EFRAG
European Financial Reporting Advisory Group

Preparatory document of the Draft Endorsement Advice

Covid-19-Related Rent Concessions – Amendment to IFRS 16

Notes to Constituents:

EFRAG has not yet received from the European Commission the letter requesting an endorsement advice in respect of Covid-19-Related Rent Concessions – *Amendment to IFRS 16* (the Amendment), as such letter will be sent only following the issuance of the Amendment in May.

Considering the tight timeline of the forthcoming due process, EFRAG is issuing this preparatory document for comments, on the basis of the contents of the IASB Exposure Draft Covid-19-Related Rent Concessions – *Amendment to IFRS 16* (the ED), in anticipation of the endorsement advice. Provided that the final contents of the Amendment are not substantially different than the contents of the ED, this preparatory document will be used as in the preparation of EFRAG's Final Endorsement Advice.

The following two appendices set out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendment.

In it, EFRAG assesses how the Amendment satisfy the technical criteria set out in the Regulation (EC) No 1606 2002 for the adoption of international accounting standards. It provides a detailed evaluation for the criteria of relevance, reliability, comparability and understandability, so that financial information is appropriate for economic decisions and the assessment of stewardship. It evaluates separately whether the Amendment leads to prudent accounting and finally considers whether the Amendment would not be contrary to the true and fair view principle.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS Standards in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS Standard or Interpretation against the technical criteria for European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRS Standards or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON COVID-19-RELATED RENT CONCESSIONS (AMENDMENTS TO IFRS 16)

Once filled in, this form should be submitted by 20 May 2020 using the 'Comment publication link' available at the bottom of the respective news item. All open consultations can be found on EFRAG's web site: Open consultations: express your views.

EFRAG expects to be asked by the European Commission to provide it with advice and supporting material on Covid-19-Related Rent Concessions - Amendment to IFRS 16. In order to do so, EFRAG has been carrying out an assessment of the Amendment against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

Before finalising its assessment, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.

EFRAG's initial assessments, summarised in this questionnaire, will be updated for comments received from constituents when EFRAG is in the process of finalising its *Letter to the European Commission* regarding endorsement of the Document.

Your details

1 Please provide the following details:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Comissão de Normalização Contabilística

(b) Are you a:

☐ Preparer ☐ User ☒ Other (please specify)

Public Authority

(c) Please provide a short description of your activity:

National Standard Setter

(d) Country where you are located:

Portugal

(e) Contact details, including e-mail address:

secretariado@cnc.min-financas.pt

EFRAG's initial assessment with respect to the technical criteria for endorsement

2 EFRAG's initial assessment of the Amendment is that it meets the technical criteria for endorsement. In other words, the Amendment is not contrary to the principle of true and fair view and meets the criteria of understandability, relevance, reliability, comparability and lead to prudent accounting. EFRAG's reasoning is set out in Appendix 3 below.

(a) Do you agree with this assessment?

[x] Yes [ ] No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 3 below regarding endorsement of the Document that you believe EFRAG should take into account in its technical evaluation of the Amendment? If there are, what are those issues and why do you believe they are relevant to the evaluation?

CNC does not support the proposed effective date of the amendment. In Portugal, the Tax Authorities may not consider for tax purposes the accounting treatment resulting from an early adoption of an amendment to an existing IFRS. Many listed firms use IFRS in their separate financial statements, meaning that they assess their corporate income tax from IFRS financial statements. This means that for tax purposes the proposed amendment could not be relevant for 2020 annual reporting period, which may cause unnecessary tax litigation.

The European public good

3 In its assessment of the impact of the Amendment on the European public good, EFRAG has considered a number of issues that are addressed in Appendix 3 below.

Improvement in financial reporting

4 EFRAG has identified that in assessing whether the endorsement of the Amendment is conducive to the European public good it should consider whether the Amendment is an improvement over current requirements across the areas which have been subject to changes (see Appendix 3 below). To summarise, EFRAG's initial assessment is that the Amendment does not compromise the overall quality of financial reporting.

Do you agree with the assessment?

