

Mr Hans Hoogervorst
Chairman
IASB
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Canary Wharf
London
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6 May 2020

Dear Mr Hoogervorst

Invitation to Comment: *Exposure Draft ED/2020/2 Covid-19-Related Rent Concessions Proposed Amendment to IFRS 16*

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the above Invitation to Comment.

We welcome the IASB's proposed amendment to IFRS 16 for Covid-19-related rent concessions and commend the Board and its staff for the swift response to urgent practical difficulties. The proposed expedient, whereby a lessee may elect not to assess whether covid-19-related rent concessions constitute lease modifications and to account for such rent concessions as if they were not lease modifications, will, we anticipate, provide practical relief without significantly reducing the usefulness of the financial information provided.

We therefore support the proposals, recognising the genuinely exceptional circumstances in which they are proposed and the restrictions on their scope to lessees. However, we make a recommendation on a point of detail on one of the eligibility conditions, and a recommendation on the wording of one of the basis for conclusions paragraphs, as noted below.

In our view, urgent amendments providing practical relief from IFRS requirements are justified in these exceptional circumstances. We recognise that such changes cannot be made lightly; before such changes are made with severely curtailed consultation processes, it must be clearly evident that the benefits (in this case, a reduction in implementation expenses when resources are stretched) exceed the risks of limiting the faithful representation of transactions and economic relationships. In our view, the current Covid-19 pandemic, combined with the challenges for lessees of implementing IFRS 16 constitute such an exceptional circumstance.

In our opinion, the case for providing practical relief to lessees is clear given they are already applying the starkly different requirements of IFRS 16 for the first time, and to large numbers of diverse lease agreements. The practical expedient could provide significant relief.

In our opinion, any case for extending relief to lessors is less clear, since the implementation of IFRS 16 does not significantly change lessor accounting. Whilst we are not in a position to conclude whether, in practice, lessors are more likely to have standard lease terms, on balance, we do not believe there is sufficient evidence to support extending the relief.

In our view, the proposed eligibility conditions are sufficient to limit the practical expedient, and to ensure that only rent concessions occurring as a direct consequence of Covid-19 are eligible. However, we recommend that the relief should be extended from any reduction in lease payments affecting only payments originally due in 2020, to include rent concessions where any reduction in lease payments is agreed in 2020 even if it affects payments beyond

2020. This would ensure, for example, that any Covid-19 related rent concession periods which straddle 31 December 2020 are fully eligible.

In our opinion, the resulting accounting remains useful. While the practical relief is optional and this may lead to less consistency between reporting entities, proposed disclosures assist comparability. We recommend that paragraph BC4 clearly states that the practical expedient, if elected by the lessee, must be applied to all Covid-19-related rent concessions if this is the intention, in order to avoid the relief being applied for some types of Covid-19-related rent concessions but not for others.

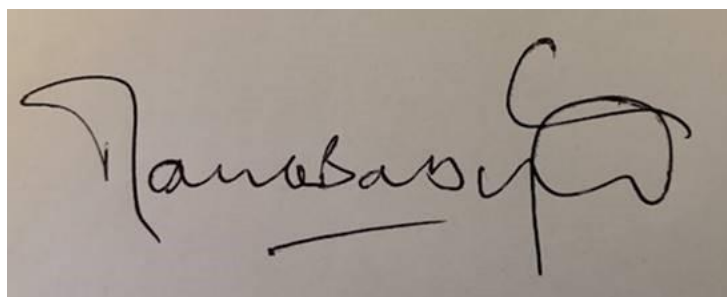
We support the proposals to permit early application because this will allow the proposed relief to be accessed when it is most needed. We support the proposal to require retrospective application of the amendment as an adjustment to the opening balance of retained earnings if the practical relief is applied retrospectively, to avoid a costly and time-consuming full restatement.

We note that in applying the proposed paragraph 46A, those electing to take the relief do not assess whether a rent concession is a modification and, in fact, treat rent concessions as if they are not modifications. On that basis, we conclude that in applying the proposed IBOR amendment IFRS16.106, the rent concession should not be considered a modification and therefore if an entity has used the practical relief proposed by the Covid-19-related proposed amendment to IFRS 16 they would not be precluded from applying the practical relief offered by the proposed IBOR amendment IFRS16.105. We ask the IASB to consider whether this conclusion is self-evident and if not, to consider providing clarification.

Our responses to the questions in the Invitation to Comment are included in Appendix 1 to this letter.

If you would like to discuss these comments, please contact me or Alison Stiles at a.stiles@frc.org.uk

Yours sincerely

A handwritten signature in black ink on a light-colored background. The signature is cursive and appears to read 'Mark Babington'. There is a horizontal line under the name.

