

# Hot Topic: Coronavirus

## FASB staff guidance on accounting for COVID-19 rent concessions

April 13, 2020 (updated May 28, 2020<sup>1</sup>)



**This Hot Topic addresses the FASB staff's guidance on accounting for COVID-19 related rent concessions.**

### **Applicability**

The FASB staff's guidance outlined herein applies only to rent concessions granted in response to the COVID-19 pandemic.<sup>2</sup> This guidance may not be applied by analogy to other circumstances.

KPMG's Hot Topic, [Accounting for rent concessions resulting from the coronavirus outbreak and Hong Kong civil unrest](#), addresses the accounting for rent concessions arising from:

- circumstances other than the COVID-19 pandemic, including the recent civil unrest in Hong Kong; and
- the COVID-19 pandemic for:
  - companies that elect not to apply the optional staff guidance outlined herein; and
  - leases that are not eligible for the staff guidance.

### **Background and key impacts**

#### **Background**

In certain countries, the novel coronavirus pandemic in 2020 forced, or is forcing, the temporary closure, or changes to the operating hours, of shopping centers, office buildings, theaters and restaurants, among other types of buildings. These temporary measures have often been involuntary and mandated by national or local governments.

Some landlords have announced that tenants are not obligated to pay rent, or the entirety of the contractual rent, for the period affected by those measures, which may range from a few days to a month or more. Other landlords are offering concessions in the form of decreased rent in future

<sup>1</sup> New guidance or significant updates added April 21, 2020 are indicated with \*\*; those added April 28, 2020 are indicated with \*\*\*; those added May 7, 2020 are indicated with †; and those added May 28, 2020 are indicated with ††.

<sup>2</sup> The FASB staff guidance referred to herein includes the FASB staff and Board members' remarks at the April 8, 2020 public meeting, and the [FASB Staff Q&A](#) issued on April 10, 2020.

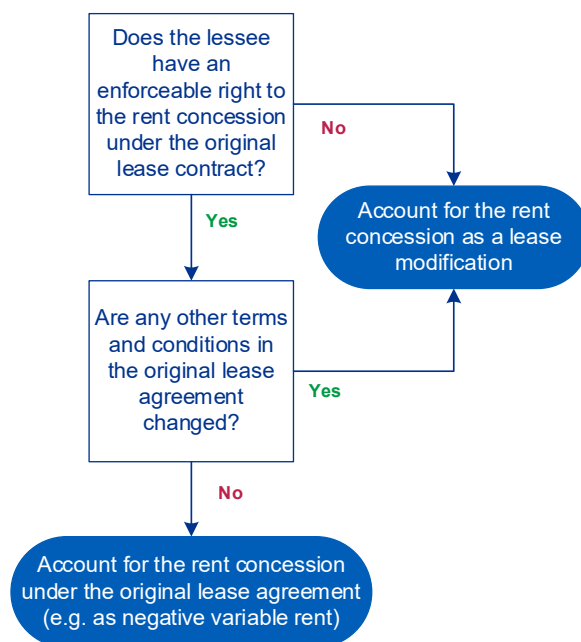
periods (e.g. for the next 12 months after the end of the temporary measure) or interest-free rent deferrals. Lessees are also seeking rent concessions where not proactively offered by their landlords to lessen their economic burden from these measures.

Generally speaking, lease contracts do not include clauses for rent concessions specific to COVID-19. Therefore, questions arose about how lessees and lessors should account for these rent concessions.

## Topic 842 and Topic 840 accounting

Absent the guidance from the FASB staff, accounting for these rent concessions under Topic 842 or Topic 840, regardless of whether proactively offered by the landlord or negotiated by the tenant, depends on the enforceable rights and obligations of the parties under the original lease contract, and the nature of any changes to the terms and conditions of that contract.

The following diagram illustrates the evaluation and its result on a company's accounting.



When ascertaining the enforceable rights and obligations of the parties under the original lease contract, it is important to remember that it is not required that those rights and obligations be written in the contract; they may arise from the laws of the jurisdiction governing the lease contract.

If, in response to recent events, a lessee 'short pays' the amount it owes under a lease – e.g. pays only 50% of the contractually required rent payment – without being entitled to do so, both parties' accounting should generally continue to follow the original contract's terms and conditions, unless and until the lessor agrees to accept (1) rent that is less than that to which it is entitled, and/or (2) late/deferred rent payment. As an exception, the lessor may need to adjust its accounting even before a modification is approved if it concludes that the lessee's short payment raises questions about the collectibility of the lease payments.

## Key impacts

Whether subject to Topic 842 or Topic 840 (e.g. a private company that has not yet adopted Topic 842), for eligible leases, the FASB staff guidance (hereinafter, the practical expedient) permits a company to *choose* to forgo the evaluation of the enforceable rights and obligations of the original lease contract. Instead, the company may account for COVID-19 related rent concessions, whatever their form (e.g. rent deferral, abatement or other) either:

- as if they were part of the enforceable rights and obligations of the parties under the existing lease contract; or
- as a lease modification.

Eligible leases are those for which the concession is COVID-19 related and the changes to the lease do not result in a substantial increase to the rights of the lessor or the obligations of the lessee. As an example, the staff refers to leases for which the total payments required by the contract will be substantially the same or less than the total payments required by the contract pre-concession as eligible for the practical expedient.

The remainder of this document answers questions about applying the FASB staff's guidance. Given the oral nature and recentness of some of the guidance, some of our responses may yet be updated. Additional questions may also continue to be added.

### Discussions with the SEC staff

In discussions that also occurred on April 8, 2020, the SEC staff provided guidance consistent with that provided by the FASB staff, as well as additional guidance that we will refer to periodically in the questions that follow.



#### Question 10

**Does the practical expedient apply to both lessees and lessors?**

**Interpretive response:** Yes. Lessees and lessors are both eligible to apply the practical expedient.



#### Question 20\*\*\*

**Is a company required to apply the practical expedient, or make the same election thereunder, for all of its COVID-19 rent concessions?**

**Interpretive response:** No. The FASB staff Q&A (Question 3) states that companies “should apply Topic 842 consistently to leases with similar characteristics and in similar circumstances.” Despite the explicit reference to Topic 842 in the question response, we believe the FASB staff guidance also applies to companies that have not yet applied Topic 842 (i.e. those still applying Topic 840).

In addition, the SEC staff indicated that it would expect a registrant not to ‘cherry pick’ its approach for particular leases, but also did not indicate that a registrant is required to apply the same approach for all leases.

We believe one reasonable approach would be to adopt consistent elections for similar concessions in similar types of leases. For example, a lessee of retail space might conclude that it can adopt one set of elections for its retail space lease concessions that are purely rent deferrals, and a different set of elections for concessions where the lessor permits the lessee to convert its fixed payments under the lease to percentage rent for the period of time COVID-19 affects the lessee's operations of the retail space.

## Question 30



**Is a company that is both a lessee and a lessor required to apply the practical expedient, or make the same election thereunder, consistently for its lessee and lessor leases?**

**Background:** An early question has arisen about whether a company that is both a lessee and a lessor is required to make the same practical expedient elections for its lessee leases as it does for its lessor leases for similar concession scenarios. For example, is it acceptable for a company to account for its lessee rent deferrals as if they were required under the enforceable terms and conditions of the existing lease contract, while accounting for similar lessor rent deferrals as lease modifications?

**Interpretive response:** No. Based on discussions with the FASB staff, we believe it is acceptable for a company that is both a lessee and a lessor to make different elections.

