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Improvement to IFRS 16 in order to contain the implications of Cov-2019

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Abstract:

Many lessees have benefited from rent concessions in order to withstand the covid-19 crisis. This study will provide an overview of the technical accounting of IFRS 16 as well as how companies can successfully achieve and maintain compliance with the standard. This study also aims to know how to account for those concessions granted to lessees, In that, a set of results has been achieved, the most important of them. The International Accounting Standards Board has issued an amendment to IFRS 16 to make it easier for lessees to account for Covid-19 related rent concessions. This study focusses solely on the changes that will affect lessees as changes arising from IFRS 16 for lessors are minor.

Keywords: Concessions; Payments; lessee; Standards; Disease.

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Introduction:

IAS 17 Leases, the predecessor to IFRS 16, requires entities to classify their contracts as either operating leases or finance leases, based on the extent to which risks and rewards incidental to ownership of the leased asset lie with the lessor or the lessee. However, IFRS 16 removes the ‘operating’ lease classifications and requiring a lessee to recognise assets and liabilities on the balance sheet for almost all leases. The IASB decided to make these changes to address concerns raised by users of financial statements about off-balance sheet lease accounting. Because for operating leases, Leases can be used to provide access to assets without significant upfront costs, and the use of those assets is of value to the entity. Without entities recognising these leased assets in their financial statements (along with the corresponding liability) users can neither see all the assets that the entity is benefiting from, nor easily compare their financial position to entities which have chosen to either buy the asset outright, or have entered into alternative financing arrangements. In other context, Due to Covid-19 many lessors have granted rent concessions to their lessees. The IASB has issued Covid-19-Related Rent Concessions, which amends IFRS 16 Leases, to simplify the accounting of Covid-19-related rent concessions by lessees.

For by means what already stated can ask this question:

What are the main changes in IFRS 16 due to IASB’s response to Covid-19-related rent concessions?

Importance of the stydy

- the leasing of assets is of importance to many entities. Leases can be used to provide access to assets without significant upfront costs;
- The COVID-19 pandemic has resulted (at the time of writing) in almost 178 million confirmed cases and about 3.7 million deaths globally.It has also produced concerns about future social-economic crises and recession;
- The impact of covid - 19 has affected most economic institutions as a result of indefinite closures due to quarantine measures and other government directives;
- COVID-19 has created unique challenges in the operation and oversight of entities. These challenges are particularly acute when it comes to financial reporting and disclosure;

- Due to the impact of Covid-19, many lessees are being offered rent concessions by their lessors;
- lessees are experiencing significant operational difficulty in applying the existing requirements of IFRS 16 for rent concessions;
- Many lessees, especially in the Retail, Hospitality and Leisure sectors, have a large volume of leases that may be affected.

Research objectives:

- Analysing the challenges lessees and lessors may face when accounting for rent concessions, and the IASB's response in alleviating some of them;
- bring attention to the potential effect on the carrying value of Right of Use Assets under IFRS 16 and impairment considerations;
- Highlighting the criteria that must be satisfied for a rent concession to qualify for the practical expedient;
- Explanation of the criteria and the practical implications of applying the practical expedient.

Research methodology

This topic was studied by following the descriptive approach to clarify the various concepts as well as the analytical approach in order to facilitate the full understanding of the topic by highlighting all its parts.

Firstly. Lease Requirements under IFRS

1. Objective and Scope of IFRS 16

This Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity. (la commission européenne, 2017, p. 3)

IFRS 16 will apply to all leases, except for: (MNP SENCRL, srl, 2017, p. 5)

- Leases to explore for or use minerals, oil, natural gas and similar non regenerative resources;

- Leases of biological assets within the scope of IAS 41 Agriculture held by a lessee;
- Service concession arrangements within the scope of IFRIC 12 Service Concession Arrangements;
- Licenses of intellectual property granted by a lessor within the scope of IFRS 15; and
- Rights held by a lessee under licensing agreements within the scope of IAS 38 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

