IFRS

STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Rent Concessions: Lessors and Lessees (IFRS 9 and IFRS 16)**		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IFRS 9 *Financial Instruments* and IFRS 16 *Leases* by both a lessor and a lessee in accounting for a particular rent concession. The rent concession is one for which the only change to the lease contract is the forgiveness by the lessor of amounts due from the lessee under the lease.

2. This paper:

   (a) provides the Committee with a summary of the matter;

   (b) presents our research and analysis; and

   (a) asks the Committee whether it agrees with our recommendation:

      (i) not to add a standard-setting project to the work plan with respect to a lessor's accounting for the rent concession described in the submission; and

      (ii) to add a standard-setting project to the work plan (an annual improvement) with respect to a lessee's accounting for the rent concession described in the submission.

Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) summary of outreach;

   (c) analysis of the questions asked in the submission;

   (d) analysis of whether to add a standard-setting project to the work plan; and

   (e) staff recommendation.

4. There are two appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision; and

   (b) Appendix B—submission.

Background information

The fact pattern

5. The submission describes a rent concession agreed by a lessor and a lessee. For the lessor, the rent concession changes a lease contract classified as an operating lease. For the lessee, the rent concession changes a lease contract for which the lessee has recognised a right-of-use asset and a lease liability (ie the lessee has elected to apply neither of the recognition exemptions in paragraph 5 of IFRS 16).

6. **Lessor of an operating lease**: The lessor legally releases the lessee from its obligation to make specifically identified lease payments while making no other changes to the lease. Until the date of granting the rent concession, the lessor had recognised some or all of the payments forgiven as an operating lease receivable and had applied the expected credit loss model in IFRS 9 to that operating lease receivable.

7. **Lessee**: The lessee is legally released by the lessor from its obligation to make specifically identified lease payments with no other changes being made to the lease. Until the date of being granted the rent concession, the lessee had recognised the

payments forgiven as part of its lease liability. The lessee has not elected to apply the covid-19-related practical expedient in paragraphs 46A–46B of IFRS 16.

Illustrative example

8. The following example illustrates the fact pattern described in the submission:

> A lessor and a lessee enter into a three-year lease contract for a retail store with monthly lease payments of CU100. To comply with government restrictions, nine months into the lease the retail store closes for a period of time. The lessee makes the first nine lease payments as required by the contract but does not make payments in the following months.
>
> One year into the lease (at the end of month 12), the lessor grants the lessee a rent concession, legally releasing the lessee from its obligation to make lease payments for months 10–14. No other changes are made to the lease.
>
> At the date of granting the rent concession (at the end of month 12), the lessor had recognised an operating lease receivable of CU300 (lease payments for months 10–12). Applying paragraph 81 of IFRS 16, the lessor recognises lease payments as income on a straight-line basis over the three-year lease term.
>
> At the date of granting the rent concession, the lessee had recognised a lease liability representing the discounted amount of all unpaid lease payments for months 10–36.

The question

9. Regarding **lessor accounting**, the submitter asks:

   (a) how the lessor applies the expected credit loss model in IFRS 9 to the operating lease receivable when the lessor expects to forgive payments due from the lessee under the lease before the rent concession is granted.

   (b) whether the lessor applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

10. Regarding **lessee accounting**, the submitter asks whether the lessee applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

11. The submitter says it has identified diversity in how lessors and lessees account for the rent concession described in the submission. Depending on the circumstances, a difference could arise in the timing of recognising the effects of the rent concession in profit or loss for both the lessor and lessee.

12. Appendix B to this paper reproduces the submission and provides further details about the accounting approaches the submitter has identified.

Summary of outreach

13. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. The submission was also made available on our website.

14. The request asked those participating to provide information about:

    a) whether the fact patterns described in paragraphs 6 and 7 are common and, if so, whether they are common only in particular jurisdictions or industries, and does the accounting have a material effect on an entity's financial statements; and

    b) whether respondents have observed material diversity among either lessees or lessors in accounting for the fact patterns described in paragraphs 6 and 7 and, if so, whether the diversity is evident only in particular jurisdictions or industries.

15. We received 14 responses—seven from national standard-setters, five from large accounting firms and two from organisations representing securities regulators. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

Findings from outreach

Lessor accounting

Is the fact pattern common and does the accounting have a material effect?

16. Some respondents said the lessor fact pattern is not common; some observed that while rent concessions might be common in some jurisdictions, they often involve payment deferrals or other changes to lease contracts beyond the forgiveness of lease payments.

17. Many respondents said the lessor fact pattern is (or has been) common and the accounting has (or could have) a material effect. Of those who said it is common, most said it is common only in particular jurisdictions and industries (which varied by respondent), while some said their observations are not specific to a jurisdiction or industry.

Is there observed material diversity in accounting for the fact pattern?

18. Many respondents said they had observed no material diversity in accounting for the lessor fact pattern. Some respondents said they have observed material diversity that is not specific to a jurisdiction or industry, while a few others said they observed material diversity only in particular jurisdictions and industries (which varied by respondent).

Lessee accounting

Is the fact pattern common and does the accounting have a material effect?

19. Half of respondents said the lessee fact pattern is not common and the accounting has no material effect for lessees. Many of these respondents said they have no experience with the fact pattern because lessees receiving rent concessions in 2020 and 2021 applied the covid-19-related practical expedient in paragraphs 46A–46B of IFRS 16. Some of these respondents observed, as for the lessor fact pattern, that rent concessions often involve payment deferrals or other changes to lease contracts beyond the forgiveness of lease payments.

