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## IASB<sup>®</sup> meeting

Date	<b>February 2024</b>
Project	<b>Annual Improvements to IFRS Accounting Standards—Volume 11</b>
Topic	<b>Derecognition of Lease Liabilities (Amendments to IFRS 9 <i>Financial Instruments</i>): Analysis of feedback</b>
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS<sup>®</sup> Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB<sup>®</sup> *Update*.

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## Introduction

1. As explained in Agenda Paper 12 *Maintenance and consistent application—Cover paper*, this paper analyses feedback on *Derecognition of Lease Liabilities (Amendments to IFRS 9 Financial Instruments)* included in the [Exposure Draft Annual Improvements to IFRS Accounting Standards—Volume 11](#). The International Accounting Standards Board (IASB) proposed to amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9. The purpose of that proposed amendment is to resolve potential confusion for a lessee applying the derecognition requirements in IFRS 9.

## Summary of staff recommendation

2. We recommend that the IASB finalise with no changes the proposed amendment to 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).

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## Structure of this paper

3. This paper includes:
- (a) [Background information](#);
  - (b) [Summary of feedback](#);
  - (c) [Staff analysis](#);
  - (d) [Staff recommendation and question for the IASB](#); and
  - (e) [Appendix A—Extract from the Exposure Draft for proposed amendment to paragraph 2.1\(b\)\(ii\) of IFRS 9 \*Financial Instruments\*](#).

## Background information

4. Paragraphs BC1–BC3 of the Basis for Conclusions on the proposed amendments to IFRS 9 *Financial Instruments* in the Exposure Draft explain the background and the IASB’s rationale for the proposed amendments. Paragraphs BC1–BC3 state:

BC1 Stakeholders informed the IASB about a lack of clarity around a lessee’s accounting for a derecognition of a lease liability. In IFRS 9 *Financial Instruments*, paragraph 2.1(b)(ii) includes a cross-reference to paragraph 3.3.1, but not to paragraph 3.3.3. The lack of a cross-reference to paragraph 3.3.3 can affect the corresponding adjustment a lessee makes when its lease liability has been extinguished and the lessee removes that liability from its statement of financial position. Some stakeholders informed the IASB that it is not clear whether a lessee recognises the gain or loss on extinguishment of the lease liability in profit or loss in accordance with paragraph 3.3.3 of IFRS 9, or in another manner—such as by making a corresponding adjustment to the right-of-use asset recognised in accordance with IFRS 16 *Leases*.

BC2 The IASB intended a lessee to apply, in sequence, paragraphs 3.3.1 and 3.3.3, and the lack of a cross-reference to paragraph 3.3.3 in paragraph 2.1(b)(ii) was an oversight. The IASB therefore proposes to amend paragraph 2.1(b)(ii) to add a cross-reference to paragraph 3.3.3.

BC3 The IASB proposes that a lessee apply the amendment to paragraph 2.1(b)(ii) to lease liabilities that are extinguished on or after the beginning of the annual reporting period in which the lessee first applies the amendment. In the IASB's view, the expected benefits of a lessee retrospectively applying the proposed amendment would not outweigh the potential costs.

5. Appendix A to this paper reproduces the proposed amendment to paragraph 2.1(b)(ii) of IFRS 9.
6. The Exposure Draft did not include proposed amendments to address the dividing line, or interaction, between IFRS 9 and IFRS 16 *Leases* regarding how a lessee distinguishes between a lease modification and an extinguishment of a lease liability. Appendix B to [Agenda Paper 12A](#) for the IASB's May 2023 meeting summarises the IFRS Interpretations Committee's discussion of that topic at its March 2023 meeting and the staff's recommendation that the IASB not address the interaction between IFRS 9 and IFRS 16 as an annual improvement.

## Summary of feedback

### *Overview of feedback*

7. Thirty-eight respondents commented on the proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9. Most

respondents agreed with the proposed amendment for the reasons set out in the Exposure Draft.

