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## IASB® meeting

Date	<b>May 2023</b>
Project	<b>Lessee derecognition of lease liabilities (IFRS 9)</b>
Topic	<b>Potential annual improvement</b>
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## Introduction

1. We have been informed about a potential lack of clarity about a lessee's accounting for derecognition of a lease liability. The lack of clarity arises because paragraph 2.1(b)(ii) of IFRS 9 *Financial Instruments* includes a cross-reference to paragraph 3.3.1, but not paragraph 3.3.3, of IFRS 9, which can affect the corresponding adjustment a lessee makes when its lease liability has been extinguished and it removes that liability from its statement of financial position.
2. The IFRS Interpretations Committee (Committee) discussed this matter at its meeting in March 2023—see [Agenda Paper 6A](#) for that meeting.
3. The objective of this paper is:
  - (a) to provide the International Accounting Standards Board (IASB) with background on the matter and staff analysis, including consideration of the Committee's discussion; and
  - (b) to ask the IASB whether it agrees with our recommendation to include a proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 in its next *Annual Improvements to IFRS Accounting Standards Cycle* (annual improvements).

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## Structure of this paper

4. This paper includes:
  - (a) [Background information](#);
  - (b) [Staff analysis](#), including consideration of the Committee's discussion and transition requirements;
  - (c) [Staff recommendations and question for the IASB](#);
  - (d) [Appendix A—recommended proposed amendment to IFRS 9](#); and
  - (e) [Appendix B—discussion of other potential annual improvements](#).

## Summary of staff recommendations

5. We recommend that the IASB:
  - (a) propose an amendment to paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9;
  - (b) require prospective application of this proposed amendment; and
  - (c) include this proposed amendment (see Appendix A to this paper) in its next annual improvements cycle.

## Background information

6. At its March 2022 meeting ([Agenda Paper 4](#)), the Committee discussed a request about a lessor's and a lessee's application of IFRS 9 and IFRS 16 *Leases* in accounting for a rent concession in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under the contract.<sup>1</sup> At its March 2023 meeting ([Agenda Paper 6A](#)), the Committee discussed a potential annual

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<sup>1</sup> The Committee addressed a **lessor's** application of IFRS 9 and IFRS 16 in Agenda Decision [Lessor Forgiveness of Lease Payments \(IFRS 9 and IFRS 16\)](#) published in October 2022.

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improvement related to **lessee** accounting for a rent concession in the submitted fact pattern—a potential amendment to IFRS 9 related to lease liability extinguishment.<sup>2</sup>

### ***Lease liability extinguishment***

7. Paragraph 2.1(b)(ii) of IFRS 9 states that ‘lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 3.3.1’ of IFRS 9.
8. Paragraph 3.3.1 of IFRS 9 states that ‘an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished ...’.
9. Paragraph 3.3.3 of IFRS 9 states that [emphasis added] ‘the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished ... and the consideration paid, including any non-cash assets transferred or liabilities assumed, *shall be recognised in profit or loss*’.
10. The staff has been informed that there is more than one way to read the requirements about how a lessee makes a corresponding adjustment when its lease liability has been extinguished and it removes that liability from its statement of financial position applying paragraph 3.3.1 of IFRS 9. The lessee could either:
  - (a) recognise the gain or loss in profit or loss applying paragraph 3.3.3 of IFRS 9—but is not required to do so because paragraph 2.1(b)(ii) of IFRS 9 does not refer to paragraph 3.3.3 of IFRS 9.
  - (b) make a corresponding adjustment to its right-of-use asset recognised applying IFRS 16.

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<sup>2</sup> The Committee also discussed at its March 2023 meeting a potential annual improvement related to the definition of a lease modification in IFRS 16. The staff recommends not further pursuing that amendment as an annual improvement. Discussion of that matter is included in Appendix B to this paper.

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**Question raised**

11. The question raised is whether a lessee applying IFRS 9 to account for an extinguishment of its lease liability should apply only paragraph 3.3.1 of IFRS 9 or both paragraphs 3.3.1 and 3.3.3 of IFRS 9.

