Leases – Rent concessions

Responding to the COVID-19 pandemic

IFRS 16

June 2020

home.kpmg/ifrs

Contents

Practical relief for lessees

Due to the impact of the COVID-19 pandemic on business conditions, many lessees are seeking rent concessions from lessors. Rent concessions may take the form of a one-off reduction in rent, a deferral of rent or a change in the nature of rent – e.g. fixed payments becoming variable.

Under IFRS 16 *Leases*, rent concessions often meet the definition of a lease modification. The accounting for lease modifications can be complex. For example, the lessee may be required to recalculate lease liabilities using a revised discount rate and adjust right-of-use assets.

The International Accounting Standards Board (the Board) has issued amendments to IFRS 16 to simplify how lessees account for rent concessions. These amendments introduce a practical expedient for lessees – i.e. a lessee is not required to assess whether eligible rent concessions that are a direct consequence of the COVID-19 pandemic are lease modifications. Instead, it accounts for them under other applicable guidance. For example, if the rent concession was in the form of a one-off reduction in rent, then it would be accounted for as a variable lease payment and be recognised in profit or loss.

The amendments were issued swiftly and, for practical purposes, can be applied immediately subject to any local endorsement process.

No such relief is provided for lessors. Lessors are required to assess whether rent concessions are lease modifications and, if so, account for them accordingly.

This publication contains practical guidance and examples illustrating how a company identifies rent concessions that qualify for the practical expedient – and how to account for them. It also discusses how both lessees and lessors account for rent concessions that are treated as lease modifications.

We hope you will find it helpful in identifying and accounting for rent concessions.

Kimber Bascom
Brian O'Donovan
Marcio Rost
KPMG's global IFRS leases leadership team
KPMG International Standards Group

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

1 At a glance

The amendments provide practical relief for lessees in accounting for eligible rent concessions that are a direct consequence of COVID-19.

1.1 Scope and objective of the amendments

The Board has issued amendments to IFRS 16 (the amendments) to provide practical relief for lessees in accounting for rent concessions.

Under the standard's previous requirements, lessees assess whether rent concessions are lease modifications and, if so, apply the specific guidance on accounting for lease modifications. This generally involves remeasuring the lease liability using the revised lease payments and a revised discount rate (see Chapter 4).

In light of the effects of the COVID-19 pandemic, and the fact that many lessees are applying the standard for the first time in their financial statements, the Board has provided an optional practical expedient for lessees.

Under the practical expedient, lessees are not required to assess whether eligible rent concessions are lease modifications, and instead are permitted to account for them as if they were not lease modifications.

IFRS 16.46A–B

Rent concessions are eligible for the practical expedient if they occur as a direct consequence of the COVID-19 pandemic and if all of the following criteria are met:

– the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
– any reduction in lease payments affects only payments originally due on or before 30 June 2021; and
– there is no substantive change to the other terms and conditions of the lease.

The way in which a lessee accounts for rent concessions to which it applies the practical expedient will depend on the facts and circumstances (see Chapter 3). In some cases, the lessee will recognise the benefit of the rent concession in profit or loss as if it were a variable lease payment.

If a rent concession does not qualify for the practical expedient or the lessee chooses not to apply the practical expedient, then the previous guidance continues to apply (see Chapter 4).

The amendments were issued on 28 May 2020 and, for practical purposes, can be adopted immediately, subject to any local endorsement process (see Chapter 7).

The lessor perspective

IFRS 16.BC240A

The practical expedient does not apply to lessors. Instead, lessors are required to assess whether rent concessions are lease modifications and, if so, to apply the specific guidance on accounting for lease modifications (see Chapters 5 and 6).

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

1.2 Key considerations

Determining whether the practical expedient applies requires judgement

Companies need to exercise judgement when determining whether a rent concession qualifies for the practical expedient. This requires careful consideration of its terms and an analysis of the original terms of the contract to ensure that there are no other substantive changes that may mean that it does not qualify.

Income statement volatility

Although the practical expedient is expected to provide relief to lessees, particularly to those with a large portfolio of leases, it may also increase volatility in the income statement. This may reduce the comparability of profits, earnings before interest, tax, depreciation and amortisation (EBITDA) and other key indicators that companies normally use for analysing year-on-year performance.

Additional disclosures

Companies electing to apply the practical expedient are required to provide adequate disclosures in their financial statements. This will include consideration of the new disclosure requirements introduced by the amendments in addition to the standard's existing disclosure requirements and those in other IFRS® Standards. For example, a lessee discloses the amount recognised in profit or loss arising from the application of the practical expedient. A lessee also discloses any non-cash changes in its lease liabilities, as required by IAS 7 *Statement of Cash Flows*. Ultimately, the extent of additional disclosure is company-specific and should communicate useful information to investors and other stakeholders.

Systems and processes

Companies that have configured new systems and developed new processes to accommodate the standard's requirements may want to continue accounting for rent concessions under the existing requirements. Electing to apply the practical expedient may involve re-configuring systems and updating existing processes. Further, because the practical expedient applies only for payments originally due on or before 30 June 2021, companies should compare the costs involved in making changes to systems and processes against the potential benefits of doing so.

Reduced comparability of results across lessees

The comparability of performance measures for many lessees in similar businesses/sectors will reduce because not all lessees will elect to apply the practical expedient.

Considerations on transition

Companies need to decide whether to elect to apply the practical expedient in their financial statements for subsequent reporting periods, or in any financial statements that are yet to be authorised. This will depend on the volume of leases and the significance of the rent concessions received. For example, if the rent concessions are expected to be material, then companies may want to apply the practical expedient in financial statements that are yet to be authorised. This allows them to communicate the impact to their investors and other stakeholders earlier.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

2 Scope of the practical expedient

The practical expedient applies only to eligible rent concessions; eligibility is strictly time-limited.

2.1 Overview

The practical expedient has been designed to be applied by lessees under limited circumstances – i.e. it applies only to rent concessions that are a direct consequence of the COVID-19 pandemic.

The key conditions for applying the practical expedient are as follows.

IFRS 16.46B

Scope of the practical expedient

↓

Is the rent concession a direct consequence of the COVID-19 pandemic?
(See Section 2.2)

↓

Is the revised consideration for the lease substantially the same as, or less than, the consideration immediately preceding the change?
(See Section 2.3)

↓

Does the rent concession reduce *only* lease payments originally due on or before 30 June 2021?
(See Section 2.4)

↓

Are there other substantive changes to the terms and conditions of the lease?
(See Section 2.5)

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

2.2

IFRS 16.46B

A direct consequence of COVID-19

The practical expedient applies only to those rent concessions that are received as a direct consequence of the effects of the COVID-19 pandemic.

Example 1 – Rent concessions that are a direct consequence of the COVID-19 pandemic

Retailer R in Country X leases several retail stores and a head office building. COVID-19 cases were first identified in X in late March 2020 and R observed decreasing sales in its stores from this point. X's government introduced lockdown measures in April 2020 and at this point R closed its stores to customers.

R agreed a rent concession for the head office building in January 2020 relating to refurbishment activities undertaken by the landlord that disrupted access to the building. R agreed further rent concessions for the retail stores in May and June 2020.

R elects to apply the practical expedient. In doing so, R notes the following.

- It *cannot* apply the practical expedient to the head office building because that rent concession related to access disruption and not to the COVID-19 pandemic. Therefore, the rent concession is not a direct consequence of the COVID-19 pandemic.
- It *can* apply the practical expedient to the retail stores provided that the other conditions of the practical expedient are met. This because the rent concession was received after COVID-19 cases were identified and its ability to use the retail stores was directly affected by the COVID-19 lockdown measures.

What factors should a lessee consider when assessing whether a rent concession is a direct consequence of the COVID-19 pandemic?

Companies should apply judgement when assessing whether a rent concession occurs as a direct consequence of the COVID-19 pandemic, based on the specific facts and circumstances. Factors to consider include, but are not limited to:

- the reasons for the initial negotiation between the lessor and the lessee regarding the rent concession;
- whether the reason for the rent concession is stated explicitly in the supplementary agreement between the lessor and the lessee or is otherwise apparent – e.g. from other communications;
- whether multiple concessions relating to the same lease need to be evaluated individually or in aggregate – i.e. to assess whether they are reasonably linked to the effects of the COVID-19 pandemic and are commensurate;

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

- the timing of the negotiation and agreement of the rent concession;
- the relevant laws and regulations in the specific jurisdiction; and
- the extent and nature of government intervention.

Does government action in a country – e.g. the introduction of a lockdown – determine the eligibility of the practical expedient?

Not necessarily. The commencement of a lockdown in a country may be important evidence that a rent concession is a direct consequence of the COVID-19 pandemic but it is not determinative. Many businesses have experienced disruption to trading activities both before and after the official lockdown periods.

In some cases, a lessee may have experienced disruption to its business before lockdown started in its own country – e.g. due to the earlier emergence of COVID-19 cases in other jurisdictions. This may have disrupted its supply chain or reduced demand in key markets. This could indicate that rent concessions agreed before commencement of a lockdown were a direct consequence of COVID-19.