8. Some respondents said the IASB should proceed with finalising the proposed amendment and undertake additional work to address the interaction between IFRS 9 and IFRS 16—in particular, to clarify whether a lessee should treat a change to a lease arrangement that reduces the consideration for the lease as either: (a) an extinguishment of a liability applying IFRS 9; or (b) a lease modification applying IFRS 16. Most of these respondents explicitly stated that addressing this interaction is beyond the scope of an annual improvement and suggested the IASB address this interaction either through a separate narrow-scope standard-setting project or the post-implementation review (PIR) of IFRS 16. A few of these respondents suggested the IASB address this interaction in the Basis for Conclusions when finalising the proposed amendment, or explain in the Basis for Conclusions its rationale for not addressing this interaction as an annual improvement.
9. Some respondents disagreed with the proposed amendment to paragraph 2.1(b)(ii) of IFRS 9. These respondents' comments are summarised in paragraphs 10–17 of this paper.

### ***Areas of disagreement***

#### *Does not resolve the conflict between IFRS 9 and IFRS 16*

10. Some respondents who disagreed with the proposed amendment said it would not resolve an identified conflict, and might introduce a new conflict, between IFRS 9 and IFRS 16. These respondents said that, for a lessee, a change in a lease arrangement that results, solely or together with other changes, in a lease liability (or a part thereof) being extinguished in accordance with IFRS 9 also meets the definition of a lease modification in Appendix A of IFRS 16—and, accordingly, the lessee would make a corresponding adjustment to its right-of-use asset rather than in profit or loss. For example:

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- (a) a few accounting firms said paragraph 46 of IFRS 16, explained in paragraph BC203(b) of the Basis for Conclusions on IFRS 16, requires a lessee to account for the remeasurement of a lease liability as a corresponding adjustment to its right-of-use asset, not in profit or loss.
- (b) a regional standard-setter said that applying IFRS 16 by precedence to IFRS 9 is consistent with applying the standard most relevant to a particular transaction (a lease), and such an approach results in an accounting outcome faithfully representing the substance of a lease modification and closely aligning gain or loss recognition with a corresponding change in the lessee's rights and obligations under the lease.
11. A few respondents said the proposed amendment does not address, or conflicts with, Illustrative Example 19 accompanying IFRS 16. For example:
- (a) an individual said Illustrative Example 19, which the IASB has not proposed to amend, illustrates a derecognition of a lease liability not taken to profit or loss.
- (b) an accounting firm said Illustrative Example 19 addresses a modification that is a change in lease consideration only, which is economically similar to a derecognition of a lease liability.
- (c) a national standard-setter said it is currently difficult to understand why a reduction in lease payments would not qualify for the treatment in Illustrative Example 19, which illustrates an adjustment of a right-of-use asset.

### *Not an annual improvement*

12. A few respondents said the proposed amendment should not be made as an annual improvement because, in their view, there is no evidence, and it is not clear, that the lack of a cross-reference to paragraph 3.3.3 of IFRS 9 was an oversight or a minor unintended consequence. For example, a regional standard-setter said that many stakeholders in their jurisdiction have interpreted paragraph 2.1(b)(ii) of IFRS 9 to leave out intentionally (rather than being an oversight) any reference to paragraph

3.3.3 of IFRS 9; in their view, paragraph 3.3.1 of IFRS 9 is helpful to provide guidance as to when part of a lease liability is extinguished before the lease modification requirements of IFRS 16 are applied.

13. A few accounting firms said the proposed amendment should not be made as an annual improvement because: (a) the matter addressed is sufficiently widespread and significant to require a dedicated amendment project; or (b) it would result in a significant change in practice and might result in follow-up application questions.

#### *Other comments*

14. An accounting firm said the accounting for rent concessions was the subject of two amendments to IFRS 16 (the May 2020 amendment *Covid-19-Related Rent Concessions* and the March 2021 amendment *Covid-19-Related Rent Concessions beyond 30 June 2021*), and these amendments demonstrate ‘that the IASB believed in the past that rent concessions meet the definition of a lease modification, which is aligned with current practice’.
15. A regional standard-setter said that not all extinguishments of financial liabilities are accounted for as an immediate gain or loss in profit or loss. This respondent said, for example, that any discount granted by a supplier of goods to a purchaser would normally be accounted for as a reduction in the cost of inventories by the purchaser rather than as a gain in profit or loss in accordance with paragraph 3.3.3 of IFRS 9.