## Question 35\*\*\*



**Are multiple concessions related to the same lease aggregated to determine whether there is a substantial increase to the rights of the lessor or the obligations of the lessee?**

**Background:** Given the uncertain timeline of returning to normal operations (e.g. for reopening or unrestricting store or restaurant operations), lessees and lessors may agree on multiple concessions for the same lease. For example, the parties may agree to a deferral of two months' rent initially, but may later agree to a further deferral or abatement. Depending on the facts and circumstances, multiple concessions evaluated individually may not give rise to a 'substantial increase to the rights of the lessor or the obligations of the lessee'. However, those same concessions, if evaluated in the aggregate, may do so.

**Interpretive response:** It depends. We believe a company (lessee or lessor), whether subject to Topic 842 or Topic 840 should evaluate the multiple concessions consistent with the applicable contract combinations guidance in Topic 842 or Topic 840. If that guidance requires the concessions to be combined, they should be evaluated in the aggregate to determine whether there is a substantial increase to the rights of the lessor or the obligations of the lessee. Otherwise, they should be evaluated separately.

We believe this is appropriate because the contract combinations guidance applies to new contracts and contract modifications, and at this point in the accounting process the concessions have not yet qualified to be accounted for as if they were part of the enforceable rights and obligations of the parties under the existing lease contract (i.e. this question pertains to deciding *if* those concessions will qualify for the practical expedient).

### Companies subject to Topic 842

Under Topic 842, two or more contracts (at least one of which is or contains a lease) entered into at or near the same time with the same counterparty (or related party) are combined as a single transaction if: [842-10-25-19]

- the contracts are negotiated as a package with a single commercial objective;
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- the leases in the contracts (or some of the leases) are a single lease component.

See section 4.6 of KPMG’s Handbook, [Leases](#), for guidance on applying the contract combinations requirements.

When evaluating the contract combinations criteria for two or more concessions granted at or near the same time (see Question 4.6.10 of the Handbook), we believe it may be relevant to consider whether the subsequent concession(s):

- can be linked to the extension or expansion of temporary COVID-19 measures (e.g. shutdown or curtailed operations), or to worsened economic conditions stemming from COVID-19 (e.g. worsening unemployment); and
- is(are) reasonably commensurate with the change in circumstances.

If the answer to either of the above is ‘no’, that may indicate the multiple concessions are, in effect, a single negotiated concession, or that a concession granted for one lease is linked to a concession granted for another lease (where the lessee has multiple leases with the lessor).

### Companies subject to Topic 840

Under Topic 840, two or more contracts entered into at or near the same time with the same counterparty (or related party) are ‘presumed to have been negotiated as a package’, and therefore accounted for as a single arrangement. The presumption may be overcome with sufficient evidence. [\[840-10-15-16\]](#)

We believe the evaluation about whether sufficient evidence exists to overcome the presumption would generally involve the same considerations about commensurate linkage to temporary COVID-19 measures and/or worsened economic conditions as outlined for companies subject to Topic 842.

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## Question 40†



### What does ‘total payments required by the contract’ refer to?

**Interpretive response:** We believe ‘total payments’ refers to all of the fixed *and* variable payments the lessee is expected to make from lease commencement through lease expiration, including amounts paid and unpaid as of the concession date, based on the ‘lease term’ under Topic 842 (see section 5.3 of KPMG’s Handbook, [Leases](#)) or Topic 840.

We are aware of a view that the total payments required by the contract should be calculated based on the *remaining* unpaid payments as of the concession date pre- and post-concession; ‘total payments’ refers only to the combination of fixed and variable payments, but not payments made before the concession date. While we would not object to a company taking that view because the FASB staff Q&A is not precise in this regard, we believe a remaining unpaid payments test can create anomalous results for similar concessions and similar leases based solely on what proportion of the Topic 842 or Topic 840 lease term remains at the time of the concession, which we do not believe is consistent with the intent of the practical expedient.

For example, consider two identical 5-year operating leases. The first lease is in month 24 of the 60-month lease term, while the second lease is in month 54 of its 60-month lease term. The lessor grants each lessee a 3-month rent deferral in exchange for a 3-month lease extension. Using a remaining unpaid payments test, and assuming the monthly payments for the extension period are the same as the rent for months 1 through 60 and that the deferred rent is not forgiven (i.e. it will be paid in the future, potentially during the extension period), the concession on the first lease will pass the remaining unpaid payments test, but the second lease concession will not.

Consistent with Question 20, we believe a company’s decision about how to calculate the total payments required by the contract should be applied consistently to leases with similar characteristics and in similar circumstances.

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## Question 50\*\*

### Are total payments required by the contract measured on a discounted or an undiscounted basis?

**Interpretive response:** We believe it is appropriate to measure total payments before and after the concession on an undiscounted basis, consistent with the undiscounted nature of the ‘lease payments’ under Topic 842 (see section 5.4 of KPMG’s Handbook, [Leases](#)) and the ‘minimum lease payments’ under Topic 840. However, we do not believe the FASB staff’s guidance prohibits a company from measuring the total payments on a discounted basis.

Consistent with Question 20, we believe a company’s approach to measuring the total payments required by the contract should be applied consistently to leases with similar characteristics and in similar circumstances.

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## Question 60

### What is meant by ‘substantially the same’ when evaluating an increase in the total payments required by the contract?

**Interpretive response:** The FASB staff did not provide guidance about what it meant in this regard, but expressed that reasonable judgment should be applied. In the absence of additional guidance, we believe it is reasonable to conclude that total payments remain substantially the same if they do not increase by more than an insignificant amount. In other contexts, more than insignificant frequently refers to changes of 10% or greater.

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## Question 70

### Are lease amendments that include both a rent concession and a term extension eligible for the practical expedient?

**Background:** Some lessees and lessors have discussed the lessee receiving a COVID-19-related rent concession (e.g. a rent deferral, rent abatement or both) in return for an extension of the non-cancellable lease term. For example, in return for the lessee being permitted to pay variable rent as a percentage of store/restaurant sales during the national emergency period (or being permitted to defer three months’ fixed rent payments), the lessee agrees to an extension of the non-cancellable term of three years.

**Interpretive response:** It depends. The practical expedient is available to be applied only to leases for which the rights of the lessor and obligations of the lessee will remain substantially the same or less than those after the COVID-19 related effects. If the extended lease term will result in more than an insignificant increase in the total payments required by the contract (see [Question 60](#)), the lease is ineligible for the practical expedient, and the modification must be accounted for as a lease modification.

Considering the background example, it appears likely that a significant term extension (e.g. more than a few months) will more than insignificantly increase the total payments required by the contract (i.e. the lease payments, including variable lease payments, the lessee will make to the lessor over the total lease term – see [Question 40](#)) as compared to total lease payments required by the contract before the concession and extension.

In contrast, it may be likely that the total payments are *not* more than insignificantly increased from a short-term extension (e.g. only 2 or 3 months), particularly if paired with a rent reduction.

The longer the original lease term, the more likely, in general, that a term extension agreed to together with a concession will not more than insignificantly increase the total required payments. Companies will need to assess their facts and circumstances on a lease-by-lease basis.

### **Bifurcate the concession and the term extension?**

It would *not* be appropriate in our view to bifurcate the rent concession and the term extension when considering eligibility for the practical expedient. We believe doing so would be inconsistent with the FASB staff's decision to include the total payments required by the contract test in its guidance as it would, in effect, override that guidance and permit any concession to be accounted for at least in part under the practical expedient. We also note that bifurcating a contract amendment is generally inconsistent with the lease modification model in Topic 842; that is, Topic 842 does not bifurcate multiple lease changes into separate modifications.