A lessee may, but is not required to, apply this standard to the lease of intangible assets other than those described in the last bullet point above. (Hassan Sarhan, 2020, p. 9)

Sublease is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and the lessee remains in effect. (International Accounting Standards Board(IASB), 2016, p. 14)

2. Definitions of Terms

Lease. A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. (RSM network, 2017, p. 6)

Lease term. IFRS 16 defines the lease term as the non-cancellable period of the lease together with periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option and periods covered by an option to terminate the lease if the lessee is reasonably certain not to. (Eddy James, 2017, p. 9)

Interest rate implicit in the lease. The interest rate implicit in the lease is defined as the rate at which the present value of the lease payments and any unguaranteed residual value is equal to the sum of the fair value of the underlying asset and any initial direct lessor costs. (Paul, 2017, p. 11)

Fixed payments. Are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments. (International Public Sector Accounting Standards Board (IPSASB), 2018)

Lease incentives. 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. (The European Commission, 2017, p. 16)

Residual value guarantee. A guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount. (Statutory Board Financial Reporting Standards (SB-FRS), 2021, p. 22)

Initial direct costs. Incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease. (Hong Kong Institute of Certified Public Accountants(cpa), 2021, p. 22)

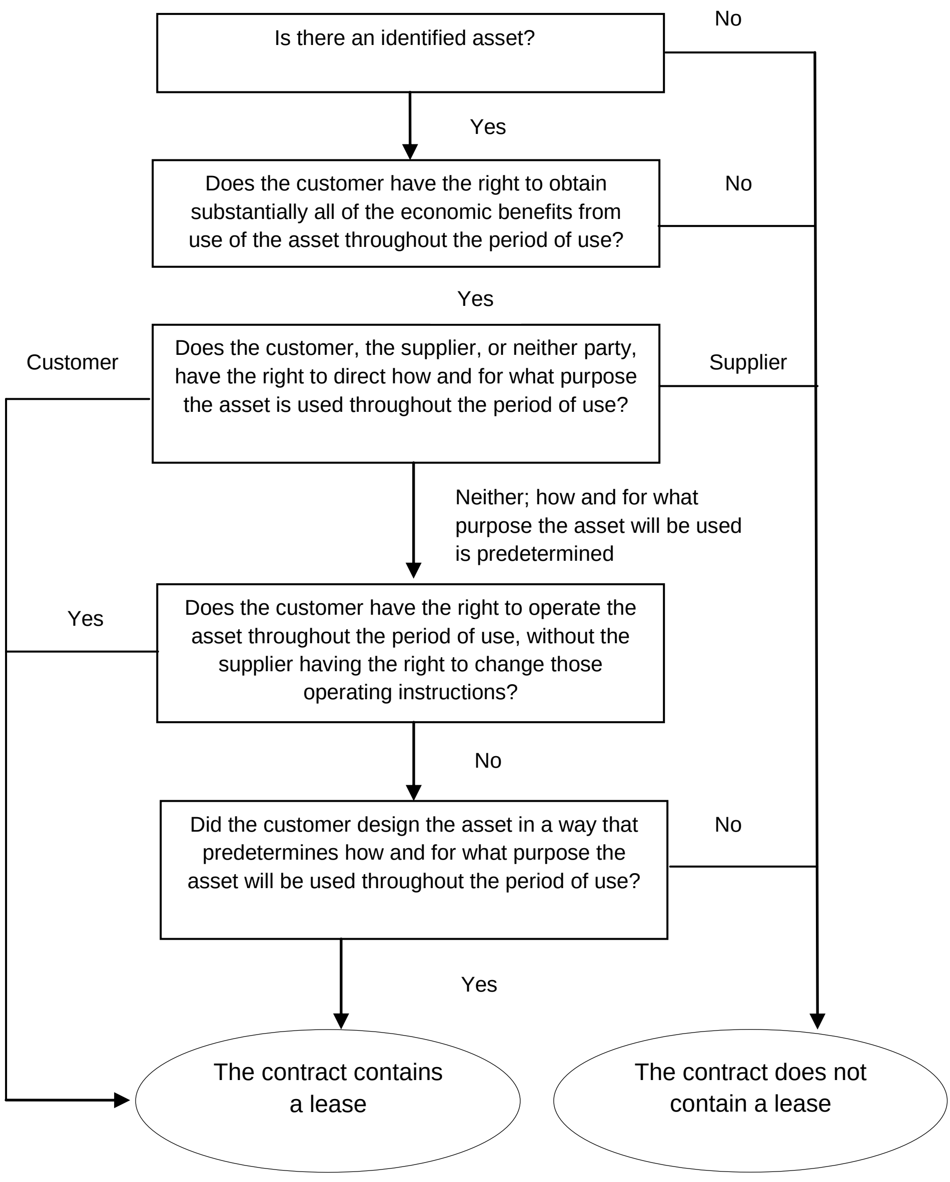
In-substance fixed lease payments. Are payments that may, in form, contain variability but that, in substance, are unavoidable. (Ernst & Young, 2019, p. 1720)

