

Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

11 May 2020

Dear Mr Hoogervorst,

Re: Covid-19-Related Rent Concessions

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft proposed amendments to IFRS 16, *Covid-19-Related Rent Concessions*, issued by the IASB on 24 April 2020 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG agrees with the proposals in the ED. EFRAG agrees with the need to provide relief for lessees given the challenges they face in assessing whether lease modifications have occurred under the circumstances of covid-19 and taking account of the initial overall challenges of implementing IFRS 16 *Leases* requirements.

However, EFRAG would support expanding the scope of the amendment to include all rent concessions granted during 2020 and not just payments due in 2020.

In order not to delay the amendments for lessees, EFRAG suggests that the IASB, as part of a separate project, consider lessor accounting for covid-19 related concessions. Like lessees, lessors also face complexity in assessing the accounting implications of covid-19 related concessions in particular, whether rent concessions should be treated as a modification or as a reduction in rent payments.

EFRAG suggests that paragraph 46B of the ED should be updated to incorporate the requirement currently in BC4 that the practical expedient has to be applied consistently to contracts with similar characteristics and in similar circumstances. In addition, the IASB should clarify whether the amendment ought to be applied to covid-19 related rent concessions on a case-by-case basis or on a portfolio by portfolio basis.

EFRAG agrees with the requirement for entities to disclose the fact that the proposed amendment has been applied. To enable users to assess the impact of entities applying the amendment, EFRAG considers that, subject to practicability, the IASB should add a specific requirement to disclose the following in respect of the amendment: nature and extent of rent concessions for which the option has been applied, the financial statement line items affected and the amount recognised in financial statements.

Finally, EFRAG notes that there is need for further clarity in the language applied in respect of the applicability of amendment to interim financial statements. The same applies on the timing of profit or loss effects of concessions that are forgiveness or reduction of rental payments. The text should be in the main standard and not only in the Basis of Conclusion.

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EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Joachim Jacobs or Vincent Papa or myself.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JPGauzès', enclosed in a thin black rectangular border.

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Question 1 - Practical expedient (paragraphs 46A and 46B of the [Draft] amendment to IFRS 16)

Paragraph 46 A of the draft amendment to IFRS 16 proposes, as a practical expedient, that a lessee may elect not to assess whether a covid-19 related rent concession is a lease modification. A lessee that makes this election would account for any change in lease payments resulting from the covid-19-related rent concession the same way it would account for the change applying IFRS 16 if the change were not a lease modification.

Paragraph 46B of the draft amendment to IFRS 16 proposes that the practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all the following conditions are met:

- (a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- (b) any reduction in lease payments affects only payments originally due in 2020; and
- (c) there is no substantive change to other terms and conditions of the lease.

Do you agree that this practical expedient would provide lessees with practical relief while enabling them to continue providing useful information about their leases to users of financial statements? Why or why not? If you disagree with the proposal, please explain what you propose and why.

EFRAG's response

EFRAG agrees with the proposal of the IASB to provide lessees with an optional exemption from assessing whether a covid-19-related rent concession is a lease modification. EFRAG agrees with the need to provide relief for lessees given the challenges they face in assessing whether lease modifications have occurred under the circumstances of covid-19 and taking account of the initial overall challenges of implementing IFRS 16 requirements. However, EFRAG would suggest expanding the scope of application in order to include rental concessions and renegotiations agreed in 2020, irrespective of when the payments were due.

In order not to delay the amendments for lessees, EFRAG suggests that, as part of a separate project, the IASB consider lessor accounting for covid-19 related concessions. Like lessees, lessors also face complexity with assessing for modification accounting a large number of covid-19-related rent concessions.

The exemption

- 2 EFRAG agrees with the proposal of the IASB to provide lessees with an exemption from assessing whether a covid-19-related rent concession is a lease modification and that the marginal benefit of the proposed relief will be highest if it is provided as soon as possible. In supporting the proposal, EFRAG takes account of the current economic environment, whereby it is expected that many lessors have provided, or are expected to provide, rent concessions to lessees. These rent concessions could take many forms such as rent holidays or rent reductions for a period of time,

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possibly followed by increased rent payments in future periods and that it involves a large volume of leases.