#### *Respondent proposed solutions*

16. Most of the respondents who disagreed with the proposed amendment suggested that the IASB not finalise it as an annual improvement and instead pursue a separate narrow-scope standard-setting project to clarify the interaction between IFRS 9 and IFRS 16 for extinguishments of lease liabilities and lease modifications.
17. A few respondents said that if the IASB decides to proceed with the proposed amendment, it should make additional changes. For example:

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- (a) an accounting firm suggested the IASB make amendments to specify that IFRS 9, including paragraph 3.3.3, applies to derecognition of lease liabilities:
    - (i) only when cancellation takes effect immediately, either via transfer or termination of the lease;
    - (ii) except when derecognition arises due to a lease modification; or
    - (iii) except when IFRS 16 requires the right-of-use asset to be adjusted.
  - (b) a different accounting firm recommended the IASB accompany the amendment to IFRS 9 with clarifying amendments to the definition of a lease modification in IFRS 16 as discussed by the IFRS Interpretations Committee at its March 2023 meeting.

### ***Proposed transition requirements***

18. Most respondents did not comment on the proposed transition requirements. A few respondents explicitly agreed with the proposed transition requirements for the reason cited in paragraph BC3 of the Basis for Conclusions on the proposed amendments to IFRS 9 in the Exposure Draft (reproduced in paragraph 4 of this paper).

## **Staff analysis**

### ***Interaction between IFRS 9 and IFRS 16***

19. We think it is important to highlight the narrow focus of the proposed amendment to paragraph 2.1(b)(ii) of IFRS 9. As we stated in paragraph 6 of this paper, the Exposure Draft did not include proposed amendments to address the dividing line, or interaction, between IFRS 9 and IFRS 16 regarding how a lessee distinguishes between a lease modification and an extinguishment of a lease liability. Accordingly, the proposed amendment does not address *when* or *whether* a lessee accounts for a change in a lease as a lease liability extinguishment or as a lease modification. Rather, the proposed amendment addresses situations in which a lessee *has already*

*determined* that a change in a lease liability meets the requirements in IFRS 9 for liability extinguishment, and the lessee accounts for the extinguishment applying IFRS 9. In that situation, the proposed amendment would provide clarity that the lessee recognises any gain or loss on extinguishment of the lease liability in profit or loss in accordance with paragraph 3.3.3 of IFRS 9.

20. We disagree with respondents who said the proposed amendment introduces a conflict between IFRS 9 and IFRS 16. The requirements in IFRS 16, including paragraph 46, are not affected by the proposed amendment. Paragraph 46 of IFRS 16 applies to a lease modification that is not accounted for as a separate lease. If a lessee has determined that a change in a lease liability meets the definition of a lease modification in IFRS 16, and applies the requirements in IFRS 16 for that lease modification, the proposed amendment to IFRS 9 would not affect that outcome.
21. We similarly disagree with respondents who said that the proposed amendment conflicts with Illustrative Example 19 accompanying IFRS 16. Illustrative Example 19 is one of a set of five examples (Illustrative Examples 15–19) that, as stated in paragraph IE7 accompanying IFRS 16, ‘illustrate the requirements of IFRS 16 regarding lease modifications for a lessee’. Each of those examples assumes, and states, that there has been a lease modification and illustrates a lessee’s accounting for the lease modification. Illustrative Example 19’s title is ‘modification that is a change in consideration only’; that example neither mentions nor illustrates liability extinguishment. Because the proposed amendment to IFRS 9 does not affect lease modifications, it does not affect Illustrative Example 19.

### ***Other comments***

22. The Covid-19-related amendments to IFRS 16 (referenced in paragraph 14 of this paper) provided a practical expedient to permit lessees not to assess whether rent concessions that occurred as a direct consequence of the covid-19 pandemic, and met specified conditions, were lease modifications and, instead, to account for those rent concessions as if they were not lease modifications. The IASB did not state that all



rent concessions are lease modifications. Rather, the IASB provided relief because it learned that lessees could find it challenging during the pandemic to *assess whether* a large volume of rent concessions were lease modifications.

