Global IFRS Specialist Group

Covid-19, Lease Accounting and Rent Concessions: A brief overview

Rent Concessions: Practical Relief for Lessees

In May 2020, the International Accounting Standards Board (IASB) issued *Covid-19-Related Rent Concessions*, which amended IFRS 16 Leases.

The amendment permits lessees, as a practical expedient, not to assess whether particular rent concessions occurring as a direct consequence of the Covid-19 pandemic are lease modifications and instead to account for those rent concessions as if they are not lease modifications. The amendment does not affect lessors.

Under IFRS 16 Leases, rent concessions often meet the definition of a lease modification and the accounting for lease modifications can be complex, with the need to recalculate lease liabilities using a revised discount rate and adjust the corresponding right-of-use assets.

Practical expedient for Covid-19 related rent concessions: e.g. 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 is recognised in profit or loss.

Scope and Objective of the Amendment

Rent concessions are eligible for the practical expedient if they occur as a direct consequence of the Covid-19 pandemic, only, and if all of the following criteria 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; and
- there is no substantive change to the other terms and conditions of the lease.

Companies electing to apply the practical expedient are required to provide adequate disclosures in their financial statements (e.g. amounts recognised in profit or loss arising from the application of the practical expedient or any non-cash changes in its lease liabilities).

Produced by the Global IFRS Specialist Group

Our Global IFRS specialists have the benefit of continuing day-to-day experience in IFRS. This means that we can bring practical knowledge to IFRS questions raised and help to apply the sometimes complex regulations in a way that minimises the risk of audit adjustments or the detection of accounting errors by national regulators.

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Accounting for Rent Free Periods (Rent Holidays): Example

The Background

Lessee A entered into a lease contract with Lessor B to lease 1,500m2 of retail space for five years. The lease commenced on 1 January 2018 and the rental payments are 100,000 payable quarterly in advance on 1 January, 1 April, 1 July and 1 October. A's incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). There are no initial direct costs, lease incentives or dismantling costs.

A's business is severely impacted by the COVID-19 pandemic and A and B negotiate a rent concession. On 1 June 2020, B agrees to provide A with an unconditional rent concession that allows A to forego payment of its rent due on 1 July – i.e. B forgives A the rent payment of 100,000 due on 1 July.

The Accounting

1. A determines that the rent concession is eligible for the practical expedient.
2. In determining how to account for the rent concession, A notes that it results in a forgiveness of rent. Applying the practical expedient, A accounts for this forgiveness of rent as a negative variable lease payment.
3. A notes that the rent concession is unconditional and so the event that triggers the variable lease payment is A and B agreeing the rent concession on 1 June 2020. Therefore, A accounts for the rent concession as a negative variable lease payment on 1 June.
4. Lease accounting entries will be as follows:
    a) recognise the rent concession as a variable lease payment in profit or loss (i.e. decrease the lease liability and a recognise a corresponding credit in the income statement);
    b) continue to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5%.
5. After accounting for the impact of the rent concession, A's lease liability represents the present value of all future lease payments owed to B, discounted at the unchanged incremental borrowing rate.
6. A has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020. In addition, A continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.

Modification Accounting: Overview

Change to the contractual terms and conditions	
Change in consideration e.g. reduction in rent	Decrease in scope e.g. reduction of lease term
Remeasure lease liability and adjust right of use asset: no effect on P/L	Recognise gain/loss for the termination, then remeasure lease liability and adjust right of use asset

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Modification Accounting: Example

The Background

Lessee A enters into a 20-year lease of office space with Lessor B. The lease commences on 1 April 2010.

Annual lease payments are €150,000, payable in arrears, and X's incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). Total lease payments are €3m.

A does not provide any residual value guarantee. There are no initial direct costs, lease incentives or other payments between A and B.

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Therefore, A initially recognises a lease liability and right-of-use asset of €1,9m (net present value of €3m total payments).

At the end of March 2020, A and B agree to reduce annual lease payments to €100,000. I.e. total lease payments reduce from €3m to €2.5m. Although the change in consideration for the lease is taking place during the COVID-19 pandemic, the reduction in lease payments relates to payments originally due beyond 30 June 2021, i.e. the **rent concession does not qualify for the practical expedient**.

The Accounting

The effective date of the modification is 31 March 2020. At this date, the lease liability is €1.2m (NPV of €1.5m), the right-of-use asset is €0.9m (€1.9m depreciated since 10 years) and A's incremental borrowing rate shall be 6% (assume that the interest rate implicit in the lease cannot be readily determined).

A remeasures the lease liability at €0.7m based on:

- annual lease payments payable of 100,000;
- a remaining lease term of 10 years; and
- a revised incremental borrowing rate of 6%.

A recognises the difference between the carrying amount of the lease liability before the modification (€1.2m) and the carrying amount of the modified lease liability (€0.7m) of €0.5m as an adjustment to the right-of-use asset. The lease modification has no effect on A's p/l.