3. Identifying a lease under IFRS 16

At inception of a contract, an entity (a lessee) shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. (Australian Accounting Standards Board(AASB), 2019, p. 7)

The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.

Fig.1. Determining whether a contract is a lease under IFRS 16



Source: (International Accounting Standards Board(IASB), 2016, p. 20)

Entities will need to focus on whether an arrangement contains a lease or a service agreement because there are significant differences in the accounting. (Ernst & Young, 2019, p. 1641)

As illustrated in the above flowchart, IFRS 16 performs a control method to the identification of lease, differentiating between service arrangements and leases based on whether contract includes an identified asset which is controlled by customers. Hence, the new leasing standard stipulates that a contract includes a lease if: (Rasulova Nigar, 2019, p. 26)

- contract defines an identified asset; and
- the contract transfers the right of controlling the use of mentioned identified asset for a time period in trade for consideration.

The standard specifies to have the right of control 'throughout the period of use, the customer has both of the following: (Barry Elliott, Jamie Elliott, 2019, p. 467)

(a) The right to obtain substantially all of the economic benefits from use of the identified asset and

(b) The right to direct the use of the identified asset . . . '

4. Lessee lease classification

The standard eliminates the classification of leases by lessees as either operating leases or financial leases (Donkersley, 2017, p. 5). Lessees are required to recognize assets and liabilities arising from all leases (International Federation of Accountants(IFAC), 2020).

However, a lessee may elect not to apply the new leasing requirements in IFRS 16 in the following situations: (International Public Sector Accounting Standards Board (IPSASB), 2018, p. 17)

(a) short-term leases; and

(b) leases for which the underlying asset is of low value.

short-term leases - i.e. a lease that, at the commencement date, has a lease term under the contract of twelve months or less (David Maxwell, 2017, p. 3) does not contain an option to purchase. (Barry Elliott, Jamie Elliott, 2019, p. 468)

For leases for which the underlying asset is of low value. A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased. (The European Commission, 2017, p. 19)

An underlying asset in a lease can be of low value only if: (Binder Dijker Otte(BDO), 2018, p. 9)

(a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and

(b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.

Examples of low-value underlying assets can include tablets, personal computers, small items of office furniture and telephones. (David Maxwell, 2017, p. 3)

A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value. As well as If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset. (Ernst & Young(EY), 2020, p. 63)

5. Lease measurement requirements for lessee

Lessees are required to recongise both a leased asset and a lease obligation/liability in the balance sheet (United Nations Conference on Trade and Development(UNCTAD), 2019, p. 14). In addition, IFRS 16 has certain exemptions for low-value assets and short-term leases. If a lessee elects to apply the above exemptions, it recognises the associated lease payments as an expense on either: (MNP SENCRL, srl, 2017, p. 6)

- A straight-line basis over the lease term; or
- Another systematic basis if it is more representative of the pattern of the lessee’s benefit.