20. The other half of respondents said the lessee fact pattern is (or could be) common and the accounting has (or could have) a material effect. Some said their observations are not specific to a jurisdiction or industry and some said they relate only to particular jurisdictions and industries (which varied by respondent). Some respondents said the lessee fact pattern could be common going forward in a few jurisdictions, while other respondents expect the prevalence of rent concessions to decrease compared to covid-19-related rent concessions in 2020 and 2021.

Is there observed material diversity in accounting for the fact pattern?

21. Many respondents said they had observed no material diversity in accounting for the lessee fact pattern. Some respondents said they have observed material diversity that is not specific to a jurisdiction or industry, while a few others said they observed material diversity only in particular jurisdictions and industries (which varied by respondent).

Staff analysis of the questions asked in the submission

22. The submitter asks three questions in relation to the rent concession described in the submission:

    (a) Before the rent concession is granted, how does the lessor apply the expected credit loss model in IFRS 9 to its operating lease receivable? (paragraphs 24–32)

    (b) When the rent concession is granted:

        (i) does the lessor apply the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16? (paragraphs 33–45)

        (ii) does the lessee apply the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16? (paragraphs 48–69)

23. It is not uncommon for lessors and lessees to renegotiate lease contracts and make changes to them before the end of the original lease term. For this reason, the IASB specifically developed lease modification requirements when it developed IFRS 16. The vast majority of changes to lease contracts are lease modifications within the

scope of IFRS 16 and are not within the scope of any other IFRS Accounting Standard. However, if a lessor agrees to legally release a lessee from its obligation to make specifically identified lease payments without any other change being made to the lease (as is the case in the submitted fact pattern), questions two and three in the submission arise.

Application of the expected credit loss model in IFRS 9 to the operating lease receivable

What IFRS 9 says

24. Paragraph 2.1(b)(i) of IFRS 9 states that 'operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements' of IFRS 9. Chapter 5 of IFRS 9 specifies the impairment requirements related to financial assets, and paragraph 5.5.1 states that 'an entity shall recognise a loss allowance for expected credit losses on…a lease receivable'.

25. IFRS 9 defines a credit loss as:

> the difference between all contractual cash flows that are due to an entity in accordance with the contract and *all the cash flows that the entity expects to receive* (ie *all cash shortfalls*)…An entity shall estimate cash flows by considering all contractual terms of the financial instrument…through the expected life of that financial instrument…' (emphasis added).

26. Paragraph 5.5.17 of IFRS 9 states:

> An entity shall measure expected credit losses of a financial instrument in a way that reflects:
>
> (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
>
> (b) the time value of money; and
>
> (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Applying the impairment requirements to the operating lease receivable

27. IFRS 9 requires a lessor to apply the expected credit loss model to an operating lease receivable from the date on which it recognises the receivable. In the submitted fact pattern, the lessor therefore applies the impairment requirements in IFRS 9 to the operating lease receivable before the rent concession is granted, during the period that it would be considering whether and when to grant the concession.

28. When estimating expected credit losses on the operating lease receivable in accordance with IFRS 9, the lessor measures any credit loss to reflect 'all cash shortfalls'—the difference between all contractual cash flows and all cash flows that the entity *expects to receive*—using 'reasonable and supportable information' about 'past events, current conditions and forecasts of future economic conditions'. Therefore, in the period before the rent concession is granted, the lessor measures expected credit losses on the operating lease receivable in a way that reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes (as required by paragraph 5.5.17 of IFRS 9), taking into account its expectations of forgiving lease payments recognised as part of that receivable. Consequently, in the submitted fact pattern we would expect a lessor to have recognised an expected credit loss allowance (and a corresponding impairment loss) on the operating lease receivable before the date on which it grants the rent concession.

29. Using the example in paragraph 8 of this paper to illustrate, at the date of granting the rent concession the lessor has an operating lease receivable of CU300, representing three amounts of CU100 that the lessee was contractually obliged to pay in each of the three months before the concession is granted. During those three months, the lessor applies the impairment requirements in IFRS 9 to the operating lease receivable—taking into account its expectations of granting a concession in estimating expected credit losses as required by paragraph 5.5.17—and measures any expected credit losses as the difference between the contractual cash flows of CU300 and all the cash flows that the entity expects to receive through the expected life of the lease receivable.

30. IASB educational materials—'IFRS 16 and covid-19: Accounting for covid-19-related rent concessions applying IFRS 16 *Leases*' (published in 2020)—refer to the

impairment requirements in IFRS 9 in the context of rent concessions granted by lessors. The educational materials state: '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….Lessors will also need to consider the applicable requirements of IFRS 9, for example when accounting for any impairment of lease receivables.' Our analysis in this section regarding the applicability of the impairment requirements in IFRS 9 therefore aligns with those educational materials.

Is there an alternative view?

31. The submitter says some hold the view that, in applying the expected credit loss model in IFRS 9 to the operating lease receivable, the lessor would ignore expected forgiveness of past lease payments on the grounds that the lessor applies the lease modification requirements in IFRS 16 to the rent concession before applying the impairment requirements in IFRS 9.

32. We disagree. The lessor has recognised the operating lease receivable in its statement of financial position before granting the rent concession and, therefore, before any consideration of the lease modification requirements in IFRS 16. The lessor is required to apply the impairment requirements in IFRS 9 to the operating lease receivable from the date on which it recognises that receivable.