In addition, disruption may continue after government lockdowns are lifted – e.g. due to continuing social distancing measures that limit customer access to retail stores. This could indicate that rent concessions agreed after a lockdown is lifted are a direct consequence of COVID-19.

2.3 Revised consideration is substantially the same as or less than the original consideration

IFRS 16.46B(a)

The practical expedient applies only to rent concessions for which 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 before the change.

Example 2A – Rent concessions that change the consideration in the lease: Time value of money

Retailer Q leases a store in a large retail mall. The rent payable is 1,000 per month. As a result of the COVID-19 pandemic, Q agrees with the lessor to defer the rent originally due in the months April to June 2020.

As part of this agreement, the rent for the period January to March 2021 will be increased by 1,100 per month, which compensates the lessor for the deferred rent as adjusted for the time value of money.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

IFRS 16.BC205D(a)

Q considers applying the practical expedient.

In assessing whether the rent deferral is eligible for the practical expedient, Q notes that the increase in rent is attributable to the time value of money. Therefore, Q concludes that the rent deferral is eligible for the practical expedient if the other conditions are met.

Example 2B – Rent concessions that change the consideration in the lease: Administrative fee

Varying Example 2A, the rent due in January to March 2021 remains the same – i.e. 1,000 per month. In addition, in April 2020 Retailer Q pays an administrative fee of 50 to the lessor.

IFRS 16.BC205D(a)

In assessing whether the rent deferral is eligible for the practical expedient, Q assesses that the revised consideration is not substantially different from the original consideration. Therefore, Q concludes that the rent deferral is eligible for the practical expedient if the other conditions are met.

Does a rent concession that increases the future lease payments to compensate the lessor for the time value of money qualify for the practical expedient?

IFRS 16.BC205D(a)

Yes. If the lease payments are deferred during the COVID-19 pandemic and the deferred payments are increased to compensate the lessor for the time value of money relating to the deferred payments, then these increases do not disqualify the concession from the practical expedient.

Are payment shortfalls not agreed with the lessor eligible for the practical expedient?

No; the practical expedient applies only to agreed rent concessions.

Some lessees may decide, or be forced by their cash flow circumstances, to make rent payments that are less than the amount that is contractually owed to the lessor. In some cases, a lessee may intend to pay any shortfalls at a later date or seek forgiveness of the unpaid amounts from the lessor.

If no change has been agreed by the parties – i.e. the lessor has not agreed to accept the payment shortfall either permanently (abatement) or temporarily (deferral) – then no 'concession' has been granted by the lessor to the lessee. Therefore, the payment shortfall is not subject to the amendments – i.e. the lessee is not permitted to account for the payment shortfall as if the unpaid amount was a contractual rent reduction for the period to which it relates.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

2.4 Consider only payments that were originally due on or before 30 June 2021

IFRS 16.46B(b)

The practical expedient applies only to rent concessions for which any reduction in lease payments affects payments originally due on or before 30 June 2021.

Example 3 – Deferral in rent payments that affects payments due after 30 June 2021

Lessee P operates a chain of restaurants and leases several outlets. As a result of the COVID-19 pandemic, P agrees a rent deferral with the lessor.

IFRS 16.BC205D(b)

Under the terms of the rent deferral, rent originally due in the period July to December 2020 will be added to the rent due in the period July to December 2021.

P considers applying the practical expedient.

In assessing whether the rent deferral is eligible for the practical expedient, P notes that the rent deferral affects rent payable until December 2021 but only reduces rents originally due up to December 2020. Therefore, P concludes that the rent deferral meets the 'payments due' eligibility criterion.

Example 4 – Reduction in rent payments that extends beyond 30 June 2021

Lessee T leases office buildings from a lessor. As a result of the COVID-19 pandemic, in September 2020 T agrees a rent concession with the lessor, under which the monthly rent will be reduced by 50% per month for the 12 months commencing 1 October 2020.

IFRS 16.BC205D(b)

T considers applying the practical expedient.

T notes that this rent concession is not eligible for the practical expedient because it reduces lease payments originally due up to September 2021 – i.e. beyond 30 June 2021. Further, T notes that this means that no portion of the rent concession is eligible for the practical expedient – i.e. T is not permitted to apply the practical expedient to the rent originally due for payment up to 30 June 2021.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

IFRS 16.46B(b)

Why is the practical expedient limited to reductions in lease payments originally due on or before 30 June 2021?

This criterion means that the practical expedient is strictly time-limited. The Board considered that a practical expedient without a time limit could potentially lead to broader application and therefore have unintended consequences. For instance:

- companies may agree to multiple amendments to lease contracts at once. If the practical expedient is not limited to a timeframe, then companies could potentially apply the practical expedient to amendments in lease contracts that may not be a direct consequence of the COVID-19 pandemic (e.g. future rent reductions intended to induce the entity into a longer-term extension, rather than to help mitigate the economic effects of COVID-19);
- the economic effects of the COVID-19 pandemic are uncertain and could extend for some time. Therefore, not having a definitive timeframe could lead to companies applying the practical expedient to future changes to the lease contract that are unrelated to the COVID-19 pandemic merely because its economic effects are long-lasting. This would result in companies not applying the lease modification guidance where they otherwise would have; and
- reduced comparability between companies that elect the practical expedient and companies that do not will arise only for a limited period.

2.5 Consider whether there are any other ‘substantive’ changes to the lease

IFRS 16.46B(c)

The practical expedient applies only to rent concessions that have no other substantive changes to the terms and conditions of the lease.

Example 5 – Deferral of rent payments by extending the lease term

A lessee is granted a rent concession by the lessor whereby the lease payments for the period April to June 2020 are deferred. Three months are added to the end of the lease term at the same monthly rent, and the lessee repays the deferred rent during those additional months. The rent concession is a direct consequence of COVID-19.

The lessee considers applying the practical expedient.

IFRS 16.BC205D(c)

In considering whether this rent concession is eligible for the practical expedient, the lessee notes the following.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Firstly, the revised consideration in the lease is substantially the same as the original – i.e. the condition in paragraph 46B(a) of IFRS 16 is met.

Secondly, the rent concession only reduces lease payments originally due in 2020 – i.e. before 30 June 2021 – so the condition in paragraph 46B(b) of IFRS 16 is met.

Thirdly, there is a change in the lease term – an extension by three months. This is a change to the terms and conditions of the lease. The lessee assesses whether this change in lease term is substantive and concludes that it is not – i.e. the condition in paragraph 46B(c) of IFRS 16 is met.

Because the rent concession is a direct consequence of COVID-19 and all three conditions in paragraph 46B of IFRS 16 are met, the lessee concludes that the rent concession is eligible for the practical expedient.

What are other substantive changes to the lease contract?

IFRS 16.46B(c), B2

A company assesses whether there are changes to other terms and conditions in the lease contract that are not a direct consequence of the COVID-19 pandemic – i.e. those for which the practical expedient does not apply. This includes lease modifications that are negotiated at or around the same time as a rent concession relating to COVID-19.

Lease modifications 'negotiated at or around the same time' may include multiple concessions granted for the same lease but agreed at different times or formalised in separate legal documents. For example, as the crisis continues a rent deferral may be followed by a further deferral or an abatement. When determining whether there has been a substantive change to the lease, a lessee needs to consider the contract combination guidance in IFRS 16 to evaluate whether to aggregate multiple concessions or to evaluate them separately.

The term 'substantive' has not been defined in the amendments, but this may not result in significant diversity in practice given the other eligibility criteria for the practical expedient. For example, defining 'substantive' precisely will not be necessary if the lessee concludes that the change in question is not a direct consequence of the COVID-19 pandemic or fails either the 'total consideration' or 'payments due' criteria. In all cases, a lessee is expected to make the judgement about whether other changes are substantive based on its understanding of those changes.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Does a change in rent payment from fixed to variable fail the 'no substantive change to other terms and conditions' criterion?

Not necessarily. A rent concession granted to a lessee can take different forms. For example, a retailer may agree that fixed rent for a retail store will be replaced by a variable rent that depends on the sales at the retail store for a period of time. This may be a fixed period (e.g. a fixed number of months) or an indeterminate period (e.g. until temporary COVID-19-related measures cease). In some cases, the variable rent may be explicitly capped at the original fixed amount or may be expected to be lower than the original fixed amount.