**Staff analysis**

12. We would expect that a lessee that has applied paragraph 3.3.1 of IFRS 9 would apply paragraph 3.3.3 of IFRS 9 to determine the amount to be recognised in profit or loss. In our view, the IASB intended a lessee to apply, in sequence, paragraphs 3.3.1 and 3.3.3 of IFRS 9, and the lack of a cross-reference to paragraph 3.3.3 in paragraph 2.1(b)(ii) of IFRS 9 was an oversight. Paragraph 3.3.1 of IFRS 9 provides requirements for derecognition of a financial liability when it is extinguished, and paragraph 3.3.3 of IFRS 9 provides requirements for accounting for a gain or loss on extinguishment of a financial liability. In our view, the IASB intended these two paragraphs to be read together. We have identified no other requirements in IFRS 9 or discussion in the Basis for Conclusions on IFRS 9 to suggest otherwise. We also see no indication that the IASB intended a lessee to account for a gain or loss on extinguishment of its lease liability by adjusting its right-of-use asset applying IFRS 16.
13. In our view, this matter can be efficiently resolved by amending paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9 (see Appendix A to this paper). This would be a minor correction to resolve an oversight in paragraph 2.1(b)(ii) of IFRS 9.

**Does this matter meet the annual improvements criteria?**

14. Paragraphs 6.10–6.13 of the *Due Process Handbook* include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:

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- (a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or
  - (b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.
15. In our view, our proposed solution to amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9 (see Appendix A to this agenda paper) meets these criteria because it is limited to correcting an oversight. Our recommended amendment would maintain consistency with the principles and requirements in IFRS 9 and would not propose a new (or change an existing) principle or requirement.

### ***The Committee's discussion***

16. The Committee discussed this potential annual improvement at its March 2023 meeting. Most Committee members agreed or did not disagree with our staff analysis and preliminary views. One Committee member expressed a preference for the view that a lessee could recognise a gain or loss on extinguishment of its lease liability as an adjustment to its right-of-use asset.

### ***Staff analysis of the Committee input***

17. After considering the input of the Committee, we recommend that the IASB propose an amendment to paragraph 2.1(b)(ii) of IFRS 9 as set out in Appendix A to this agenda paper.

### ***Transition requirements***

18. In the absence of any specific transition requirements, an entity would apply the proposed amendment retrospectively in accordance with paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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19. As described in paragraph 10 of this paper, a lessee might have previously accounted for an extinguishment of its lease liability by making a corresponding adjustment to its right-of-use asset rather than recognising the gain or loss in profit or loss. If that lessee were to be required to apply our proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 retrospectively, it would need to reassess each historical lease liability extinguishment (and corresponding adjustment to its right-of-use assets) that could potentially have an effect on its financial statements from the beginning of the earliest comparative period when first applying the amendment. The lessee would need to determine the effect on its profit or loss and the carrying amount of its right-of-use assets had it recognised, for each lease liability extinguishment, the associated gain or loss in profit or loss. The lessee would then need to determine whether the change in accounting would have a material effect on its financial statements.
20. We think that for lessees in the situation described in paragraph 19 of this paper, retrospective application of our proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 could be burdensome. However, extinguishments of a lessee's lease liabilities that result in a difference to be recognised in profit or loss are generally one-off, rather than recurring, transactions. Therefore, while users of financial statements generally benefit from comparative financial statements prepared on a consistent basis, we think, in this case, there would be limited benefits for users if lessees were to provide restated comparative financial statements, and the benefits would not outweigh the potential costs.
21. Therefore, if the IASB decides to amend IFRS 9 as set out in Appendix A to this paper, we recommend that the IASB require prospective application of the amendment—that is, an entity would apply the amendment to lease liability extinguishments that occur after the beginning of the annual reporting period in which the entity first applies the amendment.

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## Staff recommendations and question for the IASB

22. Based on our analysis in this agenda paper, we recommend the IASB, as part of its next annual improvements cycle, amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9 as set out in Appendix A to this agenda paper.

