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~~EFRAG's preparatory Draft~~ **EFRAG's 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~~ 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~~ 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]~~ 11 May 2020.

~~The~~ If certain conditions are met, 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]~~ 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at ~~[date the amendment is issued]~~ 28 May 2020.

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.

EFRAG has carried out an evaluation of the Amendment. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

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 1: Understanding the changes brought about by the Amendment

Background of the Amendment

- 1 Many lessors around the world have provided, or are expected to provide, rent concessions to lessees as a result of the covid-19 pandemic. Such rent concessions are particularly prevalent for leases of retail property and, in some cases, are encouraged or required by governments or jurisdictional authorities. Rent concessions include rent holidays or rent reductions for a period of time, possibly followed by increased rent payments in future periods.
- 2 IFRS 16 contains requirements that specify the accounting for changes in lease payments, including rent concessions. However, applying those requirements to a potentially large volume of covid-19-related rent concessions could be practically difficult, especially in the light of the many challenges stakeholders face during the pandemic. In particular, lessees have identified potential difficulties in the current environment in assessing whether covid-19-related rent concessions are lease modifications and, for those that are, applying the required accounting.
- 3 In addition, many lessees are currently preparing their first annual financial statements applying IFRS 16. Any complexity arising as a result of the covid-19 pandemic therefore adds to the work being undertaken in implementing the new lessee accounting model in IFRS 16.

The issue and how it has been addressed

- 4 The Amendment is to provide lessees with practical relief during the covid-19 pandemic while enabling them to continue providing useful information about their leases to users of financial statements.
- 5 The Amendment to IFRS 16 to 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.

What has changed?

- 6 The Amendment introduces an option that allows preparers to change the subsequent measurement accounting in respect of lease modifications for lessees.
- 7 The Amendment does not change the accounting for lessors.

Lessee: Subsequent measurement – Lease modification

- 8 As a practical expedient, a lessee may elect not to assess whether a covid-19-related rent concession is a lease modification. Lessees that makes the election shall 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. The practical expedient in applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of 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 on or before 30 June 2021 (for example, a rent concession would meet this

condition if it results in reduced lease payments before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and

(c) there is no substantive change to other terms and conditions of the lease.

9 Lessees that apply the practical expedient shall disclose:

(a) that fact; and

(b) the amount recognised in profit or loss to reflect changes in lease payments that arise from covid-19-related rent concessions.

When does the Amendment become effective?

10 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.

11 The Amendment is applied retrospectively, recognising the cumulative effect of initially applying that 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.

12 In the reporting period in which a lessee first applies the Amendment, a lessee is not required to disclose the information required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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 14;
 - (b) reliability: paragraphs 15 to 18;
 - (c) comparability: paragraphs 19 to 24;
 - (d) understandability: paragraphs 25 to 28;
 - (e) whether overall, they lead to prudent accounting: paragraphs 29 to 30; and

- (f) whether they would not be contrary to the true and fair view principle as noted in paragraphs 31 to 35.

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.~~

~~(c) 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.~~

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

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 occur as a direct consequence of the covid-19 pandemic and:

(a) result 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) reduce only payments originally due in 2020, on or before 30 June 2021; and

(c) there is no substantive change to other terms and conditions of the lease.

4412 EFRAG notes that for entities that do apply the exemption they need to disclose the fact together with the amount recognised in profit or loss to reflect changes in lease payments that arise from covid-19-related rent concessions. 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.

4213 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.

4314 Accordingly, EFRAG assesses that the Amendment results in information that is relevant.

Reliability

4415 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.

4516 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

4617 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 reduces payments and not in one period but proportionally increases payments in another does not extinguish the lessee's lease liability or change the consideration for the lease. ~~Instead a deferral is~~

~~reflected in the measurement - instead, it changes only the timing of individual payments. In this case, applying paragraph 36 of the lease liability, which IFRS 16 a lessee would continue to both recognise interest on the lease liability and reduce that liability to reflect amounts owing lease payments made~~ to the lessor;

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

~~1718~~ 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

~~1819~~ 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.

~~1920~~ 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.

~~21~~ 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. ~~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.~~

~~2022~~ It may also reduce the comparability within entities' portfolio of lease contracts.

~~2123~~ 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 that occur as a direct consequence of the covid-19 pandemic as described in paragraph 11 above;~~
- (c) entities applying the Amendment should disclose the fact ~~together with amount recognised in profit or loss to reflect changes in lease payments that arise from covid-19-related rent concessions.~~

~~2224~~ Therefore, on balance EFRAG assesses it does not significantly reduce comparability.

Understandability

~~2325~~ 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.

~~2426~~ 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.

2527 EFRAG assesses that the Amendment ~~are~~is 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.

2628 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

2729 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.

2830 EFRAG did not identify any aspects of the Amendments that would affect prudence.

True and Fair View Principle

2931 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.

3032 As stated in paragraph 9 above 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.

3133 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.

3234 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.

3335 On balance, EFRAG concludes that the application of the Amendment is consistent with the true and fair view principle.

Conclusion

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3436 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 18 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 requirements in~~ 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.

11 Unlike under US GAAP, a practical expedient has only been proposed and allowed for lessees and not for lessors. This may raise the question as to whether European lessor preparers reporting under IFRS would be at a competitive disadvantage relative to preparers that report applying US GAAP. However, EFRAG assesses that the amendment does not have an impact on competitiveness of EU preparers relative to US GAAP based preparers for the following reasons:

(a) Differences between US GAAP and IFRS requirements for lease accounting already exist.

(b) As noted in the IASB staff paper analysis¹, there are no specific IFRS 16 requirements for accounting for concessions that are not lease modifications. Therefore, unlike for lessees, the accounting by lessors for concessions that are not deemed to be modifications, will not necessarily be easier (or provide relief) from lessor modification accounting. In other words, there is no reason to assume that a practical expedient could provide relief and enable some convergence with US GAAP requirements.

Conclusion

~~412~~ 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.

¹ <https://cdn.ifrs.org/-/media/feature/meetings/2020/may/supplementary-iasb/ap32c-ifrs-16-and-covid-19.pdf>

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- ~~42~~13 EFRAG has not identified the Amendment could have any adverse effect to the European economy, including financial stability and economic growth that is significant.
- ~~43~~14 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.
- ~~44~~15 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.