In these cases, the change in rent from fixed to variable for a period of time is a rent concession and is eligible for the practical expedient if the other eligibility criteria are met.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

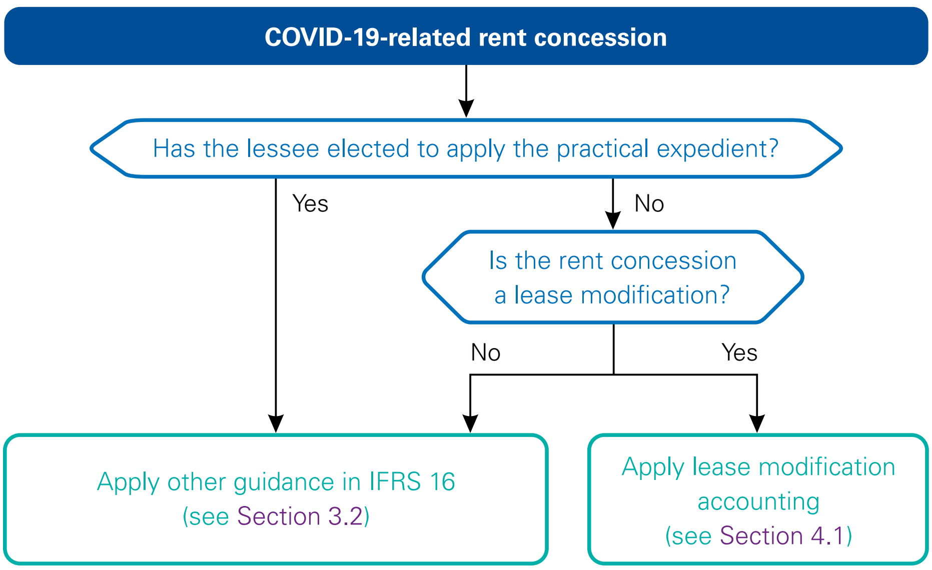
3 Applying the practical expedient

Rent concessions arising directly from the COVID-19 pandemic are not accounted for as lease modifications.

3.1 Overview

IFRS 16.46A

The amendments permit lessees, as a practical expedient, not to assess whether rent concessions relating to the COVID-19 pandemic are lease modifications. Instead, these lessees account for those rent concessions under other guidance in the standard, as set out in the following flowchart.



Is a company required to apply the practical expedient to rent concessions relating to the COVID-19 pandemic?

IFRS 16.2, 36–46, BC205C

No; applying the practical expedient is optional.

Many lessees will be attracted by the practical relief offered by the amendments. The practical expedient reduces the effort and subjectivity involved in assessing whether eligible rent concessions are lease modifications. It also avoids some of the complexities involved in lease modification accounting (see Chapter 4).

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

However, some lessees may prefer to apply the standard's existing requirements to all changes in lease contracts. This would increase the comparability between the accounting for rent concessions that do and do not qualify for the practical expedient. It would also enhance comparability year-on-year – e.g. if the lessee expects to have rent concessions in future years.

Is a company that elects to apply the practical expedient required to apply it to all eligible rent concessions?

IFRS 16.2, 60A(a), BC205C

No. However, lessees are required to apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances. This is consistent with the standard's existing requirements.

For example, a retailer may lease a large portfolio of retail stores and lease a fleet of vehicles that it uses for distribution. Depending on the facts and circumstances, it is possible that the retailer may conclude that it is acceptable to:

- apply the practical expedient consistently to eligible rent concessions relating to leases of its retail stores; and
- account for rent concessions relating to its vehicle leases by applying the standard's existing lease modification guidance.

Depending on the facts and circumstances, it is also possible that the retailer may conclude that it is acceptable to:

- apply the practical expedient consistently to rent concessions that forgive a portion of rent to which the lessor is entitled; and
- account for rent deferral concessions by applying the standard's existing requirements.

If the retailer applies the practical expedient to rent concessions granted only for its retail store leases or rent forgiveness concessions, rather than all of its eligible rent concessions, then it discloses information about the nature of the leases to which it has applied the practical expedient (see Section 3.3).

3.2 Applying the practical expedient

IFRS 16.38, BC205E

The amendments do not include application guidance on accounting for the practical expedient, instead refers to the standard's existing requirements.

The practical expedient does not alter the standard's existing requirements for lease changes that are not accounted for as lease modifications. For example, if changes in lease payments do not arise from a lease modification then they are generally accounted for as variable lease payments. A lessee recognises the variable lease payments in profit or loss in the period in which the event or condition that triggers those payments occurs.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

However, a change in lease payments is not always accounted for as variable lease payments. For example, a change in lease payments arising from resolving a variable payment contingency or a change in the amount expected to be owed under a residual value guarantee affects the measurement of the lease and profit or loss prospectively over the entire remaining lease term.

3.2.1 Forgiveness of lease payments

IFRS 16.BC205E(a)

One common form of rent concession arising from the COVID-19 pandemic is lessors offering rent-free periods or 'rent holidays' to their lessees, with no other changes to the lease.

Example 6A – Unconditional forgiveness of lease payments

IFRS 16.38, 46A–B, BC205D–BC205F, 9.3.3.1

Lessee Z entered into a lease contract with Lessor L to lease 1,500m^2 of retail space for five years. The lease commenced on 1 January 2018 and the rental payments are 100,000 payable quarterly in advance on 1 January, 1 April, 1 July and 1 October. Z's incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). There are no initial direct costs, lease incentives or dismantling costs.

Z's business is severely impacted by the COVID-19 pandemic and L and Z negotiate a rent concession. On 1 June 2020, L agrees to provide Z with an unconditional rent concession that allows Z to forego payment of its rent due on 1 July – i.e. L forgives Z the rent payment of 100,000 due on 1 July.

Z determines that the rent concession is eligible for the practical expedient.

In determining how to account for the rent concession, Z notes that it results in a forgiveness of rent. Applying the practical expedient, Z accounts for this forgiveness of rent as a negative variable lease payment. Z notes that the rent concession is unconditional and so the event that triggers the variable lease payment is Z and L agreeing the rent concession on 1 June 2020.

Therefore, Z accounts for the rent concession as a negative variable lease payment on *1 June*.

Assuming that there are no other changes to the lease, Z continues to use the retail space and the right-of-use asset is not impaired, then the lease accounting entries will be as follows:

- recognise the rent concession as a variable lease payment in profit or loss (i.e. record a debit to the lease liability and a corresponding credit in the income statement); and
- continue to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5% (i.e. record a debit to interest expense and a corresponding credit to the lease liability).

After accounting for the impact of the rent concession, Z's lease liability represents the present value of all future lease payments owing to L, discounted at the unchanged incremental borrowing rate. Z has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020.

In addition, Z continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Example 6B – Conditional forgiveness of lease payments

IFRS 16.38, 46A–B, BC205D–BC205F, 9.3.3.1

Assume the same facts as Example 6A, except that on 1 June, Lessor L agrees to a *conditional* rent concession that allows Lessee Z to forego paying the rent due on 1 July if the government lockdown remains in place at that date. If the government does continue the lockdown, then the rent of 100,000 due on 1 July will be forgiven. Otherwise, this amount will remain payable when it is due.

The government lockdown remains in place on 1 July and triggers the conditional rent concession – i.e. the forgiveness of the rent due on 1 July.

As such, Z accounts for a negative variable lease payment *on 1 July*.

Assuming that there are no other changes to the lease, Z continues to use the retail space and the right-of-use asset is not impaired, then the lease accounting entries will be as follows:

- recognise the rent concession as a negative variable lease payment in profit or loss on 1 July (i.e. record a debit to the lease liability and a corresponding credit in the income statement); and
- continue to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5% (i.e. record a debit to interest expense and a corresponding credit to the lease liability).

After accounting for the impact of the rent concession, Z's lease liability on 1 July represents the present value of all future lease payments owing to L, discounted at the unchanged incremental borrowing rate. Z has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020.

In addition, Z continues to depreciate the right-of-use asset.

Example 7 – Conditional rent abatement

IFRS 16.38(b), 46A–B

Lessee C leases retail premises for five years for fixed monthly payments of 10,000 due at the beginning of each month. Due to the COVID-19 pandemic, C has been prevented by the government from opening its premises to the public.

As a result, on 1 April 2020 Lessor D provides a rent concession whereby no rent is payable for each of the months April, May and June 2020, provided that, on each monthly due date, the government ruling remains in force and public access to C's premises is restricted. There are no other changes to the terms and conditions of the lease and the government restrictions remain in place until the end of June 2020.

C determines that the rent concession is granted as a direct consequence of the COVID-19 pandemic and qualifies for the practical expedient. Therefore, C does not assess whether the change is a lease modification and can elect to account for the monthly abatements as negative variable lease payments.

In this case, the right to the abatement each month is subject to meeting a condition at the beginning of that month – i.e. whether the government's restrictions remain in place.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

As a result, C derecognises a portion of the lease liability and recognises a negative variable lease payment in each month.

What is the 'event or condition' that triggers the variable lease payments?

IFRS 16.38(b)

Identifying the event or condition that triggers the variable lease payment is a key driver of how and when to account for a rent concession in such cases. This may depend on the facts and circumstances of the rent concession. There appear to be two main scenarios.

The first possibility is that the granting of the rent concession is the event or condition. This may be the case if, for example, the rent concession, once it is agreed, is entirely unconditional. When granting the rent concession is the event or condition:

- the lessee recognises the benefit of the rent concession as a variable lease payment in profit or loss when the rent concession is granted; and
- the amount of the variable lease payment recognised will not necessarily equal the nominal (cash) amount of the rent reduction, due to the effect of discounting.