Lessor accounting for the rent concession – IFRS 9 and IFRS 16

IFRS 9 – Derecognition of operating lease receivable

33. As mentioned above, paragraph 2.1(b)(i) of IFRS 9 states that 'operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements' of IFRS 9.

34. Paragraph 3.2.3 of IFRS 9 states that an entity 'shall derecognise a financial asset when, and only when: (a) the contractual rights to the cash flows from the financial asset expire, or (b) it transfers the financial asset…and the transfer qualifies for derecognition….'.

35. In the submitted fact pattern, the rent concession results in the lessor legally releasing the lessee from its obligation to make specifically identified lease payments, some or

all of which make up the operating lease receivable recognised by the lessor. Accordingly, on granting the rent concession, the lessor would conclude that paragraph 3.2.3(a) has been met—its contractual rights to the cash flows from the operating lease receivable expire—because it has agreed to legally release the lessee from its obligation and thus has given up its contractual rights to those specifically identified cash flows from the lease receivable. The lessor would therefore derecognise the operating lease receivable (and associated expected credit loss allowance).

36. Using the example in paragraph 8 of this paper to illustrate, at the date of granting the rent concession the lessor has an operating lease receivable of CU300. Assume that, by that date, the lessor has recognised an expected credit loss allowance of CU280 on the receivable (and associated credit losses of CU280 in profit or loss). In that example, the concession results in the lessor legally releasing the lessee from its obligation to make the three specifically identified lease payments of CU100 each (totalling CU300) that make up the operating lease receivable. Consequently, at the date of granting the rent concession, applying the derecognition requirements in IFRS 9 the lessor recognises the following:

Dr. Expected credit loss allowance	CU280	
Dr. Loss—p&l	CU20	
Cr. Operating lease receivable		CU300

IFRS 16 – Lease modification

37. The definition of a lease modification in IFRS 16 is:

> 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 (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

38. Paragraph 87 of IFRS 16 specifies how a lessor accounts for a modification to an operating lease:

> A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification,

considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

39. In our view, the rent concession in the submitted fact pattern—which results in the lessor legally releasing the lessee from its obligation to make specifically identified lease payments—meets the definition of a lease modification in IFRS 16. The rent concession is 'a change to the consideration for the lease…that was not part of the original terms and conditions of the lease'. The lessor therefore applies paragraph 87 of IFRS 16 and treats the modified lease as a new lease from the date of granting the rent concession[1]. In the submitted fact pattern, there are no prepaid or accrued lease payments relating to the original lease. Consequently, the lessor applies paragraph 81 of IFRS 16 and recognises as income the lease payments to be made by the lessee over the term of the lease on either a straight-line basis or another systematic basis.

40. Using the example in paragraph 8 of this paper to illustrate, in applying paragraph 81 of IFRS 16 to the modified lease (and treating it as a new lease), the lessor would recognise as income the lease payments to be made over the lease term (in months 15–36 of the lease) on a straight-line basis from the date of granting the rent concession.

Interaction of IFRS 9 and IFRS 16

41. Continuing our example, the lessor accounts for the forgiveness of the lease payments that make up the operating lease receivable (ie the three lease payments for months 10–12) by applying the derecognition requirements in IFRS 9—the lessor is required to do so by paragraph 2.1(b)(i) of IFRS 9. Those forgiven lease payments are *not* accrued lease payments (as referred to in paragraph 87 of IFRS 16) at the date of granting the rent concession—rather, the operating lease receivable comprises those payments.

42. Accordingly, the lessor applies the derecognition requirements in IFRS 9 in accounting for those forgiven lease payments in months 10–12. They do not form part

[1] IFRS 16 defines the effective date of the modification as 'the date when both parties agree to a lease modification'. In the submitted fact pattern, the date when both parties agree to the lease modification is the date on which the rent concession is granted.

of the new lease to which the lessor applies paragraph 81 of IFRS 16. To treat them as such would result in accounting for their forgiveness twice—once in derecognising the operating lease receivable and again in recognising income over the lease term.

Is there an alternative view?

43. The submitter says some hold the view that the lessor could (or should) apply the lease modification requirements in IFRS 16 to forgiven lease payments recognised as an operating lease receivable, rather than the derecognition requirements in IFRS 9. We disagree with this view. As noted above, paragraph 2.1(b)(i) of IFRS 9 requires a lessor to apply the impairment requirements in IFRS 9—as well as the derecognition requirements in that Standard—to an operating lease receivable. In our view, a lessor cannot ignore the derecognition requirements in IFRS 9 in accounting for the forgiveness of lease payments (the legal release of the lessee from its obligation to make specifically identified lease payments) that the lessor has recognised as an operating lease receivable.

44. Some also may consider that the lessor could (or should) treat the forgiveness of lease payments recognised as an operating lease receivable as a lease incentive related to the modified lease—if treated as a lease incentive, the lessor would recognise the effects of the rent concession over the lease term.

45. The definition of lease incentives in IFRS 16 is 'payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee'. In our view, the forgiveness of lease payments does not meet the definition of lease incentives—that forgiveness is neither a payment made by the lessor to the lessee nor is it the reimbursement or assumption by the lessor of costs of the lessee. We therefore disagree with the view that the forgiveness of lease payments recognised as an operating lease receivable can be treated as a lease incentive related to the modified lease.

Staff conclusion—lessor accounting

46. Based on our analysis, we conclude that a lessor's application of the derecognition requirements in IFRS 9 and the lease modification requirements in IFRS 16 are not mutually exclusive in the submitted fact pattern. In accounting for the rent concession, the lessor does not apply *either* the derecognition requirements in IFRS 9 *or* the lease

modification requirements in IFRS 16—instead, in the fact pattern described in the submission, the lessor applies the requirements in *both* Standards to different aspects of the rent concession.

