EFRAG
European Financial Reporting Advisory Group

EFRAG's Letter to the European Commission Regarding Endorsement of Covid-19-Related Rent Concessions beyond 30 June 2021 Amendment to IFRS 16

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European Commission
1049 Brussels

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Dear Mr Berrigan

Endorsement of Covid-19-Related Rent Concessions beyond 30 June 2021 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 beyond 30 June 2021 Amendment to IFRS 16* ('the Amendments'), which were issued by the IASB on 31 March 2021. An Exposure Draft of the Amendments was issued on 11 February 2021. EFRAG provided its comment letter on that Exposure Draft on 25 February 2021.

On 28 May 2020, the IASB issued an amendment to IFRS 16 that, as a practical expedient, provided lessees with covid-19-related rent concessions, the option for an exemption from applying lease modification accounting requirements (2020 Amendments).

The Amendments extend the scope of the 2020 Amendments by increasing the period of eligibility to apply the practical expedient from 30 June 2021 to 30 June 2022. A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement. In other words, whether the Amendments 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 Amendments would be conducive to the European public good. We provide our conclusions below.

EFRAG has carried out an evaluation of the Amendments. 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.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

EFRAG has concluded that the Amendments meet 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 Amendments do not create any distortion in its interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would not compromise financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments are 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 Amendments meet 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 Amendments are conducive to the European public good. Therefore, we recommend the Amendments 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 Amendments

Background of the Amendments

1 On 28 May 2020, the Board issued *Covid-19-Related Rent Concessions*, which amended IFRS 16 *Leases*. The 2020 Amendments permit lessees, as a practical expedient, not to assess whether rent concessions occurring as a direct consequence of the covid-19 pandemic are lease modifications and, instead, to account for those rent concessions as if they were not lease modifications.

2 Among other conditions, the 2020 Amendments permit a lessee to apply the practical expedient only to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2021. If a rent concession reduces lease payments both before and after 30 June 2021, IFRS 16 does not permit the practical expedient to be applied to that concession.

3 On 31 March 2021, the IASB issued *Covid-19-Related Rent Concessions beyond 30 June 2021-Amendment to IFRS 16*, to extend the scope of this condition so the practical expedient can be applied, as a minimum, to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022.

The issue and how it has been addressed

4 The 2020 Amendments are only applicable to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2021. The covid-19 pandemic is still in force and many lessors are granting rent concessions, as a direct consequence of the pandemic, that extend beyond 30 June 2021 resulting in contracts falling outside the scope of the 2020 Amendments. Consequently, the passage of time is creating a mixed measurement model for similar transactions and similar reasons based solely on the period for which concessions were granted.

5 The Amendments extend the scope of this condition so the practical expedient can be applied to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022.

What has changed?

6 Paragraph 46B(b) of IFRS 16 is amended to permit a lessee to apply the practical expedient in paragraph 46A of IFRS 16 to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022. Consequently, the scope has been extended so that the practical expedient in paragraph 46A can be applied, as a minimum, to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022.

7 Applying paragraph 2 of IFRS 16, a lessee that had already applied the practical expedient in paragraph 46A would be required to apply the extended scope of the practical expedient to eligible contracts with similar characteristics and in similar circumstances. Similarly, the Amendments do not allow a lessee to elect to apply the practical expedient if the lessee did not apply the practical expedient to eligible rent concessions with similar characteristics and in similar circumstances, including those that reduce only lease payments due on or before 30 June 2021.

8 At 31 March 2021, a lessee may not have established an accounting policy on applying (or not applying) the practical expedient to eligible rent concessions. Such a lessee could still decide to apply the practical expedient, however that lessee

would be required to do so retrospectively and to apply it consistently to contracts with similar characteristics and in similar circumstances.

9 Under the transition requirements, a reversal of lease modification accounting will be required by lessees that have published their annual report but had eligible concessions that fell outside the scope of the 2020 Amendments but are now within the scope of the Amendments.

When do the Amendments become effective?

10 The Amendments are effective for annual reporting periods beginning on or after 1 April 2021. Earlier application is permitted, including in financial statements not yet authorised for issue at 31 March 2021.

What are the Transition requirements?

11 The lessee is required to apply the Amendments retrospectively, recognising the cumulative effect of initially applying the Amendments 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 Amendments.

12 In the reporting period in which a lessee first applies the Amendments, 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*.