The second possibility is that the rent concession, once it is granted, remains conditional. For example, the lessee will receive the benefit of the rent concession at each payment date only if it has complied with other conditions or prescribed conditions exist – e.g. those described in Examples 6B and 7. When this is the case:

- the lessee recognises the benefit of the rent concession as a variable lease payment in profit or loss as and when the conditions are met; and
- if the conditions are tested at each payment date, the amount of the variable lease payment recognised will equal the nominal (cash) amount of the rent reduction – i.e. there will be no discounting effect.

Although the duration of the COVID-19 pandemic and its economic effects may be unknown, this does not automatically lead to a concession granted being conditional. Instead, conditionality arises if a concession is dependent on a specific circumstance occurring – e.g. where the rent forgiveness extends from month to month only if temporary COVID-19 lockdown measures remain in force for that month.

3.2.2 Deferral of lease payments

IFRS 16.36(b), BC205E(b)

Another common type of rent concession being negotiated during the COVID-19 pandemic is the deferral of lease payments. The concession granted may involve the reduction of lease payments in some periods with an increase in payments in other periods.

When a rent concession involves deferred lease payments only, the lessee accounts for the change by recognising the impact in the period when no payment is made by continuing to reduce the lease liability.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Example 8 – Deferral of lease payments

IFRS 16.36, 46A–B, BC205D–BC205F

Lessee Z enters into a lease contract with Lessor L for a retail space for two years. The lease commences on 1 March 2020 and the rental payments are 2,000 per month payable in advance. The incremental borrowing rate at commencement of the lease is 6% and the interest rate implicit in the lease cannot be readily determined. There are no initial direct costs, lease incentives or dismantling costs.

Z records a right-of-use asset of 45,351[1] and lease liability of 43,351[1] at the commencement date as follows.

Lease liability – Original amortisation schedule

Month	Opening balance	Interest	Payment	Closing balance
March 2020	43,351	217	(2,000)	41,568
April 2020	41,568	208	(2,000)	39,776
May 2020	39,776	199	(2,000)	37,975
June 2020	37,975	190	(2,000)	36,165
July 2020	36,165	181	(2,000)	34,346
August 2020	34,346	171	(2,000)	32,517
September 2020	32,517	163	(2,000)	30,680
October 2020	30,680	153	(2,000)	28,833
November 2020	28,833	144	(2,000)	26,977
December 2020	26,977	135	(2,000)	25,112
January 2021	25,112	126	(2,000)	23,238
February 2021	23,238	116	(2,000)	21,354
March 2021	21,354	107	(2,000)	19,461
April 2021	19,461	97	(2,000)	17,558
May 2021	17,558	88	(2,000)	15,646
June 2021	15,646	78	(2,000)	13,724
July 2021	13,724	69	(2,000)	11,793
August 2021	11,793	59	(2,000)	9,852
September 2021	9,852	49	(2,000)	7,901
October 2021	7,901	39	(2,000)	5,940
November 2021	5,940	30	(2,000)	3,970
December 2021	3,970	20	(2,000)	1,990
January 2022	1,990	10	(2,000)	0
February 2022	0	0	0	0

Note

1. Lease liability is calculated as the present value of future lease payments over two years, discounted at 6%. Right-of-use asset is calculated as 45,351, which is the initial measurement of the lease liability of 43,351 + rent paid at commencement of 2,000.

Z's business has since been severely impacted by the COVID-19 pandemic. Z negotiates a rent concession with L in May 2020. L agrees to a rent deferral whereby the payment originally scheduled for May 2020 (advance payment for June 2020) is deferred, interest-free, and will instead be paid over the remaining 20 months of the lease term (100 per month, resulting in each remaining monthly payment equalling 2,100). To facilitate the rent concession, other non-substantive changes are made to the lease contract.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Z determines that the rent concession is a direct consequence of the COVID-19 pandemic and qualifies for the practical expedient.

The rent concession is unconditional, notwithstanding the fact that the duration and impact of the COVID-19 pandemic are unknown.

In this case, the original rent payable in May 2020 has been deferred, not forgiven. Therefore, Z does not account for a negative variable lease payment or a partial derecognition of the lease liability for the rent of 2,000 that is deferred.

One acceptable approach is for Z to account for the rent deferral as if Z is entitled to the deferral under the existing terms and conditions of the lease. Z remeasures the lease liability using the revised timing of the lease payments and an unchanged discount rate of 6%. Z recognises the impact of the change in the present value of the lease liability in profit or loss on the date the rent concession is effective.

Lease liability – Rent deferral: Approach 1

Month	Opening balance	Interest	Payment[1]	Remeasurement[2]	Closing balance[3]
March 2020	43,351	217	(2,000)		41,568
April 2020	41,568	208	(2,000)		39,776
May 2020	39,776	199	0	(101)	39,874
June 2020	39,874	199	(2,100)		37,973
July 2020	37,973	190	(2,100)		36,063
August 2020	36,063	180	(2,100)		34,143
September 2020	34,143	171	(2,100)		32,214
October 2020	32,214	161	(2,100)		30,275
November 2020	30,275	151	(2,100)		28,327
December 2020	28,327	142	(2,100)		26,368
January 2021	26,368	132	(2,100)		24,400
February 2021	24,400	122	(2,100)		22,422
March 2021	22,422	112	(2,100)		20,434
April 2021	20,434	102	(2,100)		18,436
May 2021	18,436	92	(2,100)		16,428
June 2021	16,428	82	(2,100)		14,411
July 2021	14,411	72	(2,100)		12,383
August 2021	12,383	62	(2,100)		10,345
September 2021	10,345	52	(2,100)		8,296
October 2021	8,296	41	(2,100)		6,238
November 2021	6,238	31	(2,100)		4,169
December 2021	4,169	21	(2,100)		2,090
January 2022	2,090	10	(2,100)		0
February 2022	0	0	0		0

Notes

1. Payments for June 2020 to February 2022 are adjusted for the May 2020 deferral also being paid (2,000 original monthly payment + 100 deferral payment).
2. The impact of remeasuring the lease liability is recognised in profit or loss (i.e. record a debit to the lease liability and a corresponding credit in the income statement).
3. At the end of May 2020, the lease liability is remeasured to 39,874, which equals the present value of the remaining 20 lease payments, discounted at Z's unchanged incremental borrowing rate of 6%.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Another acceptable approach is for Z to account for the rent deferral by adjusting the timing of the future cash flows and, in effect, bifurcating the lease liability into two portions – one portion (based on the original payment schedule) that remains subject to interest and one that is not (the 'interest-free' deferral). This is necessary for the lease liability to amortise to zero by the end of the lease term.

Under this approach, there is no remeasurement of the lease liability. The carrying amount of the lease liability at the end of each month during the lease term is as follows.

Lease liability – Rent deferral: Approach 2

				Decrease in lease liability comprises		
Month	Opening balance	Interest[1]	Decrease in lease liability	Payment[2]	Deferred payable[1]	Closing balance
March 2020	43,351	217	(2,000)	(2,000)	0	41,568
April 2020	41,568	208	(2,000)	(2,000)	0	39,776
May 2020	39,776	199	(2,000)	0	(2,000)	39,975
June 2020	39,975	190	(2,000)	(2,100)	100	38,065
July 2020	38,065	181	(2,000)	(2,100)	100	36,146
August 2020	36,146	171	(2,000)	(2,100)	100	34,217
September 2020	34,217	163	(2,000)	(2,100)	100	32,280
October 2020	32,280	153	(2,000)	(2,100)	100	30,333
November 2020	30,333	144	(2,000)	(2,100)	100	28,377
December 2020	28,377	135	(2,000)	(2,100)	100	26,412
January 2021	26,412	126	(2,000)	(2,100)	100	24,438
February 2021	24,438	116	(2,000)	(2,100)	100	22,454
March 2021	22,454	107	(2,000)	(2,100)	100	20,461
April 2021	20,461	97	(2,000)	(2,100)	100	18,458
May 2021	18,458	88	(2,000)	(2,100)	100	16,446
June 2021	16,446	78	(2,000)	(2,100)	100	14,424
July 2021	14,424	69	(2,000)	(2,100)	100	12,393
August 2021	12,393	59	(2,000)	(2,100)	100	10,352
September 2021	10,352	49	(2,000)	(2,100)	100	8,301
October 2021	8,301	39	(2,000)	(2,100)	100	6,240
November 2021	6,240	30	(2,000)	(2,100)	100	4,170
December 2021	4,170	20	(2,000)	(2,100)	100	2,090
January 2022	2,090	10	(2,000)	(2,100)	100	0
February 2022	0	0	0	0	0	0

Notes

1. Z does not recognise accrued interest on the deferred payment balance. Interest is accrued as if no change in the timing of cash flows had occurred.
2. Payments for June 2020 to February 2022 are adjusted for the May 2020 deferral also being paid (2,000 original monthly payment + 100 deferral payment).