5.1. Lease liability

5.1.1. Initial measurement of the lease liability

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee’s incremental borrowing rate. (Australian Accounting Standards Board(AASB), 2019, p. 8)

The lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date: (Eddy, 2017, p. 8)

- fixed payments (including ‘in-substance’ fixed payments) less any lease incentives receivable;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date. Variable lease payments that depend on an index or a rate include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates; (International Public Sector Accounting Standards Board (IPSASB), 2018, p. 19)
- amounts expected to be payable by the lessee under residual value guarantees;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.

In subsequent years the lease liability is increased by the unwinding of the discount and reduced by lease payments made to the lessor

5.1.2. Subsequent measurement of the lease liability

After the commencement date, a lessee shall measure the lease liability by: (Institute of Chartered Accountant of Pakistan (ICAP), 2018, p. 91)

(a) increasing the carrying amount to reflect interest on the lease liability;

(b) reducing the carrying amount to reflect the lease payments made; and

(c) remeasuring the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments. (HM Treasury, 2019, p. 14)

Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate, or if applicable the revised discount rate for a lease modification (International Public Sector Accounting Standards Board (IPSASB), 2018, p. 13) that is not accounted for as a separate lease. (Statutory Board Financial Reporting Standards (SB-FRS), 2021, p. 10)

5.2. right-of-use asset

5.2.1. Initial measurement of the right-of-use asset

At the commencement date, a lessee shall measure the lessee's right-of-use asset at cost (MNP SENCRL, srl, 2017, p. 23) that shall comprise:

- the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the *interest rate implicit in the lease*, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the *lessee's incremental borrowing rate* (Australian Accounting Standards Board(AASB), 2019, p. 9). At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date: (Eddy, 2017, p. 8)
  - a) fixed payments (including 'in-substance' fixed payments) less any lease incentives receivable;
  - b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date. Variable lease payments that depend on an index or a rate include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates; (International Public Sector Accounting Standards Board (IPSASB), 2018, p. 19)
  - c) amounts expected to be payable by the lessee under residual value guarantees;
  - d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
  - e) payments of penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.
- any lease payments made at or before the commencement date, less any lease incentives received; (Eddy, 2017, p. 8)
- any initial direct costs – such as commissions, legal fees, costs of negotiating the lease and costs of arranging collateral –

incurred by the lessee; and incurred by the lessee; and (Eddy, 2017, p. 7.8)

- an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. A lessee shall recognise these costs as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies IAS 02 *Inventories* to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this Standard or IAS 02 are recognised and measured applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. (Ernst & Young, 2019, pp. 1684,1685)

5.2.2. Subsequent measurement of the right-of-use asset

After the commencement date, a lessee shall measure the right-of-use asset applying a cost model (The European Commission, 2017, p. 6), unless it applies either of other measurement models.

A. Cost model

To apply a cost model, a lessee shall measure the right-of-use asset at cost: (International Accounting Standards Board(IASB), 2016, pp. 4,5)

(a) less any accumulated depreciation and any accumulated impairment losses; and

(b) adjusted for any remeasurement of the lease liability to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments.

A lessee shall apply the depreciation requirements in IAS 16 Property, Plant and Equipment in depreciating the right-of-use asset, Consequently, If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. (Ernst & Young(EY), 2020, p. 67), However, a lessee shall apply IAS 36 *Impairment of Assets* to determine whether the right-of-use asset is impaired and to account for any impairment loss identified. (deloitte, 2016, p. 53)

B. other measurement models

After the commencement date, a lessee shall measure the right-of-use asset applying a cost model (The European Commission, 2017, p. 6), unless it applies either of the following measurement models: (Ernst & Young, 2019, p. 1686)

- If a lessee applies the fair value model in IAS 40 *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IAS 40.
- If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Secondly. The amendments to IFRS 16 as accounting implications of COVID-19