13 Applying paragraph 2 of IFRS 16, a lessee shall apply the practical expedient in paragraph 46A consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying the 2020 Amendments or the Amendments.

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

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

1 EFRAG has considered whether the Amendments meet 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 Amendments 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 Amendments 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 Amendments are appropriate both for making decisions and assessing the stewardship of management.

6 EFRAG's assessment on whether the Amendments are 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 12;

(b) reliability: paragraphs 13 to 16;

(c) comparability: paragraphs 17 to 22;

(d) understandability: paragraphs 23 to 26;

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

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

Relevance

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

8 In its 2020 Endorsement Advice, EFRAG assessed that the 2020 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.

Extending the scope of the 2020 Amendments

9 As was the case with the 2020 Amendments, EFRAG considers that the Amendments which extend the date of payments that are in scope to 30 June 2022 provide relevant information. EFRAG's 2020 Final Endorsement Advice highlighted that

(a) the lease liability in the statement of financial position will represent the present value of future lease payments.

(b) a one-off gain recognised in profit or loss when concessions are granted could create a change in an entity's profit or loss pattern relative to that which would have occurred under the application of lease modification accounting requirements. However, this impact on profit or loss may be mitigated by the recognition of impairment on the right-of-use asset. In other words, the overall difference in profit or loss for the period when the practical expedient is applied is 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.

10 EFRAG notes that entities applying the practical expedient through the extended period of application will need to disclose that fact together with the amount recognised in profit or loss to reflect changes in lease payments that arise from covid-19-related rent concessions. In addition, as per IAS 1 *Presentation of Financial Statements* and IFRS 16 requirements, entities will have to disclose any additional information needed to understand material effects of the Amendments on the primary financial statements.

11 As most of the conditions which created the need for the covid-19-related rent concessions still apply, extending the eligibility to apply the practical expedient provides relevant information. Furthermore, the lack of opportunity to cherry pick the application of the extension enhances the overall relevance of the Amendments.

12 EFRAG assesses that the Amendments result in information that is relevant.

Reliability

13 EFRAG considered the reliability of the information that will be provided by applying the Amendments. 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.

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

Extending the scope of the 2020 Amendments

15 EFRAG notes that the below requirements of the Amendments would result in faithful representation of covid-19-related rent concessions:

(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 that reduces payments 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; it changes only the timing of individual payments. In this case, applying paragraph 36 of IFRS 16 a lessee would continue to both recognise interest on the lease liability and reduce that liability to reflect lease payments made to the lessor;

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

16 As was the case with the 2020 Amendments, EFRAG assesses that the Amendments 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

17 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.

18 EFRAG has considered whether the Amendments 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.

Extending the scope of the 2020 Amendments

19 EFRAG notes that the Amendments may adversely affect comparability of financial statements between entities that elect to apply the practical expedient versus those that do not. An entity applying the practical expedient would recognise the effects of forgiveness of lease payments in profit or loss at the time the covid-19-related concessions are granted. In contrast, an entity applying the lease modification requirements would adjust the carrying amount of the right-of-use asset and recognise the effects of the rent concession over the useful life of the right-of-use asset (via lower depreciation) and over the lease term (via lower interest expense on the lease liability).

20 Furthermore, EFRAG notes that due to allowing avoidance of the lease modification accounting requirements, the Amendments will also reduce the comparability of accounting treatment across entities' portfolio of lease contracts.

21 While acknowledging that the Amendments could reduce comparability, EFRAG highlights the following mitigating factors:

(a) The Amendments are limited to rent concessions that occur as a direct consequence of the covid-19 pandemic.

(b) There is a time limit for which entities are eligible to apply the practical expedient.

(c) The possibility of a high uptake of the Amendments by entities lessens intra-company comparability concerns.

(d) Entities that applied the practical expedient in the 2020 Amendments must apply the extended scope. Correspondingly, entities that did not apply the practical expedient allowed by the 2020 Amendments cannot change that decision because of the time limit extension. This will contribute to the comparability of entities' intra-period reporting of covid-19-related concessions.

(e) Entities applying the Amendments should disclose that fact together with amount recognised in profit or loss to reflect changes in lease payments that arise from covid-19-related rent concessions.