47. As discussed in paragraphs 33–36 of this paper, the lessor applies paragraph 3.2.3(a) of IFRS 9 to the forgiven lease payments that it had recognised as an operating lease receivable, and derecognises the lease receivable (and associated expected credit loss allowance) for which its contractual rights to the cash flows have expired. As discussed in paragraphs 37–40 of this paper, the lessor applies paragraphs 81 and 87 of IFRS 16 in accounting for the operating lease modification as a new lease, recognising over the lease term the effects of forgiving lease payments not recognised as an operating lease receivable.

Lessee accounting for the rent concession – IFRS 9 and IFRS 16

IFRS 9 – Derecognition of lease liability

48. 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.

49. 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—ie when the obligation specified in the contract is discharged or cancelled or expires.'

50. Paragraph 3.3.3 of IFRS 9 states that 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'.

51. In the submitted fact pattern, the rent concession results in the lessee being legally released from its obligation to make specifically identified lease payments with no other changes being made to the lease. On the date the rent concession is granted, we would expect the lessee—in applying paragraph 3.3.1 of IFRS 9—to conclude that a part of its lease liability has been extinguished. The lessee would therefore remove from its statement of financial position the part of its lease liability for which its obligation to make lease payments specified in the contract has been cancelled by the

lessor. Having applied paragraph 3.3.1 of IFRS 9, we would expect the lessee to apply paragraph 3.3.3 of IFRS 9 to determine the amount to be recognised in profit or loss.

52. Using the example in paragraph 8 of this paper to illustrate, at the date the lessor grants the rent concession, the lessee has a lease liability representing the discounted amount of all unpaid lease payments for months 10–36. The concession results in the lessee being legally released from its obligation to make five specifically identified lease payments of CU100 each (for months 10–14 totalling CU500) that are part of its lease liability. The lessee pays no consideration, transfers no non-cash assets and assumes no liabilities as a result of the rent concession. Consequently, at the date the concession is granted, applying the derecognition requirements in IFRS 9 the lessee would recognise the following (ignoring the effects of discounting):

Dr. Lease liability	CU500	
Cr. Gain on partial lease extinguishment		CU500

53. The IASB educational materials on applying IFRS 16 (mentioned in paragraph 30 of this paper) refer to a lessee's application of the derecognition requirements in IFRS 9 in the context of rent concessions granted by a lessor. The educational materials state '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…'.

IFRS 9 – Lease modification

54. Paragraph 37 of this paper sets out the definition of a lease modification in IFRS 16.

55. Paragraph 44 of IFRS 16 states:

> A lessee shall account for a lease modification as a separate lease if both:
>
> (a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
>
> (b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in

> scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

56. Paragraphs 45–46 of IFRS 16 state:

> 45 For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:
>
> (a) allocate the consideration in the modified contract applying paragraphs 13–16;
>
> (b) determine the lease term of the modified lease applying paragraphs 18–19; and
>
> (c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
>
> 46 For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
>
> (a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognise in profit or loss any gain or loss relating to the partial or full termination of the lease.
>
> (b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.

57. As discussed in paragraph 39 of this paper, in our view the rent concession in the submitted fact pattern meets the definition of a lease modification in IFRS 16. The rent concession is 'a change to the consideration for the lease…that was not part of the original terms and conditions of the lease'.

58. The lessee therefore first applies paragraph 44 of IFRS 16 to determine whether to account for the lease modification as a separate lease. Because the lease modification in the submitted fact pattern neither increases the scope of the lease nor the consideration for the lease, the lease modification does not meet the requirements in paragraph 44 to be accounted for as a separate lease.

59. The lessee therefore applies paragraphs 45–46 of IFRS 16 to the lease modification. Paragraph 45 of IFRS 16 requires a lessee to do the following at the effective date of the lease modification:

    (a) Paragraph 45(a): the lessee allocates the consideration in the modified contract by applying paragraphs 13–16 of IFRS 16—these requirements apply if the contract contains a lease component and one or more lease or non-lease components. The submitted fact pattern does not specify whether the lease contract has more than one component. For the purposes of our analysis, we assume the lease contract has only one component—a lease component.

    (b) Paragraph 45(b): the lessee determines the lease term of the modified lease by applying paragraphs 18–19 of IFRS 16. In the submitted fact pattern, there is no change to the lease term resulting from the rent concession granted.

    (c) Paragraph 45(c): the lessee remeasures the lease liability by discounting the revised lease payments using a revised discount rate, which would apply in the submitted fact pattern.

60. Paragraph 46 of IFRS 16 requires the lessee to account for the remeasurement of the lease liability as follows:

    (a) Paragraph 46(a): the lessee decreases the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. In the submitted fact pattern, the lease modification does not decrease the scope of the lease.

    (b) Paragraph 46(b): the lessee makes a corresponding adjustment to the right-of-use asset for all other lease modifications, which would apply in the submitted fact pattern.

