COVID-19 pandemic are lease modifications. Instead, these lessees account for those rent concessions under other guidance in the standard, as set out in the following flowchart:



The practical expedient reduces the effort and subjectivity involved in assessing whether eligible rent concessions are lease modifications. It also avoids some of the complexities involved in lease modification accounting. However, some lessees may prefer to apply the standard’s existing requirements to all changes in lease contracts.

Forgiveness of lease payments - One common form of rent concession arising from the COVID-19 pandemic is lessors offering rent-free periods or ‘rent holidays’ to their lessees, with no other changes to the lease.

Deferral of lease payments - The concession granted may involve the reduction of lease payments in some periods with an increase in payments in other periods. When a rent concession involves deferred lease payments only, the lessee accounts for the change by recognising the impact in the period when no payment is made by continuing to reduce the lease liability.

Lessees are required to apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances. This is consistent with the standard's existing requirements. The practical expedient does not alter the standard's existing requirements for lease changes that are not accounted for as lease modifications. For example, if changes in lease payments do not arise from a lease modification then they are generally accounted for as variable lease payments.

3. Disclosure requirements

In addition to the standard's existing disclosure requirements, the amendments require a lessee applying the practical expedient to disclose:

- that it has applied the practical expedient to all rent concessions that meet the conditions; or
- information about the nature of the leases and/or concessions to which it has applied the practical expedient if it has not applied the practical expedient to all rent concessions that meet the conditions;
- the amounts recognised in profit or loss for the reporting period to reflect changes in lease payments arising from rent concessions that meet the conditions of the practical expedient
- If the rent concession results in the adjustment of the carrying amount of the lease liability, then the lessee discloses this as a non-cash change in lease liabilities when disclosing changes in liabilities arising from financing activities

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