- 3 IFRS 16 already contains requirements that address the accounting for rent concessions. Lessees are required to apply the requirements of IFRS 16 with regards to:
 - (a) assessing whether rent concessions are lease modifications; and
 - (b) applying the required accounting for rent concessions that are lease modifications (such as revising the discount rate and remeasuring the lease liability to reflect the revised lease payments using that rate).
- 4 EFRAG notes that assessing whether lease contracts have been modified under the circumstances of Covid-19 may be a challenging undertaking for preparers, as it relates to several different contracts at the same time. Furthermore, lease modification accounting is a costly exercise that necessitates a reassessment of future cash outflows and discount rates at the date of modification. Hence, the exemption effectively provides a double relief for preparers.
- 5 EFRAG considers that the need to assess for and apply lease modification accounting could add complexity for many entities especially those that are currently preparing their first annual financial statements in applying IFRS 16 which is effective for annual reporting periods beginning on or after 1 January 2019.
- 6 Applying the exemption, would result in:
 - (a) Any forgiveness of lease payments being recognised in profit or loss in the period in which the event or condition that triggers the forgiveness occurs.

EFRAG notes that if a reduction in lease payments (such as forgiveness of payments) does not result from a lease modification, a lessee would generally account for that change in payments as a negative variable lease payment. The lessee would apply paragraph 38 of IFRS 16 and generally recognise the variable payment in profit or loss in the period in which the event or condition that triggers those payments occurs. The lessee would also make a corresponding adjustment to the lease liability - in effect derecognising that part of the lease liability that has been extinguished by the forgiveness of lease payments. The derecognition of part of the lease liability (and recognition in profit or loss) would align with the requirements in paragraph 3.3.1 of IFRS 9, which requires an entity to remove a part of a financial liability from its balance sheet when, and only when, it is extinguished.
 - (b) Any deferral of lease payments is not affecting profit or loss in any material way. The changes affect only the timing of payments and not the consideration for the lease.

EFRAG observes that a change in lease payments that reduces payments in one period but proportionally increases payments in another ('deferred lease payments') does not extinguish the lessee's lease liability. Deferred lease payments do not change the consideration for the lease; they change only the timing of individual payments. For a change that involves only deferred lease payments, a lessee would continue to reduce the lease liability for payments made to the lessor applying paragraph 36(b) of IFRS 16.
 - (c) The lease liability representing the present value of all future lease payments owing to the lessor.
- 7 For the reasons provided in paragraphs 3 to 6 above, EFRAG supports the proposed amendment that require lessees that apply the exemption to account for covid-19-related rent concessions as if such concessions were not lease

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modifications. Applying the exemption does not impair a faithful representation of a lessee's obligations under the lease contract.

Scope: Applicability to lessors

- 8 EFRAG supports limiting the amendment to lessees (and not lessors) so as not to delay the issuance of the amendment for lessees. EFRAG notes the following reasons provided by the IASB for not granting the exemption to lessors:
- (a) For most lessors with a large volume of leases, leasing is part of their ordinary activities - a part of their core business and lessors would be expected to have processes and systems in place for their leasing activities, including when changes are made to lease payments.
 - (b) IFRS 16 substantially retained the lessor accounting model in the previously applicable IAS 17 *Leases*. Unlike many lessees, lessors are not currently preparing their first annual financial statements applying a new accounting model to their leases. Consequently, the need for relief is less of an issue for lessors than it is for lessees.
 - (c) The accounting required by IFRS 16 for lessor lease modifications – i.e. for an operating lease, to treat the modified contract as a new lease and, for a finance lease, generally to apply IFRS 9 *Financial Instruments* - would not be expected to be complicated, whereas a lessee is required to determine a new discount rate for all lease modifications.
- 9 EFRAG observes that granting a relief for the lessees and not for the lessor might result in an asymmetry, for instance, if due to granting rent concessions, a lessor assesses that a lease modification has occurred resulting in a new lease contract with differing revenue recognition patterns from the original lease, but the lessee applies the exemption and avoids accounting required for lease modification. The asymmetry in lessor and lessee accounting requirement can be particularly challenging for intermediate lessors.
- 10 EFRAG acknowledges that the overall accounting for lessors has not significantly changed from IAS 17 requirements as a result of the adoption of IFRS 16. However, EFRAG notes that there may be a need to assess the challenges of lessor accounting for covid-19 related concessions. EFRAG understands that lessors can have large volumes of quite diverse contracts in their portfolios spread across multiple jurisdictions. Therefore, as is the case with lessees, lessors face significant challenges in assessing whether contract modifications have occurred, especially as the concessions are often government imposed in many jurisdictions. In addition, granted concessions may be dissimilar within portfolios of lease contracts contributing to the complexity of analysing them, especially when considering the large volumes of contracts held by lessors. EFRAG understands that the issue relates mainly to operating leases.
- 11 EFRAG suggests that in order not to jeopardise the finalisation of this amendment, the IASB should expeditiously consider the challenges of lessor accounting in a separate project.