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### Question 75\*\*

**Is a legal lease term extension that does not change the accounting lease term a substantial change to the rights of the lessor or obligations of the lessee?**

**Background:** For purposes of this question, consider the following example. At the time a COVID-19 related concession is granted, Lessee LE is in a 5-year non-cancellable lease with Lessor LR. The lease includes one 5-year renewal option that LE has previously concluded it is reasonably certain (assured) to exercise; therefore, the 'lease term' is 10 years under Topic 842 (Topic 840). In return for the COVID-19 related concession, LE agrees to immediately exercise the 5-year renewal option, making the remainder of the 10-year lease term non-cancellable.

**Interpretive response:** Assuming the total payments required by the contract do not increase by more than an insignificant amount (see Questions 40, 50 and 70), as is the case in the background example, we believe a legal lease term extension that does not change the accounting lease term is not a substantial increase to the rights of the lessor or the obligations of the lessee for purposes of determining eligibility for the practical expedient.

If the reasonably certain (reasonably assured) threshold for including the optional period in the lease term was met (as in the background example), we believe that the lessee's obligation for the renewal period (and the lessor's right to the payments for the renewal period) already constructively existed for accounting purposes before the concession.

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### Question 80

**Does the practical expedient apply to lease changes not resulting from COVID-19?**

**Interpretive response:** No. The FASB staff indicated that its guidance was specific to COVID-19 related concessions, reasonably determined, and that it should not be analogized to in other circumstances. Other modifications, even if agreed to during the COVID-19 national emergency period, are not eligible for the practical expedient.

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## Question 85\*\*\*

**Does removing or revising a co-tenancy clause together with the rent concession render the rent concession ineligible for the practical expedient?**

**Background:** Questions 6.6.60 (lessees) and 7.6.10 (lessors) in KPMG's Handbook, [Leases](#), discuss and illustrate the accounting for co-tenancy clauses.

In the present environment, some lessors are looking to remove or revise existing co-tenancy clauses in contracts with lessees in connection with a COVID-19 related rent concession. For example, an agreement to defer the lessee's rent for a period of time may be accompanied by agreement to remove or revise the lease's co-tenancy clause.

**Interpretive response:** It depends on whether the removal or revision of the co-tenancy clause results in a more-than-insignificant increase to the total payments required by the contract (see [Question 40](#)).

Where the co-tenancy clause is currently operative (i.e. the lessee is currently paying alternative co-tenancy rent) and the clause's removal or revision will result in a more-than-insignificant increase to the total payments required by the contract (see [Question 50](#)), we believe its removal or revision would result in the concession *not* being eligible for the practical expedient.

Conversely, if the co-tenancy clause is not currently operative – i.e. it remains a protective provision for the lessee – its removal or revision may have no effect on the total payments required by the contract. This is because the assessment thereof should not assume the clause will be triggered. If, on this basis, the removal or revision of the clause has no effect on the total payments required by the contract, the concession would remain eligible for the practical expedient.



## Question 90

**If accounting for a COVID-19 related rent concession as a lease modification, are any simplifications or 'shortcuts' permitted?**

**Background:** A company may account for a COVID-19 related rent concession as a lease modification because either (1) it elected to do so under the practical expedient, or (2) the lease is ineligible for the practical expedient (see Questions [70](#) and [80](#)). Some have expressed a desire for a 'simplified' modification approach in such circumstances – e.g. not reassessing lease classification or the lease term, or updating the discount rate for the lease.

**Interpretive response:** No. Regardless of why the company is accounting for the concession as a lease modification, the FASB staff expressly stated that when doing so, the complete modification model of Topic 842 or Topic 840 applies. See sections 6.7 (lessees) and 7.6 (lessors) of KPMG's Handbook, [Leases](#), for guidance on the lease modification requirements in Topic 842.



## Question 100

**Are 'short payments' not agreed to by the lessor eligible for the practical expedient?**

**Background:** 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 (i.e. 'short pay'). Absent the



practical expedient, the accounting by the lessee and lessor depends on whether the lessee was entitled to short pay based on its enforceable rights under the original lease contract. If the lessee was entitled to short pay, the accounting by both parties will generally follow the same variable lease payment accounting model outlined in the preceding section. If the lessee was not entitled to short pay, both parties will continue to account for the lease under its original terms and conditions unless and until the lessor agrees to modify the contract by accepting the short payment or some amount other than what it is entitled to under the original contract. KPMG's Hot Topic, [Accounting for rent concessions resulting from the coronavirus outbreak and Hong Kong civil unrest](#), addresses this in additional detail.

In this case, the question arises about whether, if elected, the practical expedient permits a lessee to account for the short payment as if it was entitled to pay only that amount before the lessor accepts the reduced payment as full satisfaction of the lessee's related obligations for the related period under the lease; for example, as if the amount that it short paid was a contractually entitled rent reduction of the period to which the short payment relates.

**Interpretive response:** No. In the FASB staff Q&A, the FASB staff and Board members' meeting remarks and in our discussion with the SEC staff, the practical expedient was always referred to in the context of rent 'concessions'. A *concession*, by definition, is something to which the granting party *concedes*. We do not believe it is appropriate to recognize as a concession something to which the lessor has not conceded (or to which the lessee is not entitled by legal right). This would inappropriately, and contrary to what we believe the staffs intended, reduce the lessee's enforceable liability below its enforceable amount and recognize a lease expense reduction that may never be realized.

If the short payment is accepted by the lessor as full satisfaction of the lessee's related obligations for the related period under the lease, we believe the practical expedient can then be applied, provided the other requirements of the practical expedient (e.g. see Questions [70](#) and [80](#)) are met.



## Question 110

### How does a lessee account for a rent deferral as if it were part of the enforceable rights and obligations of the existing lease contract under Topic 842?

**Background:** In some jurisdictions affected by COVID-19, resulting rent concessions have largely taken the form of reduced rent. For example, lessees may have received fixed rent reductions (\$100 per month to \$50 per month) or had their fixed rent converted to variable rent (\$100 per month changed to 5% of monthly sales). In those cases, if accounting for the reduced rent concession as part of the existing enforceable rights and obligations, we believe both parties should generally account for the rent reduction as a variable lease payment (negative), resulting in negative variable rent in the affected period(s).

This is generally consistent with the accounting for a co-tenancy clause under Topic 842. In a co-tenancy scenario, the contract similarly stipulates a rent concession for the period affected by the specified event (i.e. the co-tenancy event). Questions 6.6.60 (lessees) and 7.6.10 (lessors) in KPMG's Handbook, [Leases](#), discuss and illustrate the accounting for co-tenancy clauses.

In other jurisdictions, including the US thus far, COVID-19 related rent concessions are largely taking the form of rent deferrals. That is, the fixed amount of the lease payments is not changing, only the timing of payment. For example, a lessee may be permitted to defer all or a portion of its monthly rent for a 3-month COVID-19 shutdown period, and repay that amount interest-free over the subsequent 6 or 12 months. In these cases, the question arises about what the accounting would be for a rent deferral concession if the lessee was entitled to such deferral under the original lease contract.

**Interpretive response:** We believe there may be multiple acceptable approaches to accounting for rent deferrals that are presumed under the staff’s guidance to be provided for by the terms and conditions of the original lease contract. The following reflect 3 such approaches.

