

Draft Comment Letter

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Comments should be submitted by 7 May 2020.

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX] May 2020

Dear Mr Hoogervorst,

Re: Covid-19-Related Rent Concessions

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft proposed amendments to IFRS 16, *Covid-19-Related Rent Concessions*, issued by the IASB on 24 April 2020 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG agrees with the proposals in the ED. EFRAG agrees with the need to provide relief for lessees given the challenges they face in assessing whether lease modifications have occurred under the circumstances of covid-19 and taking account of the initial overall challenges of implementing IFRS 16 *Leases* requirements.

However, EFRAG would support expanding the scope of the amendment to include all rent concessions granted during 2020 and not just payments due in 2020.

EFRAG agrees with the requirement to disclose if the option provided in these Amendments are used. EFRAG also notes the following requirements of IAS 1 *Presentation of Financial Statements* paragraph 31 and IFRS 16, which require entities to disclose any additional information needed to enable users to understand material effects of, for instance, covid-19-related rent concessions on the primary financial statements.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Joachim Jacobs or Vincent Papa or myself.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Notes to constituents – Summary of proposals in the ED

- 1 *The proposals of the ED permits lessees, as a practical expedient, not to assess whether particular covid-19-related rent concessions are lease modifications and, instead, account for those rent concessions as if they were not lease modifications if certain conditions are met.*
- 2 *The ED proposes to limit the scope of the practical expedient so that it applies only 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. The IASB is of the view that a change that results in more than an insubstantial increase in total payments for the lease could not result solely from a covid-19-related rent concession, except to the extent the increase reflects the time value of money.*
 - (b) *reduce only lease payments originally due in 2020. A related increase in lease payments that extends beyond 2020 would not prevent a rent concession from meeting this condition. In contrast, if reductions in lease payments extend beyond 2020, the rent concession would not be within the scope of the practical expedient. In developing this condition, the IASB observed that the economic effects of the covid-19 pandemic could continue for some time. If the practical expedient is not limited to a particular timeframe, a lessee could conclude that many future changes to lease payments are a result of the covid-19 pandemic. Limiting the practical expedient to reductions in lease payments originally due in 2020 provides relief to lessees when they are expected to need it most, while avoiding lessees applying the exemption beyond when it is needed.*
 - (c) *there is no substantive change to other terms and conditions of the lease. This condition reflects the IASB's view that lessees should not apply the practical expedient to lease modifications that are unrelated to the covid-19 pandemic but are negotiated at the same time as a covid-19-related rent concession (although, for example, a three-month rent holiday in 2020 followed by three additional months of substantially equivalent payments at the end of the lease would not prevent a rent concession from being within the scope of the practical expedient).*

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

Paragraph 46 A 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 the following conditions are met:

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- (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.

EFRAG's response

EFRAG agrees with the proposal of the IASB to provide lessees with an optional exemption from assessing whether a covid-19-related rent concession is a lease modification. EFRAG agrees with the need to provide relief for lessees given the challenges they face in assessing whether lease modifications have occurred under the circumstances of Covid-19 and taking account of the initial overall challenges of implementing IFRS 16 requirements. However, EFRAG would suggest to expand the scope of application in order to include rental concessions and renegotiations agreed in 2020, irrespective of when the payments were due.