[x] Yes [ ] No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Costs and benefits

5 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendment in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this invitation

to comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in Appendix 3 below. To summarise, EFRAG's initial assessment is that the Amendment is reducing the costs and complexity for preparers and EFRAG's assessment is that this is not likely to affect costs for users.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

6 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendment. The results of the initial assessment of benefits are set out in Appendix 3. To summarise, EFRAG's initial assessment is that preparers are likely to benefit from the Amendment as it is a practical expedient that on balance will reduce complexity and costs without compromising the quality of information and imposing additional costs for users.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Overall assessment with respect to the European public good

7 EFRAG has initially concluded that endorsement of the Document would be conducive to the European public good as set out in Appendix 3 below.

Do you agree with this conclusion?

☒ Yes ☐ No

If you do not agree, please explain your reasons.

EFRAG's preparatory Draft Letter to the European Commission Regarding Endorsement of Covid-19-Related Rent Concessions Amendment to IFRS 16

John Berrigan
Director General, Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

[XX] May 2020

Dear Mr Berrigan

[On the assumption that the final Amendment will not be substantially different from the contents of the ED, this document has been prepared on the basis of the ED, in anticipation of the intended contents of the EFRAG final endorsement advice on the forthcoming Amendment to IFRS 16.]

Endorsement of Covid-19-Related Rent Concessions *[Proposed] amendment to IFRS 16*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards, EFRAG is pleased to provide its opinion on Covid-19-Related Rent Concessions [*Proposed] amendment to IFRS 16* ('the Amendment,'), which were issued by the IASB on [date]. An Exposure Draft of the Amendment was issued on 24 April 2020. EFRAG provided its comment letter on that Exposure Draft on [xx] May 2020.

The Amendment would permit lessees, as a practical expedient, not to assess whether particular covid-19-related rent concessions are lease modifications. Instead, lessees that apply the practical expedient would account for those rent concessions as if they were not lease modifications.

The Amendment shall be applied for annual reporting periods beginning on or after [date the amendment is issued]. Earlier application is permitted, including in financial statements not yet authorised for issue at [date the amendment is issued].

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendment would meet the technical criteria for endorsement, in other words whether the Amendment would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, leads to prudent accounting and is not contrary to the true and fair view principle. We have then assessed whether the Amendment would be conducive to the European public good. We provide our conclusions below.

Does the Amendment meet the IAS Regulation technical endorsement criteria?

Based on the above reasoning, EFRAG has concluded that the Amendment meets the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship and raised no issues regarding prudent accounting.

EFRAG has also assessed that the Amendment does not create any distortion in its interaction with other IFRS Standards and that all necessary disclosures are required.

Therefore, EFRAG has concluded that the Amendment is not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Is the Amendment conducive to the European public good?

EFRAG has assessed that the Amendment would not compromise financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendment could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendment is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

Our advice to the European Commission

As explained above, we have concluded that the Amendment meets the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raise no issues regarding prudent accounting and that they are not contrary to the true and fair view principle. We have also concluded that the Amendment is conducive to the European public good. Therefore, we recommend the Amendment for endorsement without further delay.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 2: EFRAG's technical assessment on the Amendment against the endorsement criteria

Does the accounting that results from the application of the Amendment meets the technical criteria for endorsement in the European Union?

1 EFRAG has considered whether the Amendment meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); and

(b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

3 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).

4 EFRAG's assessment as to whether the Amendment would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

5 In its assessment, EFRAG has considered the Amendment from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendment is appropriate both for making decisions and assessing the stewardship of management.

6 EFRAG's assessment on whether the Amendment is not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether they lead to prudent accounting. EFRAG's assessment also includes assessing whether the Amendments do not interact negatively with other IFRS Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:

(a) relevance: paragraphs 7 to 13;

(b) reliability: paragraphs 14 to 17;

(c) comparability: paragraphs 18 to 22;

(d) understandability: paragraphs 23 to 26;

(e) whether overall, they lead to prudent accounting: paragraphs 27 to 28; and

(f) whether they would not be contrary to the true and fair view principle as noted in paragraphs 29 to 33.

Relevance

7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

8 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

9 EFRAG observes that the application of the exemption, could have the following accounting implications:

(a) *A forgiveness of lease payments (the lessee has been exonerated for some or all its lease obligations)* – In this circumstance the lease obligation is reduced, and a once-off gain is realised within profit or loss for the amount of the forgiveness.