Mark Babington
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Appendix 1

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

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

Paragraph 46B of the draft amendment to IFRS 16 proposes that the practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all 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 in 2020; and
- (c) there is no substantive change to other terms and conditions of the lease

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

- A1. We agree that this practical expedient would provide lessees with practical relief while enabling them to continue providing useful information about their leases to users of financial statements. The practical relief would give lessees an optional exemption from the need to review lease contracts in detail to establish whether Covid-19-related rent concessions constitute lease modifications.
- A2. Without the proposed relief, lessees with large numbers of non-standard lease agreements would be required to assess each agreement to establish whether the Covid-19-related rent concession were a lease modification, while also implementing the significant changes to lessee accounting introduced by IFRS 16 (effective for reporting periods beginning on or after 1 January 2019). This could create a substantial burden for entities whose resources are already stretched as a direct result of the pandemic, and who have other pressing priorities to address.
- A3. We agree that the proposal enables entities to continue to provide useful information about their leases to users of financial statements, since:
 - i. The relief is optional, so entities who choose to assess leases to establish whether a lease modification has taken place and to account for it accordingly are not prohibited from doing so.
 - ii. If entities opt to take the relief, they must apply it to all Covid-19-related rent concessions, thereby providing consistency of treatment of similar transactions. (See also paragraph A7 below).
 - iii. If entities opt to take the relief, they must disclose this fact as per the proposed paragraph 60A.

- iv. If entities meet the criteria and elect to use the practical relief, where there has been forgiveness of rent payments they are likely to recognise a reduction in the carrying value of the financial liability, and a credit to profit or loss. This would be consistent with the treatment of financial liabilities under IFRS 9.
 - v. Without using the practical relief, if the rent concession was a lease modification, the value in use asset and the lease liability would have been remeasured, and there would be no direct impact on profit or loss. This raises the issue of potential lack of comparability between those who elect to use the relief, and those who do not. However, if the practical relief is taken, the measurement of the value in use asset would be subject to an impairment review which would be likely to offset the credit to profit or loss resulting from the remeasurement of the lease liability, and so the potential lack of comparability may be mitigated.
 - vi. Whether the practical relief is used or not, a lease liability measured as the present value of future cash outflows is recognised, and this provides a degree of comparability.
- A4. On balance we support the restriction of scope to lessees, since lessor accounting has not changed significantly with the introduction of IFRS 16, and since it is more likely that lessors have standard lease terms and so the assessment of whether there has been a lease modification may be less onerous, although we acknowledge we are not in a position to conclude definitively on the extent of diversity in lessor lease agreements.
- A5. We agree with restricting the relief to rent concessions occurring as a direct consequence of the Covid-19 pandemic and acknowledge that it is beneficial to restrict the time period for which the practical relief is available, given that over time it will become increasingly difficult and judgemental to identify whether rent concessions have arisen as a direct consequence of the Covid-19 pandemic or not. Since we understand that some of the rent concessions being provided include reductions in lease payments originally due in 2021 as well as in 2020, we recommend that the scope is broadened to include rent concessions agreed in 2020. This would include, for example, any Covid-19-related rent concessions starting in 2020 and running into early months of 2021. Guidance could highlight that if a rent concession is given for a long-extended period into the future it is less likely that this would be considered to be a direct consequence of covid-19.
- A6. We agree with the proposed condition (a) that the change in lease payments results in revised consideration that is substantially the same as, or less than the consideration preceding the change and with the proposed condition (c) that there is no substantive change to other terms and conditions of the lease. In our view these conditions will support the IASB's intention to restrict practical relief to rent concessions that occur as a direct consequence of the Covid-19 pandemic.
- A7. We recommend that paragraph BC4 clearly states that the practical expedient, if elected by the lessee, must be applied to all Covid-19-related rent concessions if this is the intention, in order to avoid the relief being applied for some types of Covid-19-related rent concessions but not for others.

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

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

(a) for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at the date the amendment is issued; and

(b) retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other components of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

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

- A8. We agree with the proposal to allow lessees to apply the amendment for annual reporting periods beginning on or after 1 June 2020, with earlier application permitted. Earlier application allows the practical relief to be accessed when it is most needed, but no earlier than 1 January 2020 applying the conditions of the proposed paragraph 46B. It would allow, for example, any entities with 31 March 2020 year ends which have not authorised financial statements for issue at the date the amendment is issued, to access the practical relief.
- A9. We agree with the proposal to allow retrospective application, as this would enable any entity with a year-end date between 1 January 2020 and 1 June 2020 which has already published financial statements to access the practical relief in its 2021 financial statements.
- A10. We agree with the proposal that if such retrospective application is used, the amendment should be made as an adjustment to the opening balance of retained earnings. This would avoid a costly and demanding restatement of the full financial statements.
- A11. We note that entities in jurisdictions where endorsement is required will not be able to access the amendments as quickly as those where endorsement is not required, and that this will limit comparability across all jurisdictions until endorsement has taken place. We therefore note that the proposed requirement to disclose whether the election has been taken will be useful for users of the financial statements.