61. Using the example in paragraph 8 of this paper to illustrate, at the effective date of the lease modification (the date on which the rent concession is granted at the end of month 12), the lessee remeasures its lease liability by discounting the lease payments for months 15–36 using a revised discount rate (either the interest rate implicit in the lease for the remainder of the lease term (if that rate can be readily determined) or otherwise the lessee's incremental borrowing rate at the effective date of the modification). The lessee makes a corresponding adjustment to the right-of-use asset. Consequently, at the date on which the concession is granted, applying the lease modification requirements in IFRS 16, the lessee recognises the following (assuming the discount rate increases from 6% (applied to the original lease) to 7% (applied to the modified lease)):

Dr. Lease liability	CU19[2]	
Cr. Right-of-use asset		CU19

Interaction of IFRS 9 and IFRS 16

62. To summarise, in our example the lessee accounts for the forgiveness of the lease payments (ie the five lease payments for months 10–14) on the date the rent concession is granted by applying the derecognition requirements in IFRS 9—the lessee is required to do so by paragraph 2.1(b)(ii) of IFRS 9. As illustrated in paragraph 52 of this paper, the lessee derecognises the part of its lease liability (CU500) related to the forgiven lease payments, with a corresponding amount recognised in profit or loss in accordance with paragraph 3.3.3 of IFRS 9.

63. When the lessee accounts for the lease modification applying IFRS 16, it remeasures its lease liability by discounting the revised lease payments (ie payments of CU100 each month for months 15–36) using a revised discount rate in accordance with paragraph 45(c) of IFRS 16 and makes a corresponding adjustment (CU19) to the right-of-use asset in accordance with paragraph 46(b) of IFRS 16.

[2] Immediately before the modification at the end of month 12 (after the derecognition of forgiven lease payments as illustrated in paragraph 52 of this paper), the carrying amount of the lease liability is CU2,078 (the present value of 22 remaining monthly payments for months 15–36 of CU100 per month at the original rate of 6% annual interest (0.5% monthly)). The modified lease liability at the end of month 12 is CU2,059 (the present value of 22 remaining monthly payments of CU100 per month at the modified rate of 7% annual interest (0.58% monthly)), a decrease of CU19.

Is there an alternative view?

64. The submitter says some hold the view that the lessee in the submitted fact pattern could (or should) apply the lease modification requirements in IFRS 16 to the forgiven lease payments, rather than the derecognition requirements in IFRS 9. Using the analysis discussed in paragraphs 57–60 in this paper, the rent concession meets the definition of a lease modification in IFRS 16, and IFRS 16 includes requirements for remeasuring the lease liability when a lease is modified.

65. Using the example in paragraph 8 of this paper to illustrate, at the effective date of the lease modification (the date on which the rent concession is granted), applying the view set out in paragraph 64 above the lessee would remeasure the lease liability—to reflect the revised lease payments using a revised discount rate—and make a corresponding adjustment to the right-of-use asset (ignoring the effects of discounting on the CU500 forgiven):

Dr. Lease liability	CU519	
Cr. Right-of-use asset		CU519

66. As illustrated, the effect of this approach is that a lessee would recognise the full decrease in the carrying amount of the lease liability as a decrease in the carrying amount of the right-of-use asset, without recognising any amount in profit or loss at the date on which the rent concession is granted.

67. In our view, in developing the lease modification requirements in IFRS 16, the IASB did not intend to override the lease liability derecognition requirements in IFRS 9 for a fact pattern such as that described in the submission, ie one in which the *only* change to a lease contract is the extinguishment of the lease liability (or a part of it). However, we acknowledge that, in such a fact pattern, a lessee could conclude that the lease modification requirements in IFRS 16 apply in recognising the other side of the entry on decreasing the carrying amount of the lease liability. Using the example in paragraph 8 of this paper, the lessee cannot recognise the forgiveness of lease payments of CU500 both in profit or loss (as required by paragraph 3.3.3 of IFRS 9) and as a decrease to the carrying amount of the right-of-use asset (as required by paragraph 46(b) of IFRS 16). Therefore, the lessee is required to choose to apply either IFRS 16 or IFRS 9 when recognising the other side of the entry on decreasing

the carrying amount of the lease liability for a forgiveness of lease payments, but not both.

Staff conclusion—lessee accounting

68. Based on our analysis, we conclude that, in the submitted fact pattern, the lessee could apply paragraphs 3.3.1 and 3.3.3 of IFRS 9 to the part of the lease liability that is extinguished and paragraphs 45–46 of IFRS 16 in accounting for the lease modification (after having applied the derecognition requirements in IFRS 9 to the part of the lease liability extinguished). Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments in profit or loss at the date on which the rent concession is granted.

69. We acknowledge however that, in the submitted fact pattern, the lessee could also account for the forgiveness of lease payments by applying the lease modification requirements in IFRS 16. Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments as a decrease in the carrying amount of the right-of-use asset.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in IFRS 9 and IFRS 16 to the rent concession described in the submission, outlined for the lessor in paragraphs 24–47 of this paper and for the lessee in paragraphs 48–69 of this paper?

Whether to add a standard-setting project to the work plan

Lessor accounting

70. Paragraph 5.16 of the IFRS Foundation *Due Process Handbook* states that the Committee decides to add a standard-setting project to the work plan only if, among other things, it is necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting—ie the principles and requirements in IFRS

Accounting Standards do not provide an adequate basis for an entity to determine the required accounting.

71. Based on our analysis in paragraphs 24–47 of this paper, we conclude that this criterion is not satisfied—the principles and requirements in IFRS 9 and IFRS 16 provide an adequate basis for a lessor to determine how to apply (a) the expected credit loss model in IFRS 9 to its operating lease receivable before the concession is granted; and (b) the derecognition requirements in IFRS 9 and the lease modification requirements in IFRS 16 when the rent concession is granted.

