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IFRS 16 and covid-19

Accounting for covid-19-related rent concessions applying IFRS 16 *Leases*

This document is intended to support the consistent application of requirements in IFRS® Standards.

We have been made aware of changes in lease payments that have occurred, or are expected to occur, as a result of the covid-19 pandemic. These changes include, for example, lessors providing rent 'holidays' to commercial lessees.

IFRS 16 *Leases* contemplates that changes may occur in lease payments over the term of a lease. The required accounting for such changes (if material) involves the application of judgement and depends on a number of factors, including importantly whether those changes were part of the original terms and conditions of the lease. Changes could arise directly from amendments to the lease contract itself or indirectly—for example, from actions of government in response to the covid-19 pandemic. When accounting for changes in lease payments, an entity considers together the lease contract and any applicable law or regulation. In other words, in applying IFRS 16 an entity treats a change in lease payments in the same way, regardless of whether the change results from a change in the contract itself or, for example, from a change in applicable law or regulation.

IFRS 16 sets out specific requirements for how to account for some changes in lease payments—for example, those arising from changes in an index or rate used to determine lease payments. Otherwise the accounting required by IFRS 16 for a change in lease payments depends on whether that change meets the definition of a lease modification.

Assessing whether a change in payments is a lease modification

IFRS 16 defines a **lease modification** as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease.

In assessing whether there has been a **change in the scope of the lease**, an entity considers whether there has been a change in the right of use conveyed to the lessee by the contract—examples of a change in the scope of a lease include adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term. A rent holiday or rent reduction alone is not a change in the scope of a lease.

In assessing whether there has been a **change in the consideration for a lease**, an entity considers the overall effect of any change in the lease payments. For example, if a lessee does not make lease payments for a three-month period, the lease payments for periods thereafter may be increased proportionally in a way that means that the consideration for the lease is unchanged.

If there is no change in either the scope of the lease or the consideration for the lease, then there is no lease modification.

If there has been a change in either the scope of or the consideration for the lease, an entity next considers whether that change was **part of the original terms and conditions** of the lease. An entity applies paragraph 2 of IFRS 16 and considers both the terms and conditions of the contract and all relevant facts and circumstances. Relevant facts and circumstances may include contract, statutory or other law or regulation applicable to lease contracts[1]. For example, lease contracts or applicable law or regulation may contain clauses that result in changes to payments if particular events occur or circumstances arise. Government action (for example, requiring the closure of retail stores for a period of time because of covid-19) might be relevant to the legal interpretation of clauses, such as force majeure, that were in the original contract or in applicable law or regulation. Changes in lease payments that result from clauses in the original contract or in applicable law or regulation are part of the original terms and conditions of the lease, even if the effect of those clauses (arising from an event such as the covid-19 pandemic) was not previously contemplated. In such a case there is no lease modification for the purposes of IFRS 16.

If a change in lease payments results from a lease modification, a lessee applies paragraphs 44-46 of IFRS 16 and a lessor applies paragraphs 79-80 or paragraph 87 of IFRS 16.

Changes in payments that are not lease modifications

If a change in lease payments does not result from a lease modification, that change would generally be accounted for as a variable lease payment. In this case, a lessee applies paragraph 38 of IFRS 16 and generally recognises the effect of the rent concession in profit or loss. For an operating lease, a lessor recognises the effect of the rent concession by recognising lower income from leases.

Partial lease liability extinguishment

If a change in lease payments results in the extinguishment of a part of a lessee's obligation specified in the contract (for example, a lessee is legally released from its obligation to make specifically identified payments), the lessee would consider whether the requirements for derecognition of a part of the lease liability are met applying paragraph 3.3.1 of IFRS 9 *Financial Instruments*.

Impairment of assets

IAS 36 *Impairment of Assets* applies in determining whether right-of-use assets (for lessees) and items of property, plant and equipment subject to an operating lease (for lessors) are impaired. The circumstances that give rise to rent concessions as a result of the covid-19 pandemic are likely to indicate that assets may be impaired. For example, loss of earnings during the period covered by a rent concession may be an indicator of impairment of the related right-of-use asset. Similarly, longer-term effects of the covid-19 pandemic could affect the expected ongoing economic performance of right-of-use assets. Lessors will also

[1] This is in contrast to the approach in some other IFRS Standards.

need to consider the applicable requirements of IFRS 9, for example when accounting for any impairment of lease receivables.

Disclosure

Lessees and lessors must also apply the disclosure requirements of IFRS 16 and other IFRS Standards, such as IAS 1 *Presentation of Financial Statements*. For example, IFRS 16 requires both lessees and lessors to disclose information that gives a basis for users of financial statements to assess the effect that leases have on their financial position, financial performance and cash flows. The information disclosed will need to be sufficient to enable users of financial statements to understand the impact of covid-19-related changes in lease payments on the entity's financial position and financial performance (paragraph 31 of IAS 1).