### Approach 1: No remeasurement of the lease liability

It appears, in addition to wanting to permit companies to avoid evaluating the enforceable rights and obligations of the parties to the lease contract, the staff wanted to give companies the *option* not to remeasure their leases for COVID-19 related rent concessions.

Given that apparent intent, we believe lessees can elect to *not* remeasure the lease liability and right-of-use (ROU) asset when a rent deferral is granted. This approach has the following effects.

- Because the carrying amounts of the lease liability and the ROU asset are not adjusted at the concession date, the lessee must adjust the timing of the future cash flows and either (1) revise the discount rate or, (2) in effect, bifurcate the lease liability into the portion (based on the original payment schedule) that remains subject to accretion and the portion that is not (the ‘interest-free’ deferral). This is necessary for the lease liability and the ROU asset to both amortize to \$0 by the end of the lease term.
- Total and post-deferral period lease cost is unchanged from its pre-concession amounts. This is because the gross lease payments are unchanged, and continue to be recognized on a straight-line basis over the lease term.

### Approach 2: Remeasurement consistent with resolving a contingency

Another view is that treating the COVID-19 specific rent deferral as something to which the lessee was entitled in the circumstances under the existing lease contract, in effect treats the timing of rent payments should COVID-19 occur as a contingency in the contract. When COVID-19 occurs and the two parties agree on changed timing of the rent payments, the timing contingency is resolved. Consequently, the lessee remeasures the lease consistent with any other resolution of a contingency remeasurement based on the changed timing of the unpaid lease payments. As illustrated in the diagram in paragraph 6.6.140 in KPMG’s Handbook, [Leases](#), this means the lessee will:

- remeasure the lease payments (including those that depend on an index or rate);
- remeasure the lease liability using an unchanged discount rate for the lease (i.e. using the same discount rate in effect before changing the timing of the rent payments); and
- recognize the amount of the change in the lease liability as an adjustment to the carrying amount of the associated ROU asset.

The lessee will *not* reassess lease classification and, in the absence of a lease term or purchase option reassessment event (see paragraphs 6.6.30 – 6.6.60 in KPMG’s Handbook, [Leases](#)) will also not reassess the lease term or a lessee purchase option. Example 6.6.70 in the Handbook illustrates a resolution of a contingency remeasurement.

Because there is no actual contractual requirement for the lessor to agree any further deferrals (or requirement for the lessee to assess whether there is given the practical expedient), we believe treating the deemed contingency as resolved is appropriate even though it may still be possible that additional COVID-19 rent deferrals will be granted; that is we do not believe it is necessary to ‘hold open’ the accounting for the granted deferral simply because another deferral may still occur.

### Approach 3: Cash basis

Under this approach, the lease liability and ROU asset continue to be accounted for as if the lessee is still making the payments under the original payment terms of the lease (i.e. no deferral occurs).

To accomplish this, rather than recognizing the reduction in the lease liability (debit entry) that would have occurred from making the lease payment required under the original payment terms with a corresponding credit to cash, the lessee will instead credit variable lease cost, recognizing negative variable lease cost for the amount of the deferred payment.

In the periods when the deferred amount is paid, the lessee will recognize:

- the amount of the repayment as additional variable lease cost (dr. variable lease cost, cr. cash); and
- the *original* payment amount will continue to reduce the lease liability (dr. lease liability, cr. cash).

This approach results in lower total lease cost during the periods of the deferral and greater total lease cost during the periods in which the deferred amount is paid. It also results in recognizing a lease liability that is less than the amount to which the lessee is legally obligated, since it reduces the liability during the deferral periods *as if* the lessee was still making lease payments.

### Comparing the 3 approaches

#### Lease cost

Total lease cost, variable and non-variable, over the entire lease term is the same under all three approaches.

If there are not variable lease payments that depend on an index or rate (e.g. payments that change during the lease based on changes in the Consumer Price Index), total lease cost each period, including the split between variable and non-variable lease cost, will be the same under Approaches 1 and 2. Total lease cost under Approach 3 will be lower during deferral periods, and higher during the periods deferred amounts are paid, than under the other two approaches. The differences arise from variable lease cost; non-variable lease cost will be the same under all three approaches each period.

If there are variable lease payments that depend on an index or rate, because Approach 2 remeasures the lease liability based on the index or rate at the date the concession is agreed and Approach 1 does not, operating lease cost in total and for periods after the concession will differ between the two approaches. However, that difference in operating lease cost will be offset by the difference in variable lease cost.

#### Remeasurement

Only Approach 2 requires remeasurement of the lease liability and ROU asset (albeit on a simplified basis – i.e. without having to reassess certain key inputs to lease measurement – from lease modification accounting); Approaches 1 and 3 will not remeasure those items.

#### Systems and processes

We believe Approach 2 will permit most lessees to use their existing lease systems and processes. For at least many leasing systems, after the lessee adjusts the payment schedule in its leasing system, the system will process the lease remeasurements accordingly, including prospective adjustments to lease liability accretion, ROU asset amortization and lease cost. Lease systems that calculate quantitative lease disclosures, such as weighted average lease term, will remain current to do so under Approach 2.

By contrast, to *not* remeasure the lease liability or ROU asset (Approach 1 or Approach 3), changes to lease payment schedules may need to be maintained outside of the lessee's leasing system. To apply Approach 1 or Approach 3, manual adjustments may need to be made to lease accounts and disclosures at least for the duration of the changed payment period (i.e. until the lease reverts to its original payment schedule after the deferral is repaid).



### Example 110.10\*\*

#### Retail store lease (baseline)

Lessee LE enters into a contract with Lessor LR for the right to use retail store space in a shopping mall for a 2-year term. The right to use the retail space is a lease and there are no other components of the contract.

The following facts are relevant at the lease commencement date.

Lease payments:	24 Monthly fixed payments of \$1,000, paid in advance
Renewal Options:	None
Termination/purchase options:	None
Transfer of ownership:	No
RVG:	None
LE's incremental borrowing rate:	6%
Initial direct costs (LE):	None

## Initial measurement

### Lease liability

At the lease commencement date, LE recognizes a lease liability of \$21,676. This is the present value of the 23 remaining \$1,000 lease payments, discounted at LE's incremental borrowing rate of 6%.

### Right-of-use asset

LE recognizes a corresponding ROU asset of \$22,676 (lease liability of \$21,676 + \$1,000 prepaid lease payment).

## Lease classification

LE classifies the lease as an operating lease because none of the tests for classification as a finance lease are met (see paragraph 6.2.50 of KPMG's Handbook, [Leases](#)).

## Subsequent measurement

### Lease cost

LE recognizes a single lease cost of \$12,000 each year (\$1,000 monthly).

### Lease liability and right-of-use asset

The carrying amount of the lease liability will at all times equal the present value of the unpaid lease payments discounted at 6% (see below). The carrying amount of the ROU asset at the end of each period, using Method 2 (see paragraph 6.4.170 of KPMG's Handbook, [Leases](#)), is determined as follows.