Lessee accounting

72. Based on our analysis in paragraphs 48–69 of this paper, we conclude that there is more than one way for a lessee to read the principles and requirements in IFRS Accounting Standards in accounting for the rent concession in the submitted fact pattern. We therefore analyse the criteria in paragraph 5.16 of the *Due Process Handbook* for this lessee fact pattern to determine whether to recommend adding a standard-setting project to the work plan.

Does the matter have widespread effect and have, or is expected to have, a material effect on those affected? [3]

73. The matter arises only in a narrow set of circumstances—only when the lessor agrees to legally release the lessee from its obligation to make specifically identified lease payments and there are no other changes made to the lease. It would generally be considered unusual for a lessor to agree to forgive lease payments without other changes being made to the lease—for example, without removing or restricting the lessee's right to use the leased asset.

74. The outreach responses (summarised in paragraphs 19–21 of this paper) for the lessee submitted fact pattern indicate that fact patterns involving *only* the forgiveness of lease payments became more common during the covid-19 pandemic. The outreach responses also indicate that such fact patterns have also arisen in recent years in some jurisdictions—with a material effect on those affected—for reasons other than the

[3] Paragraph 5.16(a) of the *Due Process Handbook*.

covid-19 pandemic; for example, situations of social unrest resulting in lessors forgiving lease payments for some lessees whose businesses have been disrupted. In addition, the outreach responses indicate an expectation that these types of fact patterns could be common (and could have a material effect) going forward in at least a few jurisdictions. Accordingly, we think there would be benefits in undertaking standard-setting on the matter.

Is it necessary to add to or change requirements in IFRS Accounting Standards to improve financial reporting?[4]

75. As stated in paragraph 72 of this paper, we conclude that there is more than one way for a lessee to read the principles and requirements in IFRS Accounting Standards in accounting for the rent concession in the submitted fact pattern. Therefore, we conclude that the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for a lessee to determine the required accounting in such circumstances.

76. In our view, financial reporting would be improved if a narrow-scope amendment to the Accounting Standards could be made to resolve the matter.

Can the matter be resolved efficiently and is it sufficiently narrow in scope? [5]

77. In our view, the IASB could address the matter raised in the submission for lessees by excluding from the scope of IFRS 16 changes to a lease contract that result *only* in the extinguishment of the lessee's lease liability (or a part of it) as described in paragraph 3.3.1 of IFRS 9. For changes to lease contracts that result only in extinguishment, the lessee would apply the derecognition requirements in IFRS 9. For all other changes to lease contracts that meet the definition of a lease modification, the lessee would apply the lease modification requirements in IFRS 16. We think the matter is sufficiently narrow in scope that the IASB can address it in an efficient manner. Outreach responses indicate that the matter is not so narrow that it is not cost-effective to undertake the due process required to change IFRS 16 as described in this paragraph.

[4] Paragraph 5.16(b) of the *Due Process Handbook*.

[5] Paragraphs 5.16(c) and 5.16(d) of the *Due Process Handbook*.

Can this matter be resolved through an annual improvement?

78. In our view, the matter can be resolved efficiently within the confines of the existing Accounting Standards and the *Conceptual Framework* because it would meet the description of an annual improvement—ie a change that corrects relatively minor unintended consequences, oversights or conflicts between existing requirements of the Accounting Standards[6]. The suggested annual improvement (as described in paragraph 77 above) would not propose a new principle or change an existing principle[7].

Staff recommendation

79. **Lessor accounting**: For the reasons described in paragraph 71 of this paper, we recommend that the Committee not add a standard-setting project to the work plan in relation to the lessor accounting questions. We recommend that the Committee instead publish a tentative agenda decision that outlines how IFRS 9 and IFRS 16 apply in the lessor fact pattern described in the submission. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Accounting Standards.[8]

80. **Lessee accounting**: For the reasons described in paragraphs 73–78 of this paper, we recommend that the IASB:

    (a) propose to amend IFRS 16 in the manner described in paragraph 77 of this paper; and

    (b) include this proposed amendment in its next annual improvements cycle.

[6] Paragraph 6.11 of the *Due Process Handbook*.

[7] Paragraph 6.12 of the *Due Process Handbook*.

[8] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation:
    a. not to add a standard-setting project to the work plan with respect to a lessor's accounting for the rent concession described in the submission; and
    b. to add a standard-setting project (an annual improvement) to the work plan with respect to a lessee's accounting for the rent concession described in the submission?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision

Forgiveness of Lease Payments by a Lessor (IFRS 9 *Financial Instruments* and IFRS 16 *Leases*)

The Committee received a request about the application of IFRS 9 *Financial Instruments* and IFRS 16 *Leases* by a lessor in accounting for a particular rent concession. The rent concession is one for which the only change to the lease contract is the forgiveness by the lessor of lease payments due from the lessee under the contract.

The fact pattern

The request describes a rent concession agreed by a lessor and a lessee on the date the rent concession is granted. For the lessor, the rent concession changes a lease contract classified—applying IFRS 16—as an operating lease. The lessor legally releases the lessee from its obligation to make specifically identified lease payments while making no other changes to the lease contract. Until the date of granting the rent concession, the lessor had recognised as an operating lease receivable some or all of the payments forgiven and had applied the expected credit loss model in IFRS 9 to that operating lease receivable.