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

IFRS 16.31, 33, IAS 16.55

Does a lessee suspend depreciation of its right-of-use asset during the COVID-19 pandemic if it cannot use the underlying asset as originally intended?

No. Lessees depreciate right-of-use assets in accordance with IAS 16 *Property, Plant and Equipment*. IAS 16 notes that depreciation does not cease when an asset becomes idle.

In many cases, lessees have had to severely curtail their operations and their use of leased assets as a result of the COVID-19 pandemic. For example, retailers have closed leased retail stores to the public and airlines have reduced flight schedules dramatically for their leased aircraft.

However, if the lessee retains the right to use the underlying asset, albeit in a restricted manner – e.g. a retailer that can only use a leased retail store to hold inventory and fulfil online orders – then the lessee continues to depreciate the right-of-use asset.

The lessee applies IAS 36 *Impairment of Assets* to determine whether its right-of-use asset is impaired and to account for any impairment. After the recognition of an impairment loss, the future depreciation charges for the right-of-use asset are adjusted to reflect the revised carrying amount.

3.3 Disclosures

IFRS 16.2, 46B, 51–60A, BC205F–BC205G, IAS 7.44A

The introduction of the practical expedient for lessees will have an impact on the comparability of financial statements. IFRS 16 and other standards – e.g. IAS 1 *Presentation of Financial Statements* – require lessees to disclose information that allows users of financial statements to assess the effect that leases have on their financial position, financial performance and cash flows.

In addition to the standard's existing disclosure requirements, the amendments require a lessee applying the practical expedient to disclose:

- that it has applied the practical expedient to all rent concessions that meet the conditions; or
- information about the nature of the leases and/or concessions to which it has applied the practical expedient if it has not applied the practical expedient to all rent concessions that meet the conditions.

The lessee also discloses the amounts recognised in profit or loss for the reporting period to reflect changes in lease payments arising from rent concessions that meet the conditions of the practical expedient.

The impact of reduced or no cash outflows for leases during the period of the rent concession will affect the disclosure of cash flows in a company's statement of cash flows. If the rent concession results in the adjustment of the carrying amount of the lease liability, then the lessee discloses this as a non-cash change in lease liabilities when disclosing changes in liabilities arising from financing activities under IAS 7.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Are lessees applying the practical expedient required to disclose the quantitative information required by paragraph 28(f) of IAS 8 on adoption of the amendments?

IAS 8.28(f), IFRS 16.C20B

No; the disclosures required when applying the practical expedient are set out above. Lessees are specifically exempt from the requirement to disclose the information usually required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when a company changes an accounting policy. This reduces the burden on lessees in the reporting period in which they first apply the amendments.

Are there other disclosures that a lessee should make about its accounting for rent concessions under the amendments?

Yes. As outlined in Section 3.2, there may be multiple acceptable approaches to accounting for some types of concessions under the practical expedient. Therefore, in addition to disclosing its election to apply the practical expedient, a lessee considers the need to disclose *how* it is applying the practical expedient to different types of leases and rent concessions.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

4 Lessees - Modification accounting

A lessee that chooses not to apply the practical expedient, or agrees changes to its lease contracts that do not qualify for the practical expedient, assesses whether there is a lease modification.

4.1 Overview

IFRS 16.44–46B, A

A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions meets the standard's definition of a lease modification.

Common lease modifications arising from the COVID-19 pandemic may include, for example:

- decreasing the scope of the lease by removing the right to use one or more underlying assets, or shortening the contractual lease term; and
- changing the consideration in the lease by decreasing the lease payments.

For a modification that is not a separate lease, at the effective date of the modification the lessee remeasures the lease liability using a discount rate determined at that date and:

- *for modifications that decrease the scope of the lease:* decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, and recognising a gain or loss that reflects the proportionate decrease in scope; and
- *for all other modifications (e.g. a change in the consideration for the lease):* making a corresponding adjustment to the right-of-use asset.

The following diagram summarises how a lessee accounts for lease modifications arising from the COVID-19 pandemic.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Change to the contractual terms and conditions (excludes exercise of option included in original lease contract)

Change in consideration – reduction in rent (see Section 4.2) and other lease modifications

→ Remeasure lease liability and adjust right-of-use asset

Decrease in scope – e.g. reduction in lease term (see Section 4.3)

→ Remeasure lease liability, adjust right-of-use asset and recognise gain or loss for the partial or full termination

For detailed guidance, see our publication on Lease modifications and the 16th Edition 2019/20 of our publication Insights into IFRS.

Is modification accounting still relevant for lessees?

IFRS 16.44–46

Yes. Although the practical expedient is intended to provide practical relief to lessees, it is optional and some lessees will elect not to use it for some or all of their eligible rent concessions. They may be confident that they can identify which rent concessions are, and are not, lease modifications and have systems in place that are able to process the accounting changes that arise from lease modifications. Indeed, some may have been doing this before the amendments were issued.

In other cases, a rent concession granted during the COVID-19 pandemic may not meet all of the criteria to qualify for the practical expedient. In this case, the lessee assesses whether the change is a lease modification and, if so, applies modification accounting.

Further, the practical relief offered by the amendments is strictly time-limited and the standard's original requirements on identifying and accounting for lease modifications will continue to apply once the practical expedient has expired.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

IFRS 16.38(b), A, 9.3.3.1

If the lessee fails to pay amounts due under the lease contract with no agreement with the lessor, then is this a lease modification?

No. A lease modification is a change to the terms and conditions of the lease. Failure to comply with the terms and conditions of the lease is not a lease modification.

If the lessee fails to pay amounts due under the lease contract with no agreement with the lessor, then the lessee continues to recognise the lease liability and assesses whether it is liable for additional interest or penalties for late payment under the lease contract.

4.2 Change in consideration only

IFRS 16.45–46

A lessee accounts for a lease modification that is a change in consideration as follows:

- allocate the consideration to each lease component based on the updated relative stand-alone price of the lease components and the aggregate stand-alone price of the non-lease components;
- update the lease term;
- remeasure the lease liability by discounting the revised lease payments at the revised discount rate; and
- make a corresponding adjustment to the right-of-use asset.

This accounting applies if, for example, a rent concession reduces future rent or provides a rental rebate.

Example 9 – Reduction in rent (consideration for a lease)

IFRS 16.45–46B, A, Ex19

Lessee X enters into a 20-year lease of office space with Lessor Y. The lease commences on 1 April 2020.

The annual lease payments are 150,000, payable in arrears, and X's incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). X does not provide any residual value guarantee. There are no initial direct costs, lease incentives or other payments between X and Y. Therefore, X initially recognises a lease liability and right-of-use asset of 1,869,332[1].

At the end of March 2020, X and Y agree to reduce the lease payments to 100,000, payable in arrears. Although the change in consideration for the lease is taking place during the COVID-19 pandemic, the reduction in lease payments relates to payments originally due beyond 30 June 2021.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The change in consideration is not part of the original terms and conditions of the lease and is not eligible for the practical expedient. X considers whether the change in consideration was required under the original contract (including the laws of Country Q that apply to the lease). X concludes that the rent reduction was not required and therefore accounts for the change as a lease modification. Because the modification does not grant X an additional right of use, it cannot be accounted for as a separate lease.

The effective date of the modification is 31 March 2020. At this date, the lease liability is 1,158,260, the right-of-use asset is 934,666[(2)] and X's incremental borrowing rate is 6% (assume that the interest rate implicit in the lease cannot be readily determined).

X remeasures the lease liability at 736,009 based on:

- annual lease payments payable in arrears of 100,000;
- a remaining lease term of 10 years; and
- a revised incremental borrowing rate of 6%.

X recognises the difference between the carrying amount of the lease liability before the modification (1,158,260) and the carrying amount of the modified lease liability (736,009) of 422,251 as an adjustment to the right-of-use asset.

Notes

1. Calculated as the present value of future lease payments over 20 years (150,000 × 20) discounted at 5%.
2. As at 31 March 2020, the right-of-use asset has been depreciated for 10 years. Annual depreciation is 93,467 (1,869,332 / 20).

In which modification scenarios does a lessee revise the discount rate?

IFRS 16.45

A lessee determines a new or revised discount rate each time a lease is modified. If the modification is not accounted for as a separate lease, then the lessee remeasures the lease liability using a revised discount rate. The revised rate is determined at the effective date of the modification. The lessee uses the interest rate implicit in the lease if this is readily determinable; otherwise, the lessee uses its incremental borrowing rate.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

When does a lessee account for a lease modification?

IFRS 16.44–46, A

A lessee accounts for a lease modification on the effective date of the modification. For modifications that are not accounted for as separate leases, the lease liability and right-of-use asset are remeasured at this date.

The *effective date of the lease modification* is the date when both parties agree to the lease modification – i.e. a rent concession only under negotiation at the period end is not accounted for as a lease modification.