On 28 May 2020, the International Accounting Standards Board (the IASB or Board) issued *Covid-19-Related Rent Concessions - amendment to IFRS 16 Leases* (the amendment). The Board amended the standard to provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the covid-19 pandemic. Many lessors have provided rent concessions to lessees as a result of the covid-19 pandemic. Rent concessions include rent holidays or rent reductions for a period of time, possibly followed by increased rent payments in future periods. Applying the requirements in IFRS 16 for changes to lease payments, particularly assessing whether the rent concessions are lease modifications, and applying the required accounting, could be practically difficult in the current environment. The objective of the amendment is to provide lessees that have been granted covid-19 related rent concessions with practical relief, while still providing useful information about leases to users of the financial statements. The amendment applies to annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at 28 May 2020. (Ernst & Young(EY), 2020, p. 1)

The amendments to IFRS 16 – COVID-19 Related Rent Concessions are as follows:

- the Board tentatively decided to provide lessees with an optional exemption applies only to rent concessions occurring as a direct consequence of the COVID-19 Pandemic;
- The IASB considered but decided not to provide any additional relief for lessors.

1. Lease modifications

The IASB decided to define a lease modification as a change in the scope of a lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term). (International Accounting Standards Board(IASB), 2016, p. 59)

A lessee shall account for a lease modification as a separate lease if both: (deloitte, 2016, p. 61)

(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.

For a lease modification that is not accounted for as a separate lease, at the *effective date of the lease modification* a lessee shall: (International Public Sector Accounting Standards Board (IPSASB), 2018, p. 22)

(a) allocate the consideration in the modified contract applying the following: (The European Commission, 2017, p. 4)

- For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
- The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the

lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.

- As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. Unless the practical expedient is applied, a lessee shall account for non-lease components applying other applicable Standards.

(b) determine the lease term of the modified lease. An entity shall determine the lease term as the non-cancellable period of a lease, together with both: (Australian Accounting Standards Board(AASB), 2019, p. 7)

- periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease.

(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.

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: (Ernst & Young, 2019, p. 1690)

(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.

2. Amendment to IFRS 16 Covid-19-Related Rent Concessions

Companies in many countries announced that as part of relief to its tenants, it is waiving the rent for the month of April 2020 along with certain other waivers. Similar situations can also arise with various other entities whereby a lessor and a lessee might renegotiate the terms of a lease as a result of the COVID-19 or a lessor might grant a lessee a concession in connection with lease payments. Lessees should, therefore, consider the requirements of IFRS 16 “Leases” and whether the concession should be accounted for as a lease modification and spread over the remaining period of the lease. The modification of the lease requires the remeasurement of the lease liability using a revised discount rate (which is usually the incremental borrowing rate of the lessee). (Accountants, A. F. Ferguson & Co. Chartered, 2020, p. 8)

The treatment for COVID-19 related modifications to rental payments could qualify for simplification under Amendment to IFRS 16 Covid 19-related rent concessions, which amends the lessee accounting requirements of IASB 16 Leases. It applies from 1 June 2020 with early adoption and retrospective application permitted. Adoption of this accounting policy option includes specific disclosure requirements. (The Australian Institute of Company Directors (AICD), Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia., 2020, p. 44)

In response to the COVID-19 coronavirus pandemic, in May 2020 the International Accounting Standards Board (the Board) issued an amendment to IFRS 16 *Leases* to provide practical relief for lessees in accounting for rent concessions. Under the practical expedient, lessees are not required to assess whether eligible rent concessions are lease modifications, and instead are permitted to account for them as if they were not lease modifications. Rent concessions are eligible for the practical expedient if they occur as a direct consequence of the COVID-19 pandemic and if all of the following criteria are met: (deloitte, 2020, p. 24)

- 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;
- any reduction in lease payments affects only payments originally due on or before 30 June 2021 (a rent concession

would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and

- There are no substantive changes to other terms and conditions of the lease.