Update of paragraph 46B to ensure consistent application of amendment

- 12 EFRAG notes that BC4 states that as per paragraph 2 of IFRS 16 requirements, entities should apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances. EFRAG notes that stakeholders are still unclear on whether the amendment is to be applied on a portfolio by portfolio basis. EFRAG suggests that paragraph 46B of the ED should be updated to incorporate the requirement currently in BC4 that the practical expedient has to be applied consistently to contracts with similar characteristics and in similar

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circumstances. In addition, the IASB should clarify whether the amendment ought to be applied to covid-19 related rent concessions on a case-by-case basis or on a portfolio by portfolio basis.

Scope: Timeframe restrictions

- 13 The proposed exemption developed is applicable only to changes in lease payments arising as a direct result of the covid-19 pandemic and limited to payments due to occur in 2020. EFRAG acknowledges that, without restrictions, there is a risk that any exemption could be applied broadly and have unintended consequences.
- 14 EFRAG understands the need for imposing a restriction on the application of the amendment as it is an exception to IFRS 16 lease modification requirements that were adjudged to provide relevant information to users of financial statements. EFRAG acknowledges that due to the pervasive nature of the effects of the Covid-19 pandemic, it will likely become increasingly difficult to distinguish Covid-19 related rent concessions from those arising due to other economic factors. Furthermore, EFRAG notes that there need to be safeguards against extended application of the practical expedient beyond where needed. EFRAG also agrees with IASB's view that lessee entities will have made further progress in implementing IFRS 16 requirements after 2020 and therefore will be less in need for relief than is the case at this point in time.
- 15 However, EFRAG notes that there could be lessees to whom concessions have been granted this year but where the relief is applicable for periods beyond 2020 (e.g., for a six-month rent holiday granted in September 2020). EFRAG understands that the exemption would not be applicable to such lessee contracts. EFRAG notes that this will unnecessarily restrict the population of contracts that can benefit from the exemption particularly when considering the differing timelines in the crystallisation of the pandemic effects across jurisdictions.
- 16 For this reason, EFRAG would support expanding the scope of the amendment to include all rent concessions granted during 2020 and not just payments due in 2020.
- 17 However, should the IASB keep the current proposals, EFRAG would not oppose to the finalisation of this Amendment, in particular considering the strict timeline of the project.

Optional amendment

- 18 The proposed exemption is optional for entities. EFRAG agrees with the IASB analysis that:
 - (a) the proposed exemption represents a departure from the requirements of IFRS 16, which would be provided to lessees only to be responsive to particular concerns during the covid-19 pandemic; and
 - (b) entities should not be required to depart from the requirements of IFRS 16 as some entities (for example, those who have established systems to address changes in lease payments) may prefer the more consistent approach of applying the existing requirements to all changes to lease contracts throughout the pandemic.
- 19 EFRAG supports the exemption being optional noting that some entities may want to achieve comparability of reporting outcomes across its portfolio of contracts (i.e. between covid-19-related rent contracts and other contracts) and they should not be restricted by the exemption from doing so.
- 20 At the same time, EFRAG notes that the optional exemption may result in incomparable reporting between entities with similar lease contracts. For example, as noted in paragraph BC9 the effects of covid-19-related rent concessions on a

lessee's right-of-use asset and profit or loss could be different depending on whether an entity applies the exemption. This could be because an entity applying the exemption would generally recognise the effects of forgiveness of lease payments in profit or loss. Whereas, an entity applying the lease modification requirements would instead make an adjustment to the carrying amount of the right-of-use asset and generally recognise the effects of the rent concession over the useful life of the right-of-use asset.

- 21 Nonetheless, as noted in paragraph BC9, in principle the circumstances giving rise to rent concessions may indicate that right-of-use assets may be impaired. Consequently, EFRAG acknowledges that to some extent, an impairment loss could in some circumstances¹ reduce the potential difference between accounting - or not accounting - for a rent concession as a lease modification. Furthermore, the time restriction of the amendment reduces the period of incomparability.
- 22 The possible reduced comparability across entities due to the optional exemption makes it all the more important to have the disclosure of the financial statement effects particularly as the income statement gains for rent forgiveness could be considered as non-recurring and users need to be aware of such effects.

Question 2- Effective date and transition (paragraphs C1A and C20A of the Draft amendment to IFRS 16)

Paragraphs C1A and C20A of the draft amendment to IFRS 16 propose that a lessee would apply the amendment:

- (a) For annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at the date the amendment is issued; and
- (b) Retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.