23. We considered the example provided by a respondent (summarised in paragraph 15 of this paper) about a discount granted by a supplier of goods to a purchaser. In our view, depending on the facts and circumstances, that example would involve subsequent measurement of a trade payable by the purchaser applying paragraph 5.3.1 of IFRS 9 (which references paragraph 4.2.1 of IFRS 9), rather than extinguishment and derecognition of a financial liability applying paragraph 3.3.1 of IFRS 9.

### ***Proposed solutions***

24. We agree with respondents who said that addressing the dividing line, or interaction, between IFRS 9 and IFRS 16 regarding how a lessee distinguishes between a lease modification and an extinguishment (or a partial extinguishment) of a lease liability is beyond the scope of an annual improvement. Nonetheless, we continue to view the proposed amendment as an annual improvement because of its narrow focus (as explained in paragraph 19 of this paper). We also agree with respondents who suggested that the IASB provide additional explanation in the Basis for Conclusions, when finalising the proposed amendment to paragraph 2.1(b)(ii) of IFRS 9, about its rationale for not addressing the interaction between IFRS 9 and IFRS 16 as an annual improvement. We will consider this suggestion in drafting final amendments.
25. As noted by an accounting firm respondent, the IFRS Interpretations Committee, at its March 2023 meeting, discussed a staff recommendation 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. As summarised in Appendix B to [Agenda Paper 12A](#) for the IASB’s May 2023 meeting, the staff recommended not further pursuing that amendment as an annual improvement and suggested that the IASB

could consider that topic as part of a future project related to IFRS 9 or the PIR of IFRS 16.

26. We considered the suggestions from an accounting firm, summarised in paragraph 17(a) of this paper, that the IASB make additional amendments to IFRS 9. In our view, these suggested changes are not needed in the context of the proposed amendment to add a cross-reference to paragraph 3.3.3 of IFRS 9, and we recommend not pursuing them. In particular, in our view, the suggested changes attempt to address the dividing line between IFRS 9 and IFRS 16 regarding lease modifications and lease liability extinguishments, which would go beyond the scope of the proposed amendment as discussed in paragraph 19 of this paper, and could have broader and unintended consequences.

### ***Proposed transition requirements***

27. No respondents disagreed with the proposed transition requirements. We therefore recommend that the IASB proceed with the proposed requirement that a lessee apply the amendment to paragraph 2.1(b)(ii) of IFRS 9 to lease liabilities that are extinguished on or after the beginning of the annual reporting period in which the lessee first applies the amendment.

## **Staff recommendation and question for the IASB**

28. Based on our analysis in this agenda paper, we recommend the IASB finalise with no changes the proposed amendment to 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).

### Question for the IASB

Does the IASB agree with our recommendation to finalise with no changes the proposed amendment to 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)?

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## Appendix A—Extract from the Exposure Draft for proposed amendment to paragraph 2.1(b)(ii) of IFRS 9 *Financial Instruments*

### Chapter 2 Scope

Paragraph 2.1(b)(ii) is amended. Paragraph 2.1(b)(i) is not amended but is included for ease of reference. New text is underlined and deleted text is struck through.

- 2.1 **This Standard shall be applied by all entities to all types of financial instruments except:**
- ...
- (b) **rights and obligations under leases to which IFRS 16 *Leases* applies. However:**
- (i) **finance lease receivables (ie net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;**
  - (ii) **lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraphs 3.3.1 and 3.3.3 of this Standard; and**
- ...

### Chapter 7 Effective date and transition

Paragraphs 7.1.12 and 7.2.50 and the heading before paragraph 7.2.50 are added. For ease of reading these paragraphs have not been underlined.

#### 7.1 Effective date

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- ...
- 7.1.12 *Annual Improvements to IFRS Accounting Standards—Volume 11*, issued in [Month, Year], amended paragraphs 2.1(b)(ii) ... . An entity shall apply those amendments for annual reporting periods beginning on or after [date to be determined]. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.
- ...

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## 7.2 Transition

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### **Transition for *Annual Improvements to IFRS Accounting Standards—Volume 11***

- 7.2.50 An entity shall apply the amendment to paragraph 2.1(b)(ii) made by *Annual Improvements to IFRS Accounting Standards—Volume 11* to lease liabilities that are extinguished on or after the beginning of the annual reporting period in which the entity first applies that amendment.