4.3 Decrease in scope

IFRS 16.45–46

A lessee accounts for a lease modification that decreases the scope – i.e. removes the right to use one or more underlying assets or shortens the contractual lease term – as follows:

- allocate the consideration to each lease component based on the relative stand-alone price of the lease components and the aggregate stand-alone price of the non-lease components;
- update the lease term;
- remeasure the lease liability by discounting the revised lease payments at the revised discount rate;
- decrease the pre-modification right-of-use asset (and pre-modification lease liability) and recognise any gain or loss in profit or loss to reflect partial or full termination; and
- adjust the remaining right-of-use asset for the difference between the remaining lease liability and modified lease liability.

Example 10 – Decrease in scope and consideration

IFRS 16.40–46B, Ex17

Lessee E entered into a 10-year lease for 10,000m^2 of office space with Lessor F commencing on 1 July 2014. The rent payments are 100,000 per annum payable in arrears. The incremental borrowing rate at commencement of the lease is 7% (assume that the interest rate implicit in the lease cannot be readily determined).

Assuming no initial direct costs, lease incentives or dismantling costs, E records a right-of-use asset and a lease liability of 702,358[(1)] at the commencement date.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Subsequently in June 2020, E downscales its operations following a decrease in activity during the COVID-19 pandemic and requires less office space. Therefore, at the beginning of July 2020, E and F agree to reduce the space to 7,500m² (i.e. a reduction of 2,500m²).

E and F also agree to reduce the lease payments to 75,000 per annum, payable in arrears for the remaining four years. The incremental borrowing rate at this date is 8% (assume that the interest rate implicit in the lease cannot be readily determined).

The decreases in scope (office space) and consideration were not required by the original terms and conditions of the lease. Although the change in scope and consideration for the lease arose from the COVID-19 pandemic, the reduction in lease payments relates to payments originally due beyond 30 June 2021 and the decrease in scope is a substantive change to the other terms of the lease. Therefore, this is not eligible for the practical expedient. E concludes that the change is a lease modification.

At the beginning of July 2020 (the effective date of the modification), the carrying amount of the right-of-use asset is 280,943 and the lease liability is 338,721.

There are two elements to be accounted for:

- the decrease in the right-of-use asset and lease liability for the partial termination of the lease (reduction of 2,500m²); and
- the decrease in the remaining lease payments (reduction of 25,000 per annum).

Remeasurement of the lease liability

At the effective date of the modification – i.e. July 2020 – E remeasures the lease liability at 248,410 based on:

- annual lease payments payable in arrears of 75,000;
- a remaining lease term of four years; and
- a revised incremental borrowing rate of 8%.

E accounts separately for the reduction of space and change in consideration.

Accounting for the remeasurement of the lease liability

Partial termination of the lease

As a first step, E accounts for the partial termination of the lease (reduction of 2,500m²) by reducing the carrying amount of the right-of-use asset and lease liability and recognising any resulting gain or loss as follows.

E determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset.

Original square metres	10,000	100%
Remaining square metres	(7,500)	(75%)
Reduction in square metres	2,500	25%

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Therefore, E reduces the carrying amount of the right-of-use asset and lease liability to reflect the 25% decrease in scope. The remaining right-of-use asset is measured as 210,707 (280,943 × 75%). The remaining lease liability for the original office space is 254,041 – i.e. the present value of four annual lease payments of 75,000, discounted at the original rate of 7%.

E recognises the difference between the decrease in the right-of-use asset and the decrease in the lease liability as a gain in profit or loss at the effective date of the modification (i.e. July 2020).

	Pre-modification carrying amount	Remaining carrying amount after Step 1 (75% of pre-modification)	Difference (reduction by 25%)
Lease liability	338,721	254,041	(84,680)
Right-of-use asset	280,943	210,707	(70,236)
Gain on modification			**14,444**

Change in consideration

As a second step, at the effective date of the modification – i.e. the beginning of July 2020 – E recognises the difference between the remaining carrying amount of the lease liability after Step 1 of 254,041 and the modified lease liability of 248,410 (i.e. 5,631) as an adjustment to the right-of-use asset. This reflects the change in the consideration paid for the lease and the revised discount rate.

Note

1. Calculated as the present value of future lease payments over 10 years (100,000 × 10) discounted at 7%.

Does a change in the assessment of whether a lessee will exercise a renewal option represent a lease modification?

IFRS 16.18–20, 39–40(a)–(b)

No. A lessee is required to determine whether it is reasonably certain to exercise an option to extend the term of the lease at the commencement date. In doing so, it considers all relevant facts and circumstances that create an economic incentive for it to exercise an option.

A change in the lease term arising from a reassessment of whether a lessee will exercise a renewal option is not a lease modification. This is because the renewal option is part of the original terms and conditions of a lease and there has been no change to the contractual terms of the lease.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

If a lessee reassesses the lease term due to changes in its assessment of whether it is reasonably certain to exercise a renewal option, then it remeasures its lease liability using a revised discount rate. The lessee adjusts the carrying amount of the right-of-use asset for the remeasurement of the lease liability. If the carrying amount of the right-of-use asset is reduced to zero, then any further reductions are recognised in profit or loss.

When might a lessee reassess renewal, termination and purchase options?

IFRS 16.20, B41

A lessee reassesses the lease term only on the occurrence of a significant event or a significant change in circumstances that is within the lessee's control and that directly affects whether the lessee is reasonably certain to exercise an option (or not exercise a termination option). Examples of such events that may arise during the COVID-19 pandemic include:

- workforce reductions in certain divisions leading to a decrease in the need for leased office or workspaces;
- entering into new contracts or cancelling existing contracts with suppliers linked to leased production facilities; or
- selling assets or disposing of business units where the right-of-use asset is used.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

5 Lessors - Modification accounting

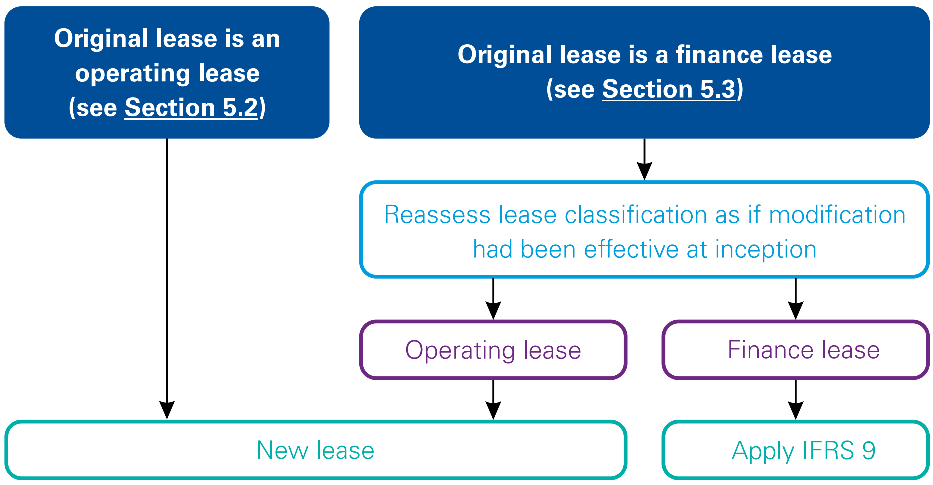
The amendments do not apply for lessors; they continue to assess whether a rent concession granted as a result of the COVID-19 pandemic is a lease modification.

5.1 Overview

IFRS 16.79–80, A, BC240A

The amendments do not include a practical expedient for lessors. Lessors are still required to assess whether a rent concession granted is a lease modification. If a lessor concludes that a rent concession is a lease modification, then it applies the specific guidance in the standard on accounting for lease modifications.

The following diagram summarises the accounting for lease modifications by a lessor for common rent concessions granted during the COVID-19 pandemic – e.g. changing the consideration in the lease.[1]



1. The accounting for lease modifications by a lessor where there is an increase in the scope of the lease by adding a right of use for one or more underlying assets is not illustrated in this diagram. See our publication Lease modifications for detailed guidance.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

5.2 Lessor modifications to operating leases

IFRS 16.81, 87

A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification. As part of the lease payments for the new lease, it considers any prepaid or accrued lease payments relating to the original lease.

A lessor recognises lease income on a systematic basis that is representative of the pattern in which the benefit of the underlying asset is diminished. This pattern of income recognition reflects the lessee's right to use the asset.

Example 11 – Decrease in scope and consideration: Lease modification

IFRS 16.87

Lessor L leases 1,500m^2 of retail space to Lessee Z for five years and classifies the lease as an operating lease. The lease commences in June 2018 and includes fixed lease payments of 10,000 per month, which increase by 2% per annum.

L accounts for the lease payments on a straight-line basis by first determining the annual rental income of 124,897 (624,485/5), which takes into account the annual increase.

Date	Lease payment
2018	120,000
2019	122,400[1]
2020	124,848[1]
2021	127,345[1]
2022	129,892[1]
Total	**624,485**

Note

1. Includes 2% increase per annum.

L accounts for the lease payments in 2018 and 2019 as follows.