The exemption

- 3 EFRAG agrees with the proposal of the IASB to provide lessees with an exemption from assessing whether a covid-19-related rent concession is a lease modification and that the marginal benefit of the proposed relief will be highest if it is provided as soon as possible. In supporting the proposal, EFRAG takes account of the current economic environment, whereby it is expected that many lessors have provided, or are expected to provide, rent concessions to lessees. These rent concessions could take many forms such as rent holidays or rent reductions for a period of time, possibly followed by increased rent payments in future periods and that it involves a large volume of leases.
- 4 IFRS 16 already contains requirements that address the accounting for rent concessions. Lessees are required to apply the requirements of IFRS 16 with regards to:
 - (a) assessing whether rent concessions are lease modifications; and
 - (b) applying the required accounting for rent concessions that are lease modifications (such as revising the discount rate and remeasuring the lease liability to reflect the revised lease payments using that rate).
- 5 EFRAG notes that assessing whether lease contracts have been modified under the circumstances of Covid-19 may be a challenging undertaking for preparers, as it relates to several different contracts at the same time. Furthermore, lease modification accounting is a costly exercise that necessitates a reassessment of future cash outflows and discount rates at the date of modification. Hence, the exemption effectively provides a double relief for preparers.
- 6 EFRAG considers that the need to assess for and apply lease modification accounting could add complexity for many entities especially those that are currently preparing their first annual financial statements in applying IFRS 16 which is effective for annual reporting periods beginning on or after 1 January 2019.
- 7 Applying the exemption, would result in:

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- (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.

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. 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.

- 8 For the reasons provided in paragraphs **3 to 6** above, EFRAG supports the proposed amendment that require lessees that apply the exemption to account for covid-19-related rent concessions as if such concessions were not lease modifications. Applying the exemption does not impair a faithful representation of a lessee's obligations under the lease contract.

Scope: Applicability to lessors

- 9 EFRAG supports limiting the amendment to lessees (and not lessors). EFRAG notes the following reasons provided by the IASB for not granting the exemption to lessors:

- (a) For most lessors with a large volume of leases, leasing is part of their ordinary activities - a part of their core business and lessors would be expected to have processes and systems in place for their leasing activities, including when changes are made to lease payments.
- (b) IFRS 16 substantially retained the lessor accounting model in IAS 17. Unlike many lessees, lessors are not currently preparing their first annual financial statements applying a new accounting model to their leases. Consequently, the need for relief is less of an issue for lessors than it is for lessees.
- (c) The accounting required by IFRS 16 for lessor lease modifications – i.e. for an operating lease, to treat the modified contract as a new lease and, for a finance lease, generally to apply IFRS 9 *Financial Instruments* - would not be expected to be complicated, whereas a lessee is required to determine a new discount rate for all lease modifications.

- 10 At the same time, EFRAG acknowledges that there may be cases where some lessors may face challenges in assessing large volumes of heterogeneous contracts.

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EFRAG is seeking views from its constituents on the specific issues that the lessors may face.

- 11 EFRAG observes that granting a relief for the lessees and not for the lessor might result in an asymmetry, for instance, if due to granting rent concessions, a lessor assesses that a lease modification has occurred resulting in a new lease contract with differing revenue recognition patterns from the original lease, but the lessee applies the exemption and avoids accounting required for lease modification. The asymmetry in lessor and lessee accounting requirement can be particularly challenging for intermediate lessors.

Scope: Timeframe restrictions

- 12 The proposed exemption developed is applicable only to changes in lease payments arising as a direct result of the covid-19 pandemic and limited to payments due to occur in 2020. EFRAG acknowledges that, without restrictions, there is a risk that any exemption could be applied broadly and have unintended consequences.
- 13 EFRAG understands the need for imposing a restriction on the application of the amendment as it is an exception to IFRS 16 lease modification requirements that were adjudged to provide relevant information to users of financial statements. EFRAG acknowledges that due to the pervasive nature of the effects of the Covid-19 pandemic, it will likely become increasingly difficult to distinguish Covid-19 related rent concessions from those arising due to other economic factors. Furthermore, EFRAG notes that there need to be safeguards against extended application of the practical expedient beyond where needed. EFRAG also agrees with IASB's view that lessee entities will have made further progress in implementing IFRS 16 requirements after 2020 and therefore will be less in need for relief than is the case at this point in time.
- 14 However, EFRAG notes that there could be lessees to whom concessions have been granted this year but where the relief is applicable for periods beyond 2020 (e.g., for a six-month rent holiday granted in September 2020). EFRAG understands that the exemption would not be applicable to such lessee contracts. EFRAG notes that this will unnecessarily restrict the population of contracts that can benefit from the exemption particularly when considering the differing timelines in the crystallisation of the pandemic effects across jurisdictions.
- 15 For this reason, EFRAG would support expanding the scope of the amendment to include all rent concessions granted during 2020 and not just payments due in 2020.
- 16 However, should the IASB keep the current proposals, EFRAG would not oppose to the finalisation of this Amendment, in particular considering the strict timeline of the project.