A lessee that applies the practical expedient would generally account for: (deloitte, 2020, p. 25)

- The forgiveness or waiver of lease payments as a variable lease payment. The lessee would consequently derecognise that part of the lease liability that has been extinguished by the forgiveness of lease payments, and recognize a corresponding gain in profit or loss;
- A change in lease payments that reduces payments in one period but proportionally increases payments in another (such that there is no change to the overall consideration for the lease and only the timing of individual payments changes), by continuing to recognise interest on the liability and reduce that liability for payments made to the lessor.

If the lease payments are reduced in one period but increased by a lower amount in a later period (hence the total consideration is lower), the change in lease payments incorporates both a forgiveness of payments and deferred lease payments. A lessee applying the practical expedient measures the revised lease liability balance using the revised cash flows at the original discount rate. The change in the carrying amount of the lease liability is recognised as a gain in profit or loss. (deloitte, 2020, p. 25)

As indicated in IFRS 16, the lease liability recognised by a lessee applying the practical expedient should represent the present value of future lease payments owing to the lessor. (deloitte, 2020, p. 25)

A lessee that makes this election accounts for any change in lease payments resulting from the COVID-19-related rent concession in the same way that it would account for the change if it were not a lease modification in accordance with IFRS 16. (deloitte, 2020, p. 24)

A lessee that chooses to apply the practical expedient is required by IFRS 16 to apply it consistently to all lease contracts with similar characteristics and in similar circumstances. (deloitte, 2020, p. 25)

Lessees that apply the exemption are required to disclose: (International Accounting Standards Board(IASB), 2020, p. 5)

(a) that it has applied the practical expedient to all rent concessions that meet the conditionsor, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient; and

(b) the amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.

The amendment is effective 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 28 May 2020. Lessees are required to apply the amendment retrospectively, recognising any difference arising on initial application of the amendment in 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. (deloitte, 2020, p. 25)

Lessees will apply the practical expedient 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. In the reporting period in which a lessee first applies the amendment, the lessee is not required to disclose the information required by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. (Ernst & Young(EY), 2020, p. 2)

3. Accounting for changes in lease payments without applying the exemption

Any variations to lease contracts that do not qualify for the recently announced relief (see amending standard - Covid 19 related rent concessions) will need to be assessed as to whether such variations meet the definition of a “lease modification” which will require remeasurement of the right-of-use asset and lease liability. (The Australian Institute of Company Directors (AICD), Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia., 2020, p. 48)

Due to the effects of the COVID – 19, the changes in management’s intention for extensions / termination lease term could have a significant impact on the carrying amount of lease assets (right of use assets) and liabilities. Further, lease contracts with purchase options may need to be reassessed if the lessee concluded initially that exercise of the purchase option was reasonably certain. If a lessee changes its assessment of whether it is reasonably certain to exercise a renewal or purchase option, or not to exercise an option to terminate the lease early, then the lease liability is re-measured using a revised discount rate with the corresponding adjustments to right-ofuse assets. This in turn will have an effect on the amount and profile of depreciation and interest expense recognised subsequently. (Accountants, A. F. Ferguson & Co. Chartered, 2020, p. 8)

Generally, the accounting treatment for lease rent concessions will depend on whether (1) the lessee was entitled to the economic relief (i.e. the contractual arrangement or jurisdictional laws provide an enforceable right) or (2) the relief was given or negotiated outside the original agreement. In determining whether the lease contained an entitlement to relief, an entity should consider contractual provisions governing the occurrence of extraordinary events (e.g. a force majeure clause or similar provision). Depending on the complexity of the arrangement and the legal framework in the applicable jurisdiction, the entity may need assistance from legal counsel. (deloitte, 2020, p. 24)

Economic relief that was given or negotiated outside the original agreement most likely represents a lease modification, in which case the lessee applies the requirements in IFRS 16. (deloitte, 2020, p. 24)

For the lessee, this means that if the economic relief affects only the lease payments but does not change the scope of the lease (i.e. there is no change in the assets leased or in the duration of the lease term), the lease liability would be remeasured by discounting the revised lease payments using a revised discount rate, and a corresponding adjustment would be made to the right of use asset. (deloitte, 2020, p. 24)