Date	Lease payment (A)	Annual rental income (B)	Accrual period end balance (C)[1]
June 2018 – May 2019	120,000	124,897	4,897
June 2019 – May 2020	122,400	124,897	7,394

Note

1. C = C prior year + (B – A).

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Z's business has since been severely impacted as a result of the COVID-19 pandemic. Therefore, at the beginning of June 2020, L and Z agree to reduce the space from 1,500m^2 to 1,000m^2.

L and Z also agree to reduce the lease payments to a fixed amount of 90,000 per annum, payable in arrears for the remaining three years.

The decreases in scope (retail space) and consideration were not included in the original terms and conditions of the lease and are therefore a lease modification. L accounts for this modification as a new operating lease from the effective date of the modification. This takes into account accrued lease payments relating to the original lease as follows.

Date	Lease payment (A)	Annual rental income (B)[1]	Accrual period end balance (C)
June 2020	90,000	87,535	4,929
June 2021	90,000	87,535	2,465
June 2022	90,000	87,535	-

Note

1. B = sum of A [lease payments] / 3 - (C at end of May 2020) / 3 [remaining lease term].
   B = (90,000 × 3) / 3 - 7,394 / 3 = 87,535.

Example 12 – Unamortised lease incentive: Lease modification

IFRS 16.81, A

Lessor M enters into a 10-year lease of office space with Lessee K, which commences on 1 April 2015. The rental payments are 15,000 per month, payable in arrears. M classifies the lease as an operating lease. M reimburses K's relocation costs of K of 600,000, which M accounts for as a lease incentive. The lease incentive is recognised as a reduction in rental income over the lease term using the same basis as for the lease income – in this case, on a straight-line basis over 10 years.

On 1 April 2020, during the COVID-19 pandemic, M agrees to waive K's rental payments for May, June and July 2020.

This decrease in consideration is not included in the original terms and conditions of the lease and is therefore a lease modification.

M accounts for this modification as a new operating lease from its effective date – i.e. 1 April 2020. M recognises the impact of the waiver on a straight-line basis over the five-year term of the new lease. M also takes into account the carrying amount of the unamortised lease incentive on 1 April 2020 of 300,000. M amortises this balance on a straight-line basis over the five-year term of the new lease.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

When does a lessor account for a lease modification?

IFRS 16.79–80, 87, A

Similar to a lessee, a lessor accounts for modifications to operating and finance leases on the effective date of the modification. This is the date when both parties agree to the lease modification.

What other matters does an operating lessor consider when there is a change to the scope or consideration of a lease during the COVID-19 pandemic?

IFRS 9.5.5.1, 16.85, IAS 40.40

An operating lessor assesses whether the underlying asset and related balances are measured appropriately.

The lessor applies IAS 36 if the underlying asset is:

- property, plant and equipment;
- a right-of use asset that is not investment property; or
- investment property measured at cost.

If the underlying asset is investment property measured at fair value, then the lessor will need to ensure that the fair value reflects the revised terms of the in-place leases and the current expectations of market participants for the value of the property.

In addition, the lessor applies the impairment requirements of IFRS 9 *Financial Instruments* to operating lease receivables.

5.3 Lessor modifications to finance leases

Accounting for a modification to a finance lease that is not accounted for as a separate lease depends on whether the lease classification would have been different had the modified terms been effective at the inception date.

5.3.1 Not a separate lease – Finance to operating lease

IFRS 16.80(a)

When a modification to a finance lease is not a separate lease, the lessor first assesses whether the lease classification would have been different if the modified terms had been effective at the inception date. If the lease would have been classified as an operating lease had the modified terms been effective at the inception date, then the lessor:

- accounts for the lease modification as a termination of the original lease and the creation of a new lease from the effective date of the modification; and
- measures the carrying amount of the underlying asset as the net investment in the original lease immediately before the effective date of the lease modification.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

IFRS 16.63–66, 79–80(a), 81, 87–88

Example 13 – Modification that is not a separate lease and lease would have been classified as an operating lease

Lessor L enters into an eight-year lease of 40 lorries with Lessee M that commences on 1 January 2018. The lease term approximates the lorries' economic life and no other features indicate that the lease does not transfer substantially all of the risks and rewards incidental to ownership of the lorries. Therefore, L classifies the lease as a finance lease.

During the COVID-19 pandemic, M's business has contracted. In June 2020, L and M amend the contract so that it now terminates on 31 December 2020.

Early termination was not part of the original terms and conditions of the lease and this is therefore a lease modification. The modification does not grant M an additional right to use the underlying assets and therefore cannot be accounted for as a separate lease.

L determines that, had the modified terms been effective at the inception date, the lease term would not have been for the major part of the lorries' economic life. Furthermore, there are no other indicators that the lease would have transferred substantially all of the risks and rewards incidental to ownership of the lorries. Consequently, the lease would have been classified as an operating lease.

In June 2020, L accounts for the modified lease as a new operating lease. L:

- derecognises the finance lease receivable and recognises the underlying assets in its statement of financial position according to the nature of the underlying asset – i.e. as property, plant and equipment in this case; and
- measures the aggregate carrying amount of the underlying assets as the amount of the net investment in the lease immediately before the effective date of the lease modification.

5.3.2 Not a separate lease – Finance to finance

IFRS 16.80(b)

If a modification to a finance lease is not a separate lease and the lease would have been classified as a finance lease had the modification been effective at the inception date, then the lessor accounts for it under the requirements of IFRS 9.

The lessor adjusts its measurement of finance lease receivables to reflect any reduction in future contractual lease payments that arise from a rent concession arising directly from the COVID-19 pandemic.

For detailed guidance on the application of IFRS 9, see the 16th Edition 2019/20 of our publication Insights into IFRS.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

6 Lessor accounting – No modification

Not all changes in lease payments are lease modifications for lessors.

6.1 Overview

IFRS 16.A, BC240A

Lease payments can often change over the term of a lease. Changes may arise either directly from the terms and conditions of the lease (e.g. changes in an index or rate that determine the contractual lease payments) or indirectly (e.g. as a result of government actions). Lessor accounting for a change in lease payments depends on whether that change meets the definition of a lease modification. In the absence of a practical expedient, lessors are still required to assess whether a rent concession granted during the COVID-19 pandemic is a lease modification.

In April 2020, the Board released a document[2], prepared for educational purposes, responding to questions regarding the application of the standard to rent concessions granted as a result of the COVID-19 pandemic. Educational materials prepared by the Board do not change, remove or add to the requirements in the standards. However, the Board's document provides helpful guidance for lessors when accounting for rent concessions granted.

6.2 Changes that are not lease modifications

IFRS 16.81

Changes in lease payments that result from terms in the original lease contract or in applicable law or regulations are part of the original terms and conditions of the lease, even if the effect of those clauses was not previously considered. If there is no change in either the scope of or the consideration for a lease, then there is no lease modification and the standard's other requirements are applied.

Example 14 – Deferral of lease payments not a lease modification

IFRS 16.81, 87

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of 10,000 per month.

Due to the COVID-19 pandemic, L and Z agree on a rent concession that allows Z to pay no rent in the period from July to September 2020 but to pay rent of 20,000 per month in the period from January to March 2021. There are no other changes to the lease.

2. IFRS 16 and COVID-19: Accounting for COVID-19-related rent concessions in applying IFRS 16 Leases.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

L determines that the reduction in lease payments in July to September 2020 and the proportional increase in January to March 2021 does not result in an overall change in the consideration for the lease.

L does not account for the change as a lease modification. L continues to recognise operating lease income on a straight-line basis, which is representative of the pattern in which Z's benefit from use of the underlying asset is diminished.

Is a rent deferral that increases the future lease payments a lease modification?

Not necessarily.

The Board's document notes that if lease payments are deferred during the period of the COVID-19 pandemic and are subsequently increased 'proportionally', then the consideration for the lease is unchanged. In the absence of other changes to the lease, this means that there is no lease modification.

The Board's document does not elaborate on the meaning of the term 'proportionally' and the amendments do not use the term. This means that lessors will need to determine an appropriate definition of the term and apply it consistently.

For example, if the lease payments are deferred during the COVID-19 pandemic and the deferred payments are increased to compensate the lessor for the time value of money relating to the deferred payments, then the lessor assesses whether the lease payments have been increased 'proportionally'.

What are the accounting implications for the lessor if a lessee does not make rent payments when they are due?

IFRS 16.38, 76, 81

As discussed in Chapters 4 and 5, a lease modification is a change to the terms and conditions of the lease. If the lessee fails to pay amounts due under the lease contract with no agreement with the lessor, then this is not a lease modification.

Instead, the lessor will continue to account for the lease under its original terms and conditions unless and until the lessor agrees to modify the contract. However, if the lessee fails to pay amounts due under the lease contract, or the lessor is otherwise concerned that the lessee may be unable to pay amounts falling due in future periods, then there are a range of other issues that the lessor needs to consider.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

For operating leases, these issues include but are not limited to the following.