The question

The submitter asks:

(a) how the lessor applies the expected credit loss model in IFRS 9 to the operating lease receivable when it expects to forgive payments due from the lessee under the lease contract before the rent concession is granted; and

(b) whether the lessor applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

Application of the expected credit loss model in IFRS 9 to the operating lease receivable

Paragraph 2.1(b)(i) of IFRS 9 states that 'operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements' of IFRS 9. A lessor is therefore required to apply the impairment requirements in IFRS 9 to an operating lease receivable from the date on which it recognises the receivable.

In the fact pattern described in the request, the lessor applies the impairment requirements in IFRS 9 to the operating lease receivable before the rent concession is granted, during the period in which it would consider whether and when to grant the concession. IFRS 9 defines credit loss as 'the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls)…'. Paragraph 5.5.17 of IFRS 9 requires an entity to measure expected credit losses in a way that reflects (a) an unbiased and probability-weighted amount determined by evaluating a range of possible outcomes; (b) the time value of money; and (c) reasonable and supportable information available without undue cost or effort at the reporting date about past events, current conditions, and forecasts of future economic conditions.

Consequently, in estimating expected credit losses on the operating lease receivable described in the request in accordance with IFRS 9, the lessor measures any credit loss to reflect 'all cash shortfalls'—the difference between all contractual cash flows due to it in accordance with the lease contract and all the cash flows it expects to receive—using 'reasonable and supportable information' about 'past events, current conditions and forecasts of future economic conditions'. The Committee therefore concluded that, in the period before the rent concession is granted, the lessor measures expected credit losses on the operating lease receivable in a way that reflects an unbiased and probability-weighted amount determined by evaluating a range of possible outcomes (as required by paragraph 5.5.17 of IFRS 9), taking into account its expectations of forgiving lease payments recognised as part of that receivable.

Lessor accounting for the rent concession – IFRS 9 and IFRS 16

Application of the derecognition requirements in IFRS 9

As noted above, paragraph 2.1(b)(i) of IFRS 9 requires a lessor to apply the derecognition requirements as well as the impairment requirements of IFRS 9 to operating lease receivables. Consequently, on granting the rent concession, the lessor considers whether the requirements for derecognition in paragraph 3.2.3 of IFRS 9 are met.

In the rent concession described in the request, the lessor legally releases the lessee from its obligation to make specifically identified lease payments, some or all of which the lessor had recognised as an operating lease receivable. Accordingly, on granting the rent concession, the lessor would conclude that paragraph 3.2.3(a) of IFRS 9 has been met—ie its contractual rights to the cash flows from the operating lease receivable expire—because it has agreed to legally release the lessee from its obligation and thus has given up its contractual rights to those specifically identified cash flows from the operating lease receivable. On the date the rent concession is granted, the lessor therefore derecognises the operating lease receivable (and the associated expected credit loss allowance) and recognises any difference as a loss in profit or loss.

Application of the lease modification requirements in IFRS 16

The rent concession described in the request meets the definition of a lease modification in IFRS 16. The rent concession is 'a change to the consideration for the lease…that was not part of the original terms and conditions of the lease'. The lessor therefore applies paragraph 87 of IFRS 16 and accounts for the modified lease as a new lease from the date on which the rent concession is granted.

Paragraph 87 of IFRS 16 requires a lessor to consider any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease. The Committee noted that lease payments due from the lessee that the lessor has recognised as an operating lease receivable (to which the derecognition and impairment requirements in IFRS 9 apply) are not accrued lease payments. Consequently, neither those lease payments nor their forgiveness are considered part of the lease payments for the new lease.

In accounting for the modified lease as a new lease, the lessor applies paragraph 81 of IFRS 16 and recognises as income the lease payments to be made by the lessee over the lease term (including any prepaid or accrued lease payments relating to the original lease) on either a straight-line basis or another systematic basis.

The Committee observed that, in the fact pattern described in the request, the lessor accounts for the rent concession by applying:

(a) the derecognition requirements in IFRS 9 to lease payments forgiven that it had recognised as an operating lease receivable; and

(b) the lease modification requirements in IFRS 16 to any lease payments forgiven that it had not recognised as an operating lease receivable.

The Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for a lessor to determine how to apply the expected credit loss model in IFRS 9 to an operating lease receivable and account for the rent concession described in the request. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—submission

B1. We have reproduced the submission below:

Agenda Item Request: Accounting for rent concessions by lessors and lessees (IFRS 9, IFRS 16)

1 Description of the issues

1) Occasionally, in certain situations, reductions in lease payments (rent concessions) are granted to lessees by lessors without changing other terms of the lease contract. Since the onset of the COVID-19 pandemic, the number of such payment reductions has increased significantly. There is currently diversity in the accounting for rent concessions for operating leases on the lessor's side and for all types of leases on the lessee's side.

a) Lessor accounting

i) Accounting treatment of a voluntary forgiveness of lease payments

2) As part of their monitoring and supervisory activities, ESMA and national enforcers have identified diversity as to how lessors account for rent concessions in case of a voluntarily forgiveness of lessees' past lease payments. Some lessors treat this forgiveness as a lease modification and therefore apply paragraph 87 of IFRS 16, which requires accounting for modification as a new lease from the effective date of the modification. This treatment leads to an effective allocation of the loss resulting from the rent concession over the remainder of the lease term.

3) Other lessors, however, apply instead the derecognition requirements of IFRS 9 to their lease receivables in these circumstances, which results in the recognition of an immediate loss equal to the receivable's carrying amount in the period when the concession is granted.

View 1: Treatment as lease modification under IFRS 16

4) Proponents of view 1 argue that a voluntary reduction of lease payments granted by the lessor – if material – meets the definition of a lease modification in IFRS 16. Appendix A of 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. A forgiveness of the past lease payments (not required by law or foreseen in the contract) meets this definition.