Mo.	Lease liability				ROU asset carrying amount			Single lease cost
	Beginning balance	Accretion	Payment	Ending balance	Beginning balance	Amortization	Ending balance	
1	\$ 21,676	\$ 108	\$ (1,000)	\$ 20,784	\$ 22,676	\$ (892)	\$ 21,784	\$ 1,000
2	20,784	104	(1,000)	19,888	21,784	(896)	20,888	1,000
3	19,888	99	(1,000)	18,987	20,888	(901)	19,987	1,000
4	18,987	95	(1,000)	18,082	19,987	(905)	19,082	1,000
5	18,082	91	(1,000)	17,173	19,082	(909)	18,173	1,000
6	17,173	86	(1,000)	16,259	18,173	(914)	17,259	1,000
7	16,259	81	(1,000)	15,340	17,259	(919)	16,340	1,000
8	15,340	77	(1,000)	14,417	16,340	(923)	15,417	1,000
9	14,417	72	(1,000)	13,489	15,417	(928)	14,489	1,000

Mo.	Lease liability				ROU asset carrying amount			Single lease cost
	Beginning balance	Accretion	Payment	Ending balance	Beginning balance	Amortization	Ending balance	
10	13,489	67	(1,000)	12,556	14,489	(933)	13,556	1,000
11	12,556	63	(1,000)	11,619	13,556	(937)	12,619	1,000
12	11,619	58	(1,000)	10,677	12,619	(942)	11,677	1,000
13	10,677	53	(1,000)	9,730	11,677	(947)	10,730	1,000
14	9,730	49	(1,000)	8,779	10,730	(951)	9,779	1,000
15	8,779	44	(1,000)	7,823	9,779	(956)	8,823	1,000
16	7,823	39	(1,000)	6,862	8,823	(961)	7,862	1,000
17	6,862	34	(1,000)	5,896	7,862	(966)	6,896	1,000
18	5,896	29	(1,000)	4,925	6,896	(971)	5,925	1,000
19	4,925	25	(1,000)	3,950	5,925	(975)	4,950	1,000
20	3,950	20	(1,000)	2,970	4,950	(980)	3,970	1,000
21	2,970	15	(1,000)	1,985	3,970	(985)	2,985	1,000
22	1,985	10	(1,000)	995	2,985	(990)	1,995	1,000
23	995	5	(1,000)	-	1,995	(995)	1,000	1,000
24	-	-	-	-	1,000	(1000)	-	1,000



### Example 110.20\*\*

#### Approach 1: No remeasurement of the lease liability

Assume the same facts as Example 110.10, with the exception of COVID-19.

As a result of the COVID-19 pandemic, LE and LR agree to a rent deferral where the \$1,000 fixed payment originally scheduled to be made in Month 3 (advance payment for Month 4) is deferred interest-free, and will instead be paid over the remaining 20 months of the lease term (\$50 per month, resulting in each remaining payment equaling \$1,050).

LE has elected to apply the practical expedient, to account for the concession as if required under the original lease contract and to not remeasure the lease liability and ROU asset to account for rent deferrals – i.e. LE elects Approach 1 in Question 110 – in similar leases. LE is eligible to apply the practical expedient to this concession because the total payments required by the contract are unchanged by the deferral.

Consequently, the carrying amounts of the lease liability and ROU asset at the end of, and lease cost, each month during the lease term are as follows.

Mo.	Lease liability				ROU asset carrying amount			Single lease cost
	Beginning balance	Accretion <sup>1</sup>	Payment <sup>2</sup>	Ending balance	Beginning balance	Amortization	Ending balance	
1	\$ 21,676	\$ 108	\$ (1,000)	\$ 20,784	\$ 22,676	\$ (892)	\$ 21,784	\$ 1,000
2	20,784	104	(1,000)	19,888	21,784	(896)	20,888	1,000

Mo.	Lease liability				ROU asset carrying amount			Single lease cost
	Beginning balance	Accretion <sup>1</sup>	Payment <sup>2</sup>	Ending balance	Beginning balance	Amortization	Ending balance	
3	19,888	99	-	19,987	20,888	(901)	19,987	1,000
4	19,987	95	(1,050)	19,032	19,987	(905)	19,082	1,000
5	19,032	91	(1,050)	18,073	19,082	(909)	18,173	1,000
6	18,073	86	(1,050)	17,109	18,173	(914)	17,259	1,000
7	17,109	81	(1,050)	16,140	17,259	(919)	16,340	1,000
8	16,140	77	(1,050)	15,167	16,340	(923)	15,417	1,000
9	15,167	72	(1,050)	14,189	15,417	(928)	14,489	1,000
10	14,189	67	(1,050)	13,206	14,489	(933)	13,556	1,000
11	13,206	63	(1,050)	12,219	13,556	(937)	12,619	1,000
12	12,219	58	(1,050)	11,227	12,619	(942)	11,677	1,000
13	11,227	53	(1,050)	10,230	11,677	(947)	10,730	1,000
14	10,230	49	(1,050)	9,229	10,730	(951)	9,779	1,000
15	9,229	44	(1,050)	8,223	9,779	(956)	8,823	1,000
16	8,223	39	(1,050)	7,212	8,823	(961)	7,862	1,000
17	7,212	34	(1,050)	6,196	7,862	(966)	6,896	1,000
18	6,196	29	(1,050)	5,175	6,896	(971)	5,925	1,000
19	5,175	25	(1,050)	4,150	5,925	(975)	4,950	1,000
20	4,150	20	(1,050)	3,120	4,950	(980)	3,970	1,000
21	3,120	15	(1,050)	2,085	3,970	(985)	2,985	1,000
22	2,085	10	(1,050)	1,045	2,985	(990)	1,995	1,000
23	1,045	5	(1,050)	-	1,995	(995)	1,000	1,000
24	-	-	-	-	1,000	(1,000)	-	1,000

Notes:

1. Accretion is the same as in Example 110.10; LE does not recognize accretion on the deferred payment balance.
2. Payments for Months 5 through 24 are adjusted for amount of the Month 4 rent deferral also being paid (\$1,050 = original monthly payment of \$1,000 + \$50 deferral repayment).



### Example 110.30\*\*

#### Approach 2: Remeasurement consistent with resolving a contingency

Assume the same facts as Example 110.20, except that LE has elected to remeasure the lease liability and ROU asset consistent with resolving a variable lease payment contingency – i.e. Approach 2 in Question 110.

Consequently, the carrying amounts of the lease liability and ROU asset at the end of, and lease cost, each month during the lease term are as follows.

Mo.	Lease liability					ROU Asset carrying amount				Single lease cost
	Beg.	Accr.	Pay. <sup>1</sup>	Re-measure.	End. <sup>2</sup>	Beg.	Amort.	Re-measure.	End. <sup>3</sup>	
1	\$21,676	\$ 108	\$(1,000)	\$ -	\$ 20,784	\$22,676	\$ (892)	\$ -	\$ 21,784	\$1,000
2	20,784	104	(1,000)	-	19,888	21,784	(896)	-	20,888	1,000
3	19,888	99	-	(51)	19,936	20,888	(901)	(51)	19,936	1,000
4	19,936	100	(1,050)	-	18,986	19,936	(900)	-	19,036	1,000
5	18,986	95	(1,050)	-	18,031	19,036	(905)	-	18,131	1,000
6	18,031	90	(1,050)	-	17,071	18,131	(910)	-	17,221	1,000
7	17,071	85	(1,050)	-	16,106	17,221	(915)	-	16,306	1,000
8	16,106	81	(1,050)	-	15,137	16,306	(919)	-	15,387	1,000
9	15,137	76	(1,050)	-	14,163	15,387	(924)	-	14,463	1,000
10	14,163	71	(1,050)	-	13,184	14,463	(929)	-	13,534	1,000
11	13,184	66	(1,050)	-	12,200	13,534	(934)	-	12,600	1,000
12	12,200	61	(1,050)	-	11,211	12,600	(939)	-	11,661	1,000
13	11,211	56	(1,050)	-	10,217	11,661	(944)	-	10,717	1,000
14	10,217	51	(1,050)	-	9,218	10,717	(949)	-	9,768	1,000
15	9,218	46	(1,050)	-	8,214	9,768	(954)	-	8,814	1,000
16	8,214	41	(1,050)	-	7,205	8,814	(959)	-	7,855	1,000
17	7,205	36	(1,050)	-	6,191	7,855	(964)	-	6,891	1,000
18	6,191	31	(1,050)	-	5,172	6,891	(969)	-	5,922	1,000
19	5,172	26	(1,050)	-	4,148	5,922	(974)	-	4,948	1,000
20	4,148	21	(1,050)	-	3,119	4,948	(979)	-	3,969	1,000
21	3,119	15	(1,050)	-	2,084	3,969	(985)	-	2,984	1,000
22	2,084	11	(1,050)	-	1,045	2,984	(989)	-	1,995	1,000
23	1,045	5	(1,050)	-	-	1,995	(995)	-	1,000	1,000
24	-	-	-	-	-	1,000	(1,000)	-	-	1,000