### Question for the IASB

Does the IASB agree with our recommendations:

- a. to propose an amendment to paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9;
- b. to require prospective application of this proposed amendment; and
- c. to include this proposed amendment in its next annual improvements cycle?

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## Appendix A—recommended proposed amendment to IFRS 9

A1. Our proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 would add a cross-reference to paragraph 3.3.3 of IFRS 9. New text is underlined.

<p>2.1 This Standard shall be applied by all entities to all types of financial instruments except:</p> <p>...</p> <p>(b) rights and obligations under leases to which IFRS 16 <i>Leases</i> applies. However:</p> <p>...</p> <p>(ii) lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraphs <u>3.3.1</u> and <u>3.3.3</u> of this Standard; and</p> <p>...</p>
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## Appendix B—discussion of other potential annual improvements

- B1. At its March 2023 meeting ([Agenda Paper 6A](#)), the Committee discussed a potential annual improvement to amend the definition of a lease modification in IFRS 16. This appendix summarises the Committee’s discussion and staff analysis related to that potential annual improvement, which is not further analysed as part of this agenda paper.
- B2. The Committee discussed a staff recommendation that the IASB clarify, potentially as an annual improvement, whether a lessee applies IFRS 9 or IFRS 16 in accounting for a rent concession such as the one described in the submitted fact pattern (described in paragraphs 7–9 of [Agenda Paper 6A](#)). The staff had recommended that the IASB amend the definition of ‘lease modification’ in IFRS 16 to exclude from that definition, for a lessee, a change that solely results in a lease liability (or a part of it) being extinguished in accordance with IFRS 9.
- B3. Two Committee members agreed with the staff recommendation that the IASB amend the definition of ‘lease modification’ in IFRS 16. Most Committee members disagreed with the staff recommendation.
- B4. Some Committee members said they are unsure about the boundary or dividing line between IFRS 9 and IFRS 16 regarding how a lessee distinguishes between a lease modification and a partial extinguishment of a lease liability. Some Committee members said the proposed amendment would not provide the intended clarity, and some said the proposed amendment would go beyond the scope of an annual improvement.
- B5. Many Committee members raised questions about Illustrative Example 19 accompanying IFRS 16<sup>3</sup> which illustrates a lease modification that is a change in consideration only; some of these Committee members suggested that the IASB amend Illustrative Example 19 to explain why the change to the lease in that fact pattern is not accounted for as a partial extinguishment of the lessee’s lease liability.

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<sup>3</sup> Illustrative Example 19 accompanying IFRS 16 is further discussed in [Agenda Paper 6A](#) for the March 2023 Committee meeting and is reproduced in Appendix B to that paper.

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One Committee member, however, said Illustrative Example 19 starts with a presumption that there has been a lease modification; the example addresses only the *mechanics* of how to account for a lease modification that is a change in consideration only and should not be read as explaining *when* a lease modification has taken place.

- B6. After considering the Committee's input on a potential amendment of the definition of a lease modification in IFRS 16, the staff recommends not further pursuing that amendment as an annual improvement. We note that the Committee's discussion of Illustrative Example 19 accompanying IFRS 16 raises questions about whether a lease modification that is a change in consideration only can occur without there also being a partial extinguishment of a lessee's lease liability. These questions are beyond the scope of the fact pattern submitted to the Committee in which the lessor legally releases the lessee from its obligation to make specifically identified lease payments.
- B7. We think the IASB could consider this matter (that is, whether a lessee applies IFRS 9 or IFRS 16 in accounting for a rent concession such as the one described in the submitted fact pattern) as part of a future project related to IFRS 9 or the post-implementation review of IFRS 16. We note that the questions from Committee members about how to distinguish between a lease modification and an extinguishment of a lease liability are similar to questions about modifications of financial assets and financial liabilities raised by respondents to the post-implementation review of the classification and measurement requirements in IFRS 9; the IASB has decided to add a project to the research pipeline on amortised cost measurement that would explore that topic.