If the exemption had not been taken, modification accounting would have taken effect and a new lease obligation would have been determined considering a new discount rate. Also, the carrying amount of the right-of-use asset would have been adjusted and the effect of the rent concession would have been recognised over the useful life of the right-of-use asset. EFRAG considers that it is relevant to account for these types of temporary forgiveness of payments in profit or loss in the same period as they occur.

(b) *Deferred lease payments* – Here the overall lease obligation is not reduced but the payments are being deferred to a later date with no impact on profit or loss.

Under modification accounting a new lease obligation would have been determined considering a new discount rate.

10 EFRAG notes that for changes to the leasing contracts that are accounted for adopting the exemption, the Amendment will result in accounting outcome that may deviate from the outcome of the application of IFRS 16 applicable requirements. EFRAG considers that the overall difference in profit or loss for the period when the option is applied will be limited to the difference between the gain recorded due to forgiven payments and the impairment loss on the right-of-use asset that may result from the concession.

11 EFRAG highlights that the Amendment is limited to rent concessions that reduce only payments originally due in 2020. EFRAG notes that for entities that do apply the exemption they need to disclose the fact. EFRAG also notes that such entities need to comply with the overarching disclosure requirement objectives of IAS 1 *Presentation of Financial Statements* and IFRS 16 and would therefore be expected to disclose any additional information needed to enable users to understand material effects of the amendment on the primary financial statements.

12 EFRAG finally considers that the resulting information (being the liability for leasing contracts that have been subject to changes measured at their net present value) continues to provide relevant information.

13 Accordingly, EFRAG assesses that the Amendment results in information that is relevant.

Reliability

14 EFRAG also considered the reliability of the information that will be provided by applying the Amendment. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

15 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

16 EFRAG notes that 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;

(b) any deferral of lease payments not affecting profit or loss to the extent that the changes affect only the timing of payments and not the consideration for the lease. Instead a deferral is reflected in the measurement of the lease liability, which would reflect amounts owing to the lessor;

(c) the lease liability representing the present value of all future lease payments owing to the lessor.

17 Therefore, EFRAG assesses that the above effects do not impair a faithful representation of a lessee's obligations under the lease contract and thus do not impair the reliability of the resulting information.

Comparability

18 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

19 EFRAG has considered whether the Amendment result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

20 EFRAG notes that the exemption may adversely affect comparability between entities that do apply the exemption and those that are not as the effects of covid-19-related rent concessions on a lessee's right-of-use asset and profit or loss could be different. It may also reduce the comparability within entities' portfolio of lease contracts.

21 EFRAG acknowledges that the Amendment could reduce comparability, but also highlights that the following that might mitigate that:

(a) the Amendment is optional therefore entities do not have to apply it;

(b) the Amendment is limited to rent concessions that reduce only payments originally due in 2020;

(c) entities applying the Amendment should disclose the fact.

22 Therefore, on balance EFRAG assesses it does not significantly reduce comparability.

Understandability

23 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business

and economic activity and accounting, and the willingness to study the information with reasonable diligence.

24 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

25 EFRAG assesses that the Amendment are a simplification of the current requirements in IFRS 16 with regards to lease modifications, which enables lessees not to:

(a) assess a large volume of contracts to determine whether each rent concession is a lease modification; and

(b) apply the required accounting for rent concessions that are lease modifications.

26 The effects of the exemption would be easier for users of financial statements, and others, to understand if all entities applying the exemption use the same accounting. EFRAG considers that the disclosure requirements mitigate difficulties in understanding the effects of the Amendment and as noted previously the information provided is relevant and reliable.

Prudence

27 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated, and liabilities or expenses are not understated.

28 EFRAG did not identify any aspects of the Amendments that would affect prudence.

True and Fair View Principle

29 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

30 As stated in paragraph 9 EFRAG notes that in applying the Amendment a once-off gain can be recognised in profit or loss when there is a forgiveness of lease payments, to the extent that the impairment of the correspondent right-of-use do not completely offset the gain, and that a higher lease obligation could be recognised in periods where the lease payments are being deferred.