- *Income recognition:* Operating lease income reflects the rental payments to which the lessor is entitled under the enforceable terms and conditions of the lease. In addition, the lessor will need to assess whether it remains appropriate to recognise income from non-lease components – e.g. maintenance income under IFRS 15 *Revenue from Contracts with Customers*.
- *Carrying amount of the underlying asset:* Lessors will need to ensure that the underlying asset is appropriately measured. For investment property measured at fair value, this will include ensuring that the fair value reflects current market participant expectations about in-place leases and residual values. For other underlying assets, this will include considering whether there is a trigger for impairment testing.
- *Lease receivables:* Operating lease receivables are subject to impairment testing under IFRS 9.

In a finance lease, although the lessor will continue to account for the lease under its original terms and conditions, the carrying amount of the net investment in the lease and interest income related thereto may be impacted. The lessor applies IFRS 9's impairment requirements to the net investment in the lease and regularly reviews the estimated, unguaranteed residual values used in computing the gross investment in the lease. The lessor applies IFRS 16 to recognise reductions in the unguaranteed residual value of the underlying asset.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

7 Effective date and transition

For practical purposes, the amendments are available for use immediately, subject to local endorsement processes.

IFRS 16.C1A

The amendments are effective for annual periods beginning on or after 1 June 2020. Early application is permitted. For instance, a lessee would be permitted to apply the practical expedient to any set of financial statements not authorised for issue at 28 May 2020 – the date the amendments were issued.

IFRS 16.C20A

A lessee applies the amendments retrospectively, recognising the cumulative effect of the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate. This means that a lessee does not adjust comparative figures. However, in interim reporting a restatement of the results for a previous interim period may arise when the amendment is applied retrospectively.

IFRS 16.C20B

Application of the amendments is a change in accounting policy. However, a lessee is not required to disclose the quantitative information required by paragraph 28(f) of IAS 8 in the reporting period in which it first applies the amendments.

Example 15 – Company with a 31 December reporting date: Early adoption

Lessee K prepares annual financial statements with a 31 December reporting date. K agrees on a number of rent concessions that reduce rents originally due in the period from March to September 2020.

K elects to adopt the amendments early.

K applies the amendments in its annual financial statements for the year ending 31 December 2020. This means that K applies the amendments to eligible rent concessions that reduce rents originally due in the period from March to September 2020 – i.e. including rent reductions that occurred before the amendments were published.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Example 16 – Company with a 31 March reporting date: Early adoption

Lessee L prepares annual financial statements with a 31 March reporting date. In February 2020, it agrees rent concessions with Lessor X that forgive rents originally due in March 2020. In addition, in May 2020 L agrees rent concessions with another Lessor Y that forgive rents originally due in the period from June to September 2020. L elects to adopt the amendments early and determines that both of the rent concessions are eligible for the practical expedient.

L applies the amendments in its annual financial statements for the year ending 31 March 2021 (because its financial statements for the year ending 31 March 2020 were filed before the issue of the amendments). This means that L applies the amendments to eligible rent concessions that reduce rents originally due in the period from March to September 2020 as follows.

- L recognises the effect of rent concessions from Y that reduce rent in the period from June to September in profit or loss in the year ending 31 March 2021.
- L recognises the effect of rent concessions from X that reduce rent in March 2020 as an adjustment to equity on 1 April 2020.
- L does not restate its comparatives for the year ended 31 March 2020.

Example 17 – Interim financial statements not yet authorised for issue

Lessee M prepares annual financial statements with a 28 February reporting date and prepares interim financial statements each quarter. M's interim financial statements for the three-month period ended 31 May 2020 were not authorised for issue when the amendments were issued.

In March 2020, M agrees a number of rent concessions that reduce rents originally due in the period from March to September 2020.

M elects to adopt the amendments early.

M applies the amendments in its interim financial statements for the three-month period ended 31 May 2020. This means that M applies the amendments to eligible rent concessions that reduce rents originally due in the period from March 2020 onwards – i.e. including rent reductions that occurred before the amendments were published.

If the rent concessions were unconditional, then M would recognise the impact of the reduction in rents originally due in the period from March to September 2020 in its interim financial statements for the three-month period ended 31 May 2020.

M notes that there were no eligible rent concessions before March 2020 and, therefore, M makes no adjustment to opening equity on 1 March 2020.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Are the amendments available for immediate application?

In effect, yes. By choosing to adopt the amendments early, including in financial statements not yet authorised for issue, a lessee can effectively adopt the amendments immediately.

An important standard-setting consideration for any amendment is when and how to apply the amendment in the financial statements. The Board normally sets a later effective date for amendments so that a preparer gets adequate time to reflect them. However, because of the urgent nature of the COVID-19 situation, the Board issued the amendments with an effective date beginning on or after 1 June 2020, with earlier application permitted.

Are the amendments subject to local endorsement requirements?

This will depend on the legal and regulatory framework in each jurisdiction. However, because the amendments change the standard's requirements, the availability of the amendments may depend on appropriate completion of local endorsement processes.

Can a first-time adopter of IFRS Standards use the amendments?

Yes. The amendments form part of the body of IFRS Standards that a first-time adopter would apply.

For example, if a company adopts IFRS Standards in its annual financial statements for the year ended 31 December 2020 and presents one year of comparative financial information, then it would apply the amended version of the standard – including the optional practical expedient for lessees.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Appendix I – List of examples

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

This edition considers the requirements of IFRS 16 *Leases* published by the Board in January 2016 and amended in May 2020.

The text of this publication refers to IFRS 16 and to selected other current standards in issue at 31 May 2020.

Further analysis and interpretation will be needed for a company to consider the impact of IFRS 16 in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group and these observations may change. Therefore, neither this publication nor any of our other publications should be used as a substitute for referring to IFRS Standards themselves.

Acknowledgements

We would like to acknowledge the efforts of the following members of the KPMG International Standards Group, who were the principal authors of this publication: Anushree Agrawal, Sashank Gopalswami, Mostafa Mouit, Brian O'Donovan and Sinead Slattery.

We would also like to thank the members of KPMG's global IFRS leases topic team for their contribution:

Kimber Bascom (leader)	US
Archana Bhutani	India
Judit Boros	Hungary
Yen San Chan	Singapore
Úna Curtis	Ireland
Andrew Marshall	UK
Scott Muir	US
Brian O'Donovan (deputy leader)	UK
Emmanuel Paret	France
Marcio Rost	Brazil
Volker Specht	Germany
Patricia Stebbens	Australia
Mag Stewart	Canada
Alwyn Van Der Lith	South Africa
Beth Zhang	China

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Keeping in touch

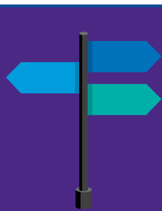
Follow 'KPMG IFRS' on LinkedIn or visit home.kpmg/ifrs for the latest news.

Whether you are new to IFRS Standards or a current user, you can find digestible summaries of recent developments, detailed guidance on complex requirements, and practical tools such as illustrative disclosures and checklists.

IFRS Today

News

COVID-19 financial reporting resource centre



KPMG IFRS on LinkedIn

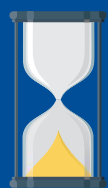
IFRS toolkit

Insights into IFRS®

Helping you apply IFRS Standards to real transactions and arrangements

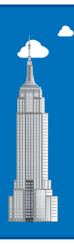
Guides to financial statements

Illustrative disclosures and checklists



Newly effective standards web tool

IFRS compared to US GAAP



Q&A: Fair Value Measurement

Combined and/or carve-out financial statements

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Major new standards

Leases

Revenue

Financial instruments

Insurance contracts

Other topics

Earnings per share handbook

Share-based payments handbook

Business combinations and consolidation

Better communication in financial reporting

Sector updates

Banks

IFRS app

IFRS app

For access to an extensive range of accounting, auditing and financial reporting guidance and literature, visit KPMG's Accounting Research Online. This web-based subscription service is a valuable tool for anyone who wants to stay informed in today's dynamic environment. For a free 30-day trial, go to aro.kpmg.com and register today.

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

home.kpmg/ifrs

Publication name: *Leases – Rent concessions*

Publication number: 137180

Publication date: June 2020

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG International Cooperative ('KPMG International') is a Swiss entity that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind any member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

This publication contains copyright © material and trademarks of the IFRS® Foundation. All rights reserved. Reproduced by KPMG IFRG Limited with the permission of the IFRS Foundation. Reproduction and use rights are strictly limited. For more information about the IFRS Foundation and rights to use its material please visit www.ifrs.org.

Disclaimer: To the extent permitted by applicable law the Board and the IFRS Foundation expressly disclaims all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise (including, but not limited to, liability for any negligent act or omission) to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

'IFRS®', 'IAS®', 'IFRIC®' and 'IASB®' are registered Trade Marks of the IFRS Foundation and are used by KPMG IFRG Limited under licence subject to the terms and conditions contained therein. Please contact the IFRS Foundation for details of countries where its Trade Marks are in use and/or have been registered.