If the lessee was entitled to the economic relief because of either contractual or legal rights, the relief would be treated as variable rent (i.e. negative variable rent) in the period incurred. The lessee would then recognise variable lease payments in profit or loss when the associated variability or conditionality is resolved. (deloitte, 2020, p. 25)

If a change in lease payments results in extinguishment of part of a lessee’s obligation under the lease, the lessee applies IFRS 9 to determine if part of the lease liability should be derecognised. (deloitte, 2020, p. 26)

4. Other lease considerations under IFRS in response to covid-19

4.1. Impairment of right of use assets

Lease contracts As a result of the COVID-19 pandemic, certain entities are experiencing significantly reduced consumer traffic in retail stores and shopping areas, or indefinite closures due to quarantine measures and other government directives. (deloitte, 2020, p. 23)

Impairments to right-of use (ROU) assets could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying asset. ROU assets measured applying a cost model are carried at cost less any accumulated depreciation and any impairment losses (and adjusted for specific remeasurement of the lease liability). Impairment is assessed applying the requirements in IAS 36. (deloitte, 2020, p. 23)

Economic stimulus measures put in place to address the financial consequences of the COVID-19 pandemic have led to a lower interest rate environment across many jurisdictions, which may result in bigger lease liabilities having to be recognised following lease modifications. The impact of the decrease in discount rate will be particularly pronounced for those who on transition to IFRS 16 adopted a full retrospective approach. The current economic conditions are likely to lead to the need to test the ROU asset for impairment and may indeed result in an impairment loss. (deloitte, 2020, p. 24)

The impairment of Right of Use Assets under these contracts are subject to impairment testing under IAS 36 – “Impairment of Assets” and would be assessed as part of a cash generating unit. Suspension of operations and reduced economic activity in respect of right of use assets can be identified as impairment triggers and hence management needs to incorporate these elements and similar conditions for impairment assessment of Right of Use Assets. (Accountants, A. F. Ferguson & Co. Chartered, 2020, p. 8)

In case of operating leases, a lessor includes the underlying leased asset in the carrying amount of the CGU and applies IAS 36 for assessing the impairment thereof. While assessing the recoverable value, the lessor includes the future cash receipts in its cash flow forecasts and identifies whether any impairment needs to be recognised. (Accountants, A. F. Ferguson & Co. Chartered, 2020, p. 8)

In addition, an entity applies IFRS 9 to test operating and financing lease receivables for expected credit losses.

4.2. Onerous lease

The last one to mention on the committed costs is the rent. These days, many ask if they should consider providing for an onerous lease. (Ian Greenwood, 2020, p. 5)

Under the new lease requirements in IFRS 16 [Leases] entities can no longer have an onerous lease provision. Instead the right-of-use asset needs to review for impairment. (Ian Greenwood, 2020, p. 5)

And a provision cannot be created for any lease-related costs that were excluded from measurement of the lease liability (and the right-of-use asset) under IFRS 16. (Ian Greenwood, 2020, p. 5)

4.3. Government Grants

In some jurisdictions, tenant relief is provided by governments as subsidies in support of the economy. If the lessee receives the relief directly from the government, the tenant relief is accounted for as a government grant applying IAS 20 Accounting for Government Grants and Disclosure of Government Assistance. If the government relief is provided to the lessor who then passes it to the lessee, careful assessment is needed to establish whether the lessor is acting as an agent and the relief to the lessee is a government grant or whether the relief to the lessee is provided by the lessor and thus is a lease modification. (deloitte, 2020, p. 24)

Conclusion:

To respond to this situation, many governments have offered certain reliefs to businesses. In addition, parties to contracts are beginning to renegotiate contract terms for reliefs and concessions. One of such reliefs or concessions is providing some relief regarding rent holidays and temporary rent reductions.