31 EFRAG considers that a once-off gain recognised in profit or loss and the recognition of the lease liability after a rent holiday without an interest component could create a distortion in and entity's financial position and profit or loss. However, EFRAG highlights that the impact in profit or loss may be mitigated by the recognition of impairment on the right-of-use asset. In addition, considering the restriction on time, consideration and other terms and conditions associated with the Amendment, EFRAG has assessed that, on balance, it does not lead to unavoidable distortions which could impede financial statements from providing a true and fair view.

32 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial

position and profit or loss are required through the Amendment and through the overarching disclosure requirement objectives in paragraph 31 of IAS 1.

33 On balance, EFRAG concludes that the application of the Amendment is consistent with the true and fair view principle.

Conclusion

34 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendment is conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendment. In addition to its assessment included in Appendix 2. In order to identify any potential negative effects for the European economy on the application of the Amendment, EFRAG considered:

(a) Whether the Amendment improves financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS Standards as a whole;

(b) The costs and benefits associated with the Amendment; and

(c) Whether the Amendment could have an adverse effect to the European economy, including financial stability and economic growth.

2 These assessments allow EFRAG to draw a conclusion as to whether the Amendment is likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of impact of the Amendment on the quality of financial reporting

3 EFRAG notes that the Amendment will provide relief to lessees from having to comply with the complex requirements of accounting for lease modifications resulting from the pandemic crisis. As noted in paragraph 17 of Appendix 2 above, the Amendment does not impair the faithful representation of the lessee's obligation. However, EFRAG notes that the exemption may lessen the comparability in the reporting of lessee obligations across and within entities of a lessee's obligations but this effect will be minimised if there is a significant uptake of the amendment by lessees and in so far as entities disclose the effects of the amendment on financial statements.

4 Therefore, EFRAG concluded that, on balance, the Amendment does not compromise the overall quality of financial reporting.

EFRAG's initial analysis of the costs and benefits of the Amendment

5 EFRAG has considered that a less extensive cost-benefit analysis of the effects of the proposal is proportionate and needed for the narrow scope amendment than would be the case for Standards or Interpretations that have a wide scope. Furthermore, the urgency of the relief limits the extent to which any formal effects analysis can be carried out.

Cost for preparers

6 EFRAG notes that the objective of the Amendment is to provide lessees' relief from the challenges of accounting for lease modification under circumstances of the covid-19 pandemic. Therefore, the Amendment reduces the complexity and costs around the application of IFRS 16 lease modification requirements.

Costs for users

7 EFRAG's assessment is that the optional application of the Amendment could adversely affect comparability across and within entities depending on the application of the Amendment. EFRAG notes that the disclosure of the fact that the amendment is applied alongside the overarching disclosure requirements of IAS 1

and IFRS 16 that require preparers to disclose information that is relevant for users if considered material and useful for decision making- will lessen the concerns about comparability. In addition, the possibility of a high uptake of the amendment by entities coupled with the limited time frame to which entities can apply exemption from lease modification requirements will also lessen comparability concerns.

8 Overall, EFRAG's assessment is that this narrow scope Amendment is not likely to affect costs to users.

Conclusion on the costs and benefits of the Amendment

9 Overall, EFRAG's assessment is that preparers are likely to benefit from the Amendment, as it is a practical expedient that on balance will reduce complexity and costs without compromising the quality of information and imposing additional costs for users.

EFRAG's assessment of whether the Amendment could have an adverse effect to the European economy, including financial stability and economic growth.

10 EFRAG is not aware of any evidence to suggest that the Amendment could have an adverse effect on the European economy, including financial stability and economic growth. Conversely, the proposed relief is intended to alleviate the overall challenges that preparers face under the challenging circumstances of the covid-19 pandemic and it can be seen as a contributing to the multiple efforts which aim to help businesses navigate through this challenging period.

Conclusion

11 EFRAG believes that the Amendment will, on balance, not compromise the quality of financial reporting when compared to current guidance. Furthermore, in the peculiar situation of the ongoing crisis due to the covid-19 pandemic, the amendment will reduce the complexity and costs for lessees in respect of lease modification requirements without imposing addition costs for users of financial statements. As such, the endorsement of the amendment is conducive to the European public good in that it provides an operational simplification without compromising the quality of the reported information.

12 EFRAG has not identified the Amendment could have any adverse effect to the European economy, including financial stability and economic growth that is significant.

13 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.

14 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendment, EFRAG assesses that endorsing the Amendment is conducive to the European public good.