Notes:

1. Payments for Months 5 through 24 are adjusted for the amount of the Month 4 rent deferral also being paid (\$1,050 = original monthly payment of \$1,000 + \$50 deferral repayment).
2. End of Month 3 lease liability is remeasured to \$19,936, which equals the present value of the remaining 20 \$1,050 payments, discounted at LE's unchanged incremental borrowing rate of 6%.
3. End of Month 3 ROU asset reflects recognizing the \$51 remeasurement reduction to the lease liability as a corresponding decrease to the carrying amount of the ROU asset.



## Example 110.40\*\*

### Approach 3: Cash basis

Assume the same facts as Example 110.20, except that LE has elected the cash basis approach – i.e. Approach 3 in Question 110.

Consequently, the carrying amounts of the lease liability and ROU asset at the end of, and lease cost (operating [single, non-variable] and variable), each month during the lease term are as follows.

Mo.	Lease liability				ROU asset carrying amount			Single lease cost <sup>1</sup>	Variable Lease Cost <sup>2</sup>
	Beg. <sup>1</sup>	Accr. <sup>1</sup>	Payment <sup>1</sup>	End. <sup>1</sup>	Beg. <sup>1</sup>	Amort. <sup>1</sup>	End. <sup>1</sup>		
1	\$ 21,676	\$ 108	\$ (1,000)	\$ 20,784	\$ 22,676	\$ (892)	\$ 21,784	\$1,000	\$ -
2	20,784	104	(1,000)	19,888	21,784	(896)	20,888	1,000	-
3	19,888	99	(1,000)	18,987	20,888	(901)	19,987	1,000	-
4	18,987	95	(1,000)	18,082	19,987	(905)	19,082	1,000	(1,000)
5	18,082	91	(1,000)	17,173	19,082	(909)	18,173	1,000	50
6	17,173	86	(1,000)	16,259	18,173	(914)	17,259	1,000	50
7	16,259	81	(1,000)	15,340	17,259	(919)	16,340	1,000	50
8	15,340	77	(1,000)	14,417	16,340	(923)	15,417	1,000	50
9	14,417	72	(1,000)	13,489	15,417	(928)	14,489	1,000	50
10	13,489	67	(1,000)	12,556	14,489	(933)	13,556	1,000	50
11	12,556	63	(1,000)	11,619	13,556	(937)	12,619	1,000	50
12	11,619	58	(1,000)	10,677	12,619	(942)	11,677	1,000	50
13	10,677	53	(1,000)	9,730	11,677	(947)	10,730	1,000	50
14	9,730	49	(1,000)	8,779	10,730	(951)	9,779	1,000	50
15	8,779	44	(1,000)	7,823	9,779	(956)	8,823	1,000	50
16	7,823	39	(1,000)	6,862	8,823	(961)	7,862	1,000	50
17	6,862	34	(1,000)	5,896	7,862	(966)	6,896	1,000	50
18	5,896	29	(1,000)	4,925	6,896	(971)	5,925	1,000	50
19	4,925	25	(1,000)	3,950	5,925	(975)	4,950	1,000	50
20	3,950	20	(1,000)	2,970	4,950	(980)	3,970	1,000	50
21	2,970	15	(1,000)	1,985	3,970	(985)	2,985	1,000	50
22	1,985	10	(1,000)	995	2,985	(990)	1,995	1,000	50
23	995	5	(1,000)	-	1,995	(995)	1,000	1,000	50
24	-	-	-	-	1,000	(1,000)	-	1,000	50

Notes:

1. The amounts in these columns are the same as in Example 110.10.
2. For Month 4, is a negative amount equal to the payment deferred (i.e. not made); for Months 5 through 24, equals the amount of the deferral repaid that month.

The above table reflects LE continuing to account for the lease liability and ROU asset as if it is still making the payments under the original payment terms of the lease (i.e. as if no deferral was granted). To accomplish this, LE records journal entries in Month 4, and in each month for Months 5 through 24, as follows.

	Debit	Credit
Lease liability	1,000	
Variable lease cost		1,000



	Debit	Credit
<i>To recognize negative variable lease cost for the amount of the deferral in Month 4, in lieu of making the \$1,000 contractually required payment for that month.</i>		
Variable lease cost	50	
Lease liability	1,000	
Cash		1,050
<i>To reduce the lease liability by the original monthly payment amount and to record the additional monthly deferral repayment as variable lease cost in Months 5-24.</i>		



## Question 112\*\*\*

**How does a lessee account for a rent deferral as if it were part of the enforceable rights and obligations of the existing lease contract under Topic 840?**

**Background:** See the background to [Question 110](#).

**Interpretive response:** While the terminology and/or basis for each approach may not be exactly as expressed in Question 110 if applying Topic 840, we believe the approaches in Question 110 are also acceptable for lessees with capital leases under Topic 840.

For operating leases, because lessees do not recognize lease liabilities or ROU assets under Topic 840, the approaches in Question 110 cannot be applied. However, consistent with our response to Question 110, we believe there may be multiple acceptable approaches to accounting for rent deferrals that are presumed under the FASB staff's guidance to be subject to the terms and conditions of the original lease contract under Topic 840. The following are two such approaches.

### Approach 1: Accrual accounting only

This approach mirrors that in [Question 120](#) for operating lessors. That is, we believe it is appropriate for an operating lessee's lease expense recognition to be unaffected by the deferral. Despite the change in payment timing, the lessee can continue to recognize the unchanged total lease payments on a straight-line basis over the lease term.

However, the lessee's balance sheet changes for the effects of accrual accounting; that is, for the effects of not making cash rent payments during the deferral period, and making greater cash payments in future periods when the deferred rent is paid.

### Approach 2: Cash basis

Under this approach, straight-line operating lease expense is offset by negative contingent rent expense equal to the rent amount deferred for the period. For example, if straight-line operating lease expense for April 20X0 is \$105, but the \$100 contractual rent payment is deferred, the lessee would recognize only \$5 of operating lease expense in the income statement (\$105 operating lease expense, reduced by \$100 in negative contingent rent).

In the periods when the deferred amount is paid, the lessee will recognize:

- its straight-line operating lease expense (\$105 in the example in the preceding paragraph); and
- the amount of the deferral being repaid during the period as additional contingent rent expense.

This approach results in lower total lease expense during the periods of the deferral and greater total lease expense during the periods in which the deferred amount is paid.



## Question 113††

### How should a lessee account for a rent deferral secured by the issuance of a promissory note if applying the ‘as if’ practical expedient option?