The grant of reliefs and concessions has therefore triggered some accounting issues to which the International Accounting Standard Board (IASB) has provided certain responses. In May 2020, the IASB issued amendments to IFRS 16 on Leases to address the accounting and reporting issues arising from the rent concessions provided to lessees as a response to the COVID-19 Pandemic.

IFRS 16 – “Leases” became effective from January 1, 2019 and in most cases had a significant impact on the lessee’s accounting for lease contracts whereby Right of Use Assets and Lease Liability were recorded for all leases under the scope of IFRS 16 (whether finance or operating leases). The adoption of this standard requires significant management judgement in the determination of lease term i.e. whether extension or termination options available to the lessee are likely to be exercised and entities had to exercise judgement based on their business needs to assess the likelihood of exercising these options. Further, judgement was also required in estimation of the incremental borrowing rate of the lessee (IBR) applicable on transition date. As a result of the COVID – 19 outbreak, the assumptions used on December 31, 2019 may no longer hold valid.

Due to the economic disruption caused by the COVID-19 coronavirus pandemic, the entities have granted a rent holiday to several tenants that have been significantly hit by the pandemic. The highly uncertain economic outlook for the period may have a material adverse effect on the tenants' operations, the viability of their business and their ability to meet their rental obligations. This uncertainty is factored into the valuation, specifically in estimating rent payments from existing tenants, the void periods, occupancy rates, expected market rental growth rates and the discount rate, all these impacts and other issues have been further discussed in this study, which ultimately resulted in these outcomes:

- At inception of a contract, the entity assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the entity uses the definition of a lease in IFRS 16.
- As a lessee:
  - At commencement or on modification of a contract that contains a lease component, the entity allocates the consideration in the contract to each lease component on the basis of its relative stand-alone prices. However, for leases of property the entity has elected not to separate non-lease components and account for the lease and non-lease components as a single lease component;
  - The entity recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an

estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received;

- The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term, unless the lease transfers ownership of the underlying asset to the entity by the end of the lease term or the cost of the right-of-use asset reflects that the entity will exercise a purchase option. In that case, the right-of-use asset will be depreciated over the useful life of the underlying asset, which is determined on the same basis as those of property and equipment. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability;
- The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the entity's incremental borrowing rate. Generally, the entity uses its incremental borrowing rate as the discount rate;
- The entity determines its incremental borrowing rate by obtaining interest rates from various external financing sources and makes certain adjustments to reflect the terms of the lease and type of the asset leased;
- The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the entity's estimate of the amount expected to be payable under a residual value guarantee, if the entity changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment;
- When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero;
- If the entity has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term

leases, including IT equipment. The entity recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

- On 28 May 2020, the Board published an amendment to IFRS 16 adding a practical expedient which allows a lessee to elect not to assess whether a COVID-19-related rent concession is a lease modification. The amendment introduces an optional practical expedient for leases in which the entity is a lessee. No practical expedient is available to lessors;
- IFRS 16 – Leases – requires lessees to recognise assets and liabilities for most leases. this will result in a more faithful representation of lessees' assets and liabilitiesand greater transparency about lessees' financial obligations and leasing activities;
- Rent concessions may take different forms, such as rent deferrals or rent holidays;
- the accounting required by IFRS 16 for a change in lease payments depends on whether that change meets the definition of a lease modification". Determining this may prove challenging, especially for entities with large volumes of leases;
- The amendment to IFRS 16 provides a practical expedient to lessees applicable to lease concessions that arise as a direct result of COVID-19 and that meet certain other criteria. Generally, lessees will find the amendments to IFRS 16 discussed above to be the most specific and relevant source of guidance for those lease concessions that meet the specified criteria;
- Lessees may elect to apply a practical expedient. In this case, lessees won't have to assess whether the rent concession is a modification and won't have to apply modification accounting;
- The IASB did not amend the accounting requirements for lessors;
- The IASB considered but decided not to provide any additional relief for lessors as the current situation is not as equally challenging for them and the required accounting is not as complicated.

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