EFRAG's response

EFRAG agrees with the suggested proposal that entities should apply the exemption retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but are not be required to restate prior period figures.

- 23 EFRAG notes that retrospective application would not capture rent concessions that affect payments before January 2020 as the proposed exemption is limited to rent concessions that reduce only payments originally due in 2020. However, retrospective application may benefit entities that, for example:
- (a) have a 31 March 2020 year-end and publish financial statements before the IASB would finalise an amendment. Such entities would be able to

¹ EFRAG understands that right of use assets will often form part of larger cash-generating units (CGU) and there might not be impairment losses at the level of the CGU.

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- retrospectively apply the amendment to covid-19-related rent concessions arising in March 2020 (and later) in their 31 March 2021 financial statements;
- (b) prepare interim financial statements before the IASB would finalise an amendment but would like to use the exemption in their next annual financial statements.
- 24 EFRAG observes that for entities such as those in paragraph 23(a) above, restatement of prior period figures would have little benefit due to the short timeframe of the exemption and expects the such a restatement to be potentially costly.
- 25 Therefore, EFRAG agrees with the suggested proposal that entities should apply the exemption retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but are not be required to restate prior period figures. Instead, a lessee would recognise any difference arising on initial application of the amendment in opening retained earnings (or other component of equity, as appropriate) in the annual reporting period that includes the date of initial application.
- 26 EFRAG notes that entities will be required to apply the amendment retrospectively but are not required to restate prior period figures. EFRAG agrees with this approach, as a restatement would not result in a different outcome, given that the scope of the optional relief is limited to payments due for 2020.
- 27 EFRAG notes that the proposed amendments will be effective for annual and interim periods beginning on or after 1 June 2020 and that many entities are already preparing their first annual financial statements applying IFRS 16 or will do so in the coming months. Entities will also have to apply IFRS 16 in preparing interim financial statements.
- 28 The proposed amendments are limited to rent concessions that reduce only payments originally due in 2020. Therefore, EFRAG considers that the proposal of the IASB to make the amendment effective for annual periods beginning on or after 1 June 2020 with earlier application permitted including in financial statements not yet authorised for issue at the date the amendment is issued, is important. EFRAG also highlights that the proposed amendments are optional therefore entities are not obligated to implement them and would therefore not be restricted to the timeline of the proposed amendments.

Other matters

Disclosures

- 29 EFRAG acknowledges that by allowing entities with an option to apply the exemption, comparability could be reduced. Therefore, EFRAG supports the proposal in paragraph 60A of the ED to require entities applying the exemption to disclose that fact. EFRAG notes that paragraph 59(b)(i) of IFRS 16 requires entities to disclose the nature of future cash flows, such as variable payments. EFRAG also observes that paragraph 38 of IAS 1 *Presentation of Financial Statements* requires entities to disclose any additional information needed to enable users to understand material effects of, for instance, covid-19-related rent concessions on the primary financial statements.
- 30 However, EFRAG notes the threshold of materiality in respect of financial statements as per IAS 1 requirements may not necessarily capture the disclosure of specific information that may be material at the level of the line item. Therefore, to enable users to assess the impact of the amendment, EFRAG considers that, subject to practicability and if material to the line item and useful to the understanding by users, the IASB should add a specific requirement to disclose the

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following in respect of the amendment: nature and extent of rent concessions for which the optional relief is used, the financial statement line items affected and the amount recognised in financial statements.

Applicability to interim financial statements

- 31 EFRAG questions whether interim financial statements are covered by the wording *'including in financial statements not yet authorised for issue at the date the amendment is issued'* when linking words like *'annual reporting period'* with *'authorised for issue'*. Therefore, EFRAG suggests that it may be more helpful to either delete the wording or to explicitly include interim financial statements in paragraph C1A of the ED to avoid such confusion.

Timing of Profit or Loss Effects

- 32 EFRAG notes that there is ambiguity in the ED on the timing of profit or loss effects for concessions that are forgiveness or reduction of lease payments. Paragraph BC7(a) states that forgiveness of lease payments would be accounted for as a variable lease payment applying paragraph 38 of IFRS 16. However, paragraph BC9 states that the practical expedient would generally recognise the effects of forgiveness of lease payments in profit or loss in the period in which the event or condition that triggers the event occurs. Hence, it is not clear whether the profit or loss effects would be the entirety of the concessions at inception or whether the reduction in income would be spread across the periods that the forgiven rentals relate to.
- 33 EFRAG would also suggest that clarifying language on the effects on profit or loss in paragraphs BC7(a) and BC9 should be stated in the main standard and not only in the Basis of Conclusion.