Optional amendment

- 17 The proposed exemption is optional for entities. EFRAG agrees with the IASB analysis that:
- (a) the proposed exemption represents a departure from the requirements of IFRS 16, which would be provided to lessees only to be responsive to particular concerns during the covid-19 pandemic; and
 - (b) entities should not be required to depart from the requirements of IFRS 16 as some entities (for example, those who have established systems to address changes in lease payments) may prefer the more consistent approach of applying the existing requirements to all changes to lease contracts throughout the pandemic.

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- 18 EFRAG supports the exemption being optional noting that some entities may want to achieve comparability of reporting outcomes across its portfolio of contracts (i.e. between covid-19-related rent contracts and other contracts) and they should not be restricted by the exemption from doing so.
- 19 At the same time, EFRAG notes that the optional exemption may result in incomparable reporting between entities with similar lease contracts. For example, as noted in the April 2020 IASB staff paper¹ the effects of covid-19-related rent concessions on a lessee's right-of-use asset and profit or loss could be different depending on whether an entity applies the exemption. 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.
- 20 Nonetheless, as noted in the IASB staff paper analysis, in principle the circumstances giving rise to rent concessions may indicate that right-of-use assets may be impaired. Consequently, to some extent, an impairment loss could in some circumstances² reduce the potential difference between accounting - or not accounting - for a rent concession as a lease modification. Furthermore, the time restriction of the amendment reduces the period of incomparability.
- 21 The possible reduced comparability across entities due to the optional exemption makes it all the more important to have the disclosure of the financial statement effects particularly as the income statement gains for rent forgiveness could be considered as non-recurring and users need to be aware of such effects.

Question to Constituents

- 22 EFRAG supports the IASB proposal to limit the scope of this amendment to lessees noting that the overall operational challenge of implementing IFRS 16 requirements is more pronounced for lessees than it is for lessors. Up until now, EFRAG have not heard of specific issues for the lessors. However, EFRAG would be interested in understanding if there are specific issues from the lessor perspective that the IASB should consider. Please provide inputs.

Notes to constituents – Summary of proposals in the ED

- 23 *The IASB tentatively decided to require lessees that apply the exemption to account for covid-19-related rent concessions as if such concessions were not lease modifications (e.g. forgiveness of rent will be accounted for as variable consideration and recognised through profit or loss).*
- 24 *The ED proposes that the amendment is effective for annual periods beginning on or after 1 June 2020 therefore enabling, rather than requiring, immediate application - thereby ensuring lessees have the opportunity to obtain the information needed if they wish to apply the practical expedient.*
- 25 *The ED also proposes to require lessees to apply the amendment retrospectively. The scope of the practical expedient (see paragraph BC5) means that retrospective application would not capture rent concessions that affect payments due before*

¹ <https://cdn.ifrs.org/-/media/feature/meetings/2020/april/iasb-supplementary-meeting/ap32b-impact-of-covid-19-on-board-timelines.pdf>

² EFRAG understands that right of use assets will often form part of larger cash-generating units (CGU) and there might not be impairment losses at the level of the CGU.

January 2020. However, retrospective application may benefit lessees that authorise annual or interim financial statements for issue after receiving covid-19-related rent concessions but before the amendment is issued.

- 26 Retrospective application would also benefit lessees applying the practical expedient during their first year of applying IFRS 16. For example, a lessee that applies IFRS 16 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and applies the practical expedient to covid-19-related rent concessions would not determine a revised discount rate for those leases. Instead, the lessee would use a discount rate determined as if IFRS 16 had always been applied (for example, a rate determined at the commencement date).
- 27 Nonetheless, restatement of comparative information would provide little benefit, and requiring this may be costly for lessees. The Board therefore proposes to require lessees to recognise 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.