5) In accordance with paragraph 87 of IFRS 16, the contract modification shall be accounted for as a new lease from the effective date of the modification.

6) Considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease, the granted concession is spread over the remaining term of the contract, reducing future lease payments.

7) Applying paragraph 81 of IFRS 16, lease payments from operating leases shall be recognised as income on a straight-line-basis (except if another basis is more representative) which generally represents the pattern in which benefit from the use of the underlying asset is diminished. Therefore, the effect of a rent concession will be spread over the remaining lease term reducing future lease income.

View 2: Derecognition of the operating lease receivable according to IFRS 9

8) On the other hand, proponents of view 2 note that, while in accordance with paragraph 2.1(b) of IFRS 9 rights and obligations under leases to which IFRS 16 applies are in general excluded from the application scope of IFRS 9, subsection (i) of this paragraph states that operating lease receivables are subject to derecognition and impairment requirements of IFRS 9.

9) They also observe that the IASB's educational guidance "IFRS 16 and covid-19" released on 10 April 2020, includes a section highlighting the application of requirements of IFRS 9 as follows: "*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*."

10) Regarding lessors' lease receivables, paragraph 3.2.3 of IFRS 9 requires derecognition of a financial asset when the contractual rights to the cash flows from this financial asset expire. According to paragraph 3.2.12 of IFRS 9, on derecognition of a financial asset, the difference between the carrying amount (measured at the date of derecognition) and the consideration received shall be recognised in profit or loss.

11) Under this accounting treatment, the concession would be recognised as a loss in the income statement, with a corresponding reduction to the lease receivable in the period in which the reduction is contractually agreed. The lessor will continue to recognise the unchanged amount of lease income over the lease term.

View 3: Accounting policy choice to apply IFRS 9 or IFRS 16

12) Proponents of view 3 believe that given the uncertainty as to which requirements apply to a voluntary reduction of past lease payments, entities have an accounting policy choice to apply either the requirements of IFRS 9 or IFRS 16.

ii) Calculation of an impairment allowance for the lease receivable when the lease liability is expected to be forgiven

13) ESMA and national enforcers have identified diversity as to how lessors estimate impairment losses when, at the end of the reporting period, they expect to forgive part or all of the outstanding lease receivable after that date. Diversity in how an expected future forgiveness of past lease payments is accounted for is also linked to issue (i) above.

14) Those who support view 1 presented above argue that the application of IFRS 16 guidance on accounting for lease modifications precedes the application of the impairment requirements to the lease receivable. In this case, paragraph 87 of IFRS 16 explicitly states that a lessor shall account for a modification to an operating lease from the effective date of the modification. Consequently, the expected forgiveness of past payments will not be included in the assessment of the expected credit losses on the lease receivable. Hence, when calculating the expected credit losses on the lease receivable, it should not be assumed that the concession may be granted. This argumentation is also shared by some proponents of views 2 and 3.

15) On the other hand, some other proponents of views 2 and 3 point out that the impairment requirements of IFRS 9, which are applicable to operating lease receivables according to paragraph 2.1(b)(i) of IFRS 9, stipulate the use of reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions (paragraph 5.5.17(c) of IFRS 9). In their opinion, expectations regarding forgiveness should be taken into account when calculating the impairment at the reporting date.

b) Lessee accounting

16) ESMA and national enforcers also note that lessee accounting for a voluntary forgiveness of a lease liability granted by the lessor appears to be similarly unclear which results in diversity. This is particularly the case if the lessee does not take advantage of the optional relief from applying IFRS 16 lease modification requirements for rent concessions arising as a direct consequence of the COVID-19 pandemic[1].

View 1: Treatment as lease modification under IFRS 16

17) Proponents of view 1 support the application of the guidance in IFRS 16 on lease modification accounting. In accordance with paragraph 45(c) of IFRS 16, this leads to a remeasurement of the lease liability by discounting the revised lease payments using a revised discount rate on the modification date (date of the liability's forgiveness).

View 2: Derecognition of the lease liability according to IFRS 9

18) Since paragraph 2.1(b)(ii) of IFRS 9 requires the derecognition principles of IFRS 9 to be applied to lease liabilities recognised by the lessee, proponents of view 2 argue that applying paragraph 3.3.1 of IFRS 9 to the lessee's lease liability, it shall be (partly) derecognised as a result of the voluntary forgiveness by the lessor and, therefore, no revision of the discount rate is required.

[1] The optional relieve only affects payments originally due on or before 30 June 2021.

View 3: Accounting policy choice to apply IFRS 9 or IFRS 16

19) Proponents of view 3 believe that entities have an accounting policy choice to apply either IFRS 9 or IFRS 16.

2 Request

20) ESMA seeks clarification on how a voluntary forgiveness of a lease liability granted by a lessor needs to be accounted by

- the lessor (see details in (a)(i) under section 1); and

- the lessee (see details in (b) under section 1).

Moreover, ESMA asks for clarification regarding the calculation of an impairment allowance for the lease receivable when the lease liability is expected to be forgiven (see details in (a)(ii) under section 1).

21) ESMA is of the view that the lack of clarity about whether the derecognition requirements of IFRS 9 or the guidance in IFRS 16 on lease modification accounting shall be applied leads to divergent practices of European issuers. Taking into account that those divergent practices have been identified in several European jurisdictions, ESMA considers that this matter is relevant across the EU with a material effect on the financial statements of the affected entities.