**Background:** We are aware that some lessors are permitting lessees to defer certain cash rent payments during the COVID-19 crisis in return for a promissory note to repay these amounts in full at a future date(s). For example, a lessee and a lessor may have reached an agreement to permit the lessee to defer its April and May 2020 rent payments (\$50 due in advance each month) in return for the lessee issuing a promissory note for those amounts. At the time the promissory note is signed, one or more of those payments may be past due.

In general, assuming the amount of the promissory note does not increase the ‘total payments required by the contract’ by more than an insignificant amount (see Questions 40, 50 and 60), we believe this transaction will qualify for the practical expedient.

Therefore, the question arises as to whether this transaction is subject to the same considerations as the rent deferrals addressed by Questions 110 and 112, which do not contemplate the lessee issuing a promissory note.

**Interpretive response:** The lessee’s accounting depends on whether it has adopted Topic 842, and if not, on the classification of the lease under Topic 840 as capital or operating.

#### Topic 842 (capital lease under Topic 840)

We believe the lessee records and accounts for the promissory note consistent with any other note payable under Topic 470 (debt) and Topic 835 (interest). This is irrespective of a lessee’s particular elections for other rent deferral scenarios or which lease standard it applies (Topic 842 or Topic 840).

The note payable is recorded by contemporaneously writing off the portion of the lease or other accrued liability (or capital lease obligation) related to the deferred payments – i.e. those lease payments are satisfied by the issuance of the note. Any difference between the two amounts – e.g. arising from the difference between the discount on the lease payments covered by the note and an imputed discount on the note if its stated or coupon rate is below market – should be recorded as either:

- an adjustment to the carrying amount of the ROU asset (capital lease asset); or
- positive or negative variable lease cost.

The first option treats the difference as a change in the total lease cost arising from the difference between the discount rate for the lease and the interest on the note payable, and adjusts the cost-basis ROU asset (capital lease asset) accordingly. Under this option, the income effect of the difference gets recognized over the remainder of the lease term through operating lease cost (or finance lease ROU asset (capital lease asset) amortization).

The second option recognizes the difference immediately as a positive or negative variable lease cost.

We believe either of these options is acceptable, applied consistently to similar circumstances (see Question 20), based on the FASB staff’s guidance about applying the practical expedient.

#### Operating lease under Topic 840

Consistent with the accounting that we believe would apply under Topic 842 or for a capital lease, we believe the lessee records and accounts for the promissory note consistent with any other note

payable under Topic 470 (debt) and Topic 835 (interest). This is irrespective of a lessee’s particular elections for other rent deferral scenarios.

We believe the lessee records the note payable (credit) by:

- first, writing off (debiting) any existing liability for payments satisfied by issuance of the note (e.g. payments for which the lessee is past due when the note is issued); and
- second, recognizing (debiting) prepaid rent for the amount of the payments satisfied by the issuance of the note not subject to an existing liability.

Any difference between the initial carrying amount of the note payable and the sum of the amounts in the preceding bullets should be recorded as either:

- a prepayment that is attributable to the entire remaining lease term or a lease incentive (which will increase or reduce operating lease expense over the remainder of the lease term, respectively); or
- positive or negative contingent rent expense.

We believe either of these options is acceptable, applied consistently to similar circumstances (see [Question 20](#)), based on the FASB staff’s guidance about applying the practical expedient.

Using the background example to illustrate, and assuming the April 2020 payment of \$50 is past due when the terms of the promissory note are agreed to, the lessee would record the following entry on issuing the note (assume it is initially measured, on a discounted basis, at \$95):

	<i>Debit</i>	<i>Credit</i>
Accrued liabilities	50 <sup>1</sup>	
Prepaid rent	50 <sup>2</sup>	
Note payable		95
Contingent rent expense (or lease incentive liability)		5
Notes:		
1. April rent that is past due when the terms of the note are agreed to.		
2. May rent prepaid by the note.		

**Question 115\*\*\***

**Are the approaches in Questions 110 and 112 acceptable when the lease term is extended in return for the deferral but the total payments required by the contract remain substantially the same or less?**

**Background:** We are aware that some COVID-19 rent deferrals are being accompanied by short lease term extensions (e.g. 2 or 3 months), often based on the period for which rent is deferred. In such cases, the total payments required by the contract *may* remain ‘substantially the same’ (see [Question 60](#)) as before the concession and extension.

**Interpretive response:** Yes. We believe all of the approaches outlined in [Question 110](#) (Topic 842) and [Question 112](#) (Topic 840) are acceptable for a rent deferral concession in situations where the lease term is extended in return for the deferral, but the total payments required by the contract remain substantially the same or less.

**Topic 842 (Question 110)**

While the application of Approach 2 to scenarios like those described in the background is clear, it is less clear how to apply Approaches 1 and 3. That said, we believe those approaches would be applied to scenarios such as those in the background as follows.

- Under Approach 1, we believe the agreed payments for the additional lease periods get incorporated into the lease liability (and therefore also the ROU asset) using unchanged assumptions (e.g. unchanged discount rate for the lease), and without adjusting the carrying amount of the lease liability related to the pre-extension lease term.
- Under Approach 3, we believe it may be appropriate to either:
  - incorporate the agreed payments for the additional lease periods into the lease liability in the same manner as under Approach 1 and treat only the portion of the extension period payments that is repaying the rent deferral as variable lease payments; or
  - make no adjustment to the carrying amounts of the lease liability and ROU asset as a result of the extension, and instead treat the extension periods as subject to only variable payments.

### Topic 840 (Question 112)\*\*\*

#### Capital leases

Under Topic 840, renewals and extensions of a capital lease are accounted for as new agreements. [840-30-35-17, 35-19]

- If the new lease for the extension period is classified as a capital lease, we believe all three [Question 110](#) approaches would be applied in the same manner as described for leases under Topic 842.
- If the new lease for the extension period is classified as an operating lease, it is accounted for as a separate lease. Because of this, we do not believe Approach 2 can be applied, because it does *not* treat the extension period as separate from the original lease term.
  - Under Approach 1, we believe the remaining accrual for original lease deferred rent not yet repaid becomes part of the accounting for the new lease. The minimum rental payments for the new lease, to be recognized as straight-line operating lease expense over the extension period, will equal the payments required during the extension period (inclusive of any deferral repayments), less the amount of any remaining deferred rent balance.
  - Under Approach 3, noting that there is no accrual for original lease deferred rent (i.e. it is derecognized as if it had been paid in accordance with the original contract, with offset to negative contingent rent), it may be appropriate to do any of the following, noting that the income statement effects will be the same under all three as long as the extension period payments, including rent deferral repayments, are equal throughout the extension period.
    - Recognize straight-line operating lease expense based on treating all of the payments required during the extension period (inclusive of any deferral repayments) as the minimum rental payments for the new lease.
    - Recognize straight-line operating lease expense based on treating the payments required during the extension period (*exclusive* of any deferral repayments) as the minimum rental payments for the new lease, and account for any rent deferral repayments as contingent rent.
    - Recognize contingent rent expense based on treating all of the payments required to be made during the extension period as contingent rental payments.

#### Operating leases

Under either Approach 1 or Approach 2, we believe that the extension period is treated as a new lease, separate from the lease to which the concession applies. Therefore, the accounting for the existing lease is the same in this short-term extension scenario as in [Question 112](#). Under Topic 840, an action

that extends the lease beyond the expiration of the existing term is considered a new lease agreement. [840-10-35-4]

Under either approach, the deferral repayment may continue into the extension period (i.e. the rent deferred is repaid partially or wholly over this period).