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 component 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.

EFRAG's response

EFRAG agrees with the suggested proposal that entities should apply the exemption retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but are not be required to restate prior period figures.

- 28 EFRAG notes that retrospective application would not capture rent concessions that affect payments before January 2020 as the proposed exemption is limited to rent concessions that reduce only payments originally due in 2020. However, retrospective application may benefit entities that, for example:
- (a) have a 31 March 2020 year-end and publish financial statements before the IASB would finalise an amendment. Such entities would be able to retrospectively apply the amendment to covid-19-related rent concessions arising in March 2020 (and later) in their 31 March 2021 financial statements;
 - (b) prepare interim financial statements before the IASB would finalise an amendment but would like to use the exemption in their next annual financial statements.

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- 29 EFRAG observes that for entities such as those in paragraph 28(a) above, restatement of prior period figures would have little benefit due to the short timeframe of the exemption and expects the such a restatement to be potentially costly.
- 30 Therefore, EFRAG agrees with the suggested proposal that entities should apply the exemption retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but are not be required to restate prior period figures. Instead, a lessee would recognise any difference arising on initial application of the amendment in opening retained earnings (or other component of equity, as appropriate) in the annual reporting period that includes the date of initial application.
- 31 EFRAG acknowledges the possible reduction in comparability between entities in jurisdictions subject to endorsement and those that are not, in cases where the proposed amendments are finalised by the IASB on different dates that does not coincide with their quarterly reporting. For example, if an entity prepares quarterly reports on 30 June 2020 and the IASB finalise their amendments before that date the portion related to forgiveness of lease payments in that quarter will be recognised in profit or loss. Entities subject to an endorsement process, including European entities, may not be able to immediately apply the Amendment and may have to reflect in equity as opposed to profit or loss a portion of the forgiveness of lease payments.
- 32 EFRAG notes that entities will be required to apply the amendment retrospectively but are not required to restate prior period figures. EFRAG agrees with this approach, as a restatement would not result in a different outcome, given that the scope of the optional relief is limited to payments due for 2020.
- 33 EFRAG notes that the proposed amendments will be effective for annual and interim periods beginning on or after 1 June 2020 and that many entities are already preparing their first annual financial statements applying IFRS 16 or will do so in the coming months. Entities will also have to apply IFRS 16 in preparing interim financial statements.
- 34 The proposed amendments are limited to rent concessions that reduce only payments originally due in 2020. Therefore, EFRAG considers that the proposal of the IASB to make the amendment effective for annual periods beginning on or after 1 June 2020 with earlier application permitted including in financial statements not yet authorised for issue at the date the amendment is issued, is important. EFRAG also highlights that the proposed amendments are optional therefore entities are not obligated to implement them and would therefore not be restricted to the timeline of the proposed amendments.

Other matters

- 35 EFRAG acknowledges that by allowing entities with an option to apply the exemption, comparability could be reduced. Therefore, EFRAG supports the proposal in paragraph 60A of the ED to require entities applying the exemption to disclose that fact.

Question to Constituents

- 36 EFRAG supports the IASB proposal to require entities applying the exemption to disclose that fact. EFRAG notes the overarching disclosure requirements in paragraph 31 of IAS 1 and IFRS 16 would necessitate entities to disclose any additional information needed to enable users to understand material effects of, for instance, covid-19-related rent concessions on the primary financial

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statements. Acknowledging that the main purpose of this amendment is to reduce the accounting burden to the preparers resulting from the concessions, EFRAG seeks views on the feasibility of requiring additional specific disclosure, such as:

- (a) the nature of rent concessions granted;
- (b) how the practical relief has been applied;
- (c) the financial statement line items affected; and
- (d) the amount recognised in the financial statements resulting from covid-19 related rent concessions.

Please explain your views.