22 Therefore, on balance, EFRAG assesses the Amendments do not significantly reduce comparability.

Understandability

23 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

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

Extending the scope of the 2020 Amendments

25 EFRAG assesses that the Amendments with an extended date of eligibility to apply the practical expedient will ensure that entities apply a consistent accounting treatment for their covid-19-related rent concessions and this will contribute to understandable information.

26 Therefore, concurring with EFRAG's assessment on the relevance, reliability and comparability, EFRAG assesses that the Amendments will not reduce the overall understandability of information and will enhance the understandability of the reporting related to covid-19-related rent concessions.

Prudence

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

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

True and Fair View Principle

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

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

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

Extending the scope of the 2020 Amendments

30 EFRAG notes that in applying the Amendments an entity may recognise a one-off gain in profit or loss when there is a forgiveness of lease payments, to the extent that the impairment of the corresponding right-of-use does not completely offset the gain, and that a higher lease obligation could be recognised in periods where the lease payments are being deferred.

31 EFRAG considers that a one-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 an 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 Amendments, EFRAG has assessed that it does not, on balance, prevent financial statements from providing a true and fair view.

32 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required through the Amendments and through the overarching disclosure requirement objectives in paragraph 31 of IAS 1.

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

Conclusion

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

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. 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 Amendments, EFRAG considered:

(a) Whether the Amendments improve 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 Amendments; and

(c) Whether the Amendments 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 Amendments are 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 Amendments on the quality of financial reporting

3 EFRAG notes that the Amendments extend the relief period during which lessees are not required to apply the complex requirements on accounting for lease modifications.

4 As noted in Appendix 2, the Amendments result in relevant information and do not impair the faithful representation of the lessee’s obligation. However, EFRAG notes that the Amendments may reduce the comparability of reporting. Nevertheless, as noted in Appendix 2-Paragraph 21, several factors mitigate the concern of reduced comparability including if there is a significant uptake by entities and, in so far, as entities disclose the effects of the Amendments on their financial statements.

5 Therefore, EFRAG concluded that, the Amendments do not compromise the overall quality of financial reporting.

EFRAG’s analysis of the costs and benefits of the Amendments

6 EFRAG has considered that a less extensive cost-benefit analysis of the effects of the narrow-scope Amendments is proportionate and needed 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

7 EFRAG notes that the objective of the Amendments is to provide lessees with continuing relief from the challenges, including the costs and complexity of accounting for lease modification under circumstances of the covid-19 pandemic. Therefore, the Amendments are expected to provide operational simplification and to not create any new costs for preparers as they are already applying the relief.

8 EFRAG notes that due to the transition requirements, the reversal of lease modification accounting will be required by lessees that have published their annual report but had eligible concessions that fell outside the scope of the 2020 Amendments but are within the scope of the Amendments. This requirement could introduce additional costs. It is likely the relief from concessions that were within the

scope of amendments outweighs the costs due to reversal of lease modification for the noted eligible concessions. In addition, the reversal ensures comparability of reporting across similar contracts held by lessee entities.

Costs for users

9 EFRAG's assessment is that the application of the Amendments could adversely affect comparability across and within entities. However, this is unlikely to create significant costs for users as the entities applying the Amendments will continue their current practices. Further, as noted in Appendix 2-Paragraph 21, several factors mitigate the reduced comparability concerns.

10 These include the Amendments' disclosure requirements alongside the overarching disclosure requirements of IAS 1 and those in IFRS 16 that require preparers to disclose information that is relevant for users if considered material and useful for decision making. The fact that extended scope will not be optional (i.e. entities that applied the 2020 Amendments have to apply the Amendments and those that did not cannot choose to do so) lessens comparability concerns.

11 Overall, EFRAG's assessment is that the Amendments are not likely to affect costs to users.

Conclusion on the costs and benefits of the Amendments

12 Overall, EFRAG's assessment is that it is unlikely that significant costs will be imposed on either prepares or users while preparers are likely to benefit from the Amendments that will reduce complexity and costs without compromising the quality of information provided to users.

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

13 EFRAG is not aware of any evidence to suggest that the Amendments 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 contributes to the multiple efforts aiming to help businesses navigate through this challenging period.

Conclusion

14 EFRAG believes that the Amendments will not, on balance, 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 Amendments will extend the relief in the 2020 Amendments that 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 Amendments is conducive to the European public good in that it provides an operational simplification without compromising the quality of the reported information.

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

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

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