- Under Approach 1, any remaining accrual for original lease deferred rent not yet repaid becomes part of the accounting for the new lease. The minimum rental payments for the new lease, to be recognized as straight-line operating lease expense over the extension period, will equal the payments required during the extension period (inclusive of any deferral repayments), less the amount of any remaining deferred rent balance.
  - Under Approach 2, because there is no accrual for original lease deferred rent at the end of the original lease, we believe it is reasonable to either (1) treat all of the payments to be made during the extension period as minimum rentals, or (2) continue to treat any portion of the extension period rental payments that is repaying the rent deferral as contingent rent expense.
- 



## Question 120

**How does an operating lessor account for a rent deferral as if it were part of the enforceable rights and obligations of the existing lease contract?**

**Background:** See the background to [Question 110](#).

**Interpretive response:** Assuming the collectibility of the remaining unpaid lease payments is not less than probable after the deferral, and the lease term is not extended (in a manner that still permits applying the practical expedient – see [Question 70](#)), we believe it is appropriate for an operating lessor’s lease revenue recognition to be unaffected by the deferral. That is, despite the change in payment timing, the lessor can continue to recognize the unchanged total lease payments on a straight-line basis over the lease term.

However, the lessor’s balance sheet changes for the effects of accrual accounting; that is, for the effects of not receiving cash rent payments from the lessee during the deferral period, and receiving greater cash payments in future periods when the deferred rent is paid.

### Collectibility

Regardless of a lessor’s election of, or optional selection under, the practical expedient, it will need to monitor for changes in collectibility of the remaining unpaid lease payments. The economic effects of the COVID-19 outbreak may change the assessment of collectibility for some leases, and significant rent deferrals may call into question whether the lessee will be able to repay the deferred rent.

If at any time, whether linked to COVID-19 or not, it becomes less than probable that the lessee will pay at least substantially all of the lease payments due under the lease, the lessor must adjust its accounting for the affected lease. See section 7.5.2 of KPMG’s Handbook, [Leases](#), for information about a lessor’s accounting when this occurs. [842-30-25-13]

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## Question 121††

### How should an operating lessor account for a rent deferral secured by the issuance of a promissory note if applying the ‘as if’ practical expedient option?

**Background:** We are aware that some lessors are permitting lessees to defer certain cash rent payments during the COVID-19 crisis in return for a promissory note to repay these amounts in full at a future date(s). For example, a lessee and a lessor may have reached an agreement to permit the lessee to defer its April and May 2020 rent payments (\$50 due in advance each month) in return for the lessee issuing a promissory note for those amounts. At the time the promissory note is signed, one or more of those payments may be past due.

In general, assuming the amount of the promissory note does not increase the ‘total payments required by the contract’ by more than an insignificant amount (see Questions 40, 50 and 60), we believe this transaction will qualify for the practical expedient.

Therefore, the question arises as to whether this transaction is subject to the same considerations as the rent deferrals addressed by [Question 120](#).

**Interpretive response:** This scenario differs from that in Question 120 because of the receipt of a financial instrument (note receivable). We believe the note receivable must be recognized and accounted for, initially and subsequently, consistent with any other note receivable (which includes necessary adjustments to reflect a market rate of interest), irrespective of a lessor’s approach to other rent deferral scenarios or which lease standard it applies (Topic 842 or Topic 840).

We believe the note receivable is recognized by:

- first, writing off any existing operating lease receivable for payments satisfied by the issuance of the note (e.g. payments for which the lessee is past due when the note is issued); and
- second, recognizing the amount of the payments satisfied by the issuance of the note not subject to an existing receivable as deferred rent.

We believe any difference between the sum of those amounts and the initial carrying amount of the note receivable should be recorded as either:

- a lessee prepayment attributable to the entire remaining lease term or a lease incentive (which will increase or reduce operating lease revenue over the remainder of the lease term, respectively); or
- positive or negative variable lease revenue (contingent rental revenue).

We believe either option is acceptable, applied consistently to similar circumstances (see [Question 20](#)), based on the FASB staff guidance.

Using the background example to illustrate, and assuming the April 2020 payment of \$50 is past due when the terms of the promissory note are agreed, the lessor would record the following entry on issuing the note (assume it is initially measured, on a discounted basis, at \$95):

	<i>Debit</i>	<i>Credit</i>
Note receivable	95 <sup>1</sup>	
Variable lease revenue (deferred lease incentive)	5 <sup>2</sup>	
Operating lease receivable		50 <sup>1</sup>
Deferred rent		50 <sup>2</sup>
Notes:		
1. April rent that is past due when the terms of the note are agreed to.		
2. May rent prepaid by the note.		

Additionally, lessors will need to continue to evaluate the collectibility of the notes receivable and the collectibility of their unpaid lease payments not subject to notes receivable (see [Question 120](#)).



## Question 122\*\*\*

**How does a sales-type/direct financing lessor account for a rent deferral as if it were part of the enforceable rights and obligations of the existing lease contract?**

**Background:** See background to [Question 110](#).

**Interpretive response:** There is no single answer to this question; multiple approaches may be acceptable depending on the facts and circumstances. The following are example scenarios and approaches thereto that we believe are acceptable.

Under the approach outlined for each scenario, the lessor does not remeasure the components of the net investment in the lease, revise the rate implicit in the lease or re-assess lease classification.

### **Scenario 1: Lease payments are increased in later periods to repay the deferred payment(s) and retain the pre-deferral rate of return on the lease**

Assuming the total payments required by the contract do not increase by a more than insignificant amount (see [Question 60](#)), the lessor:

- does *not* reduce the lease receivable during the deferral period for amounts not paid;
- continues to recognize interest income each period throughout the remainder of the lease term based on the carrying amounts of the lease receivable and the unguaranteed residual asset (and deferred selling profit, if any); and
- reduces the lease receivable in later periods for the greater amounts paid.

We believe this approach remains acceptable if the rent deferral is accompanied by a short lease term extension (e.g. 2 or 3 months), as long as the total payments required by the contract, inclusive of both the increased payments to retain the lessor's rate of return on the lease and payments for the extension periods, remain substantially the same or less than before the concession and extension.

### **Scenario 2: Lease payments are increased in later periods to repay the deferred payment(s) only**

The lessor:

- does not reduce the lease receivable during the deferral period for amounts not paid;
- recognizes interest income each period throughout the remainder of the lease term equivalent to what it would recognize had it increased the lease payments consistent with Scenario 1;
- recognizes *negative* variable lease income each period throughout the remainder of the lease term for the difference between (1) the interest income recognized in the preceding bullet and (2) the interest income it would earn based on the deferred payment schedule and a revised implicit rate (calculated based on the deferred payment schedule); and
- reduces the lease receivable in later periods for the amounts (original payment plus deferral repayment) paid.

Consistent with Scenario 1, we believe this approach remains acceptable if the rent deferral is accompanied by a short lease term extension (e.g. 2 or 3 months), as long as the total payments required by the contract, inclusive of the payments required for the extension period(s), remain substantially the same or less than before the concession and extension.

## Collectibility

As also highlighted in Question 120 on operating leases, the economic effects of the COVID-19 pandemic, including significant rent deferrals granted to the lessee, may call into question whether the lessee will be able to repay the deferred rent and other of the lease payments.

However, unlike for operating leases, collectibility is not reassessed in sales-type or direct financing leases after the commencement date, even for significant events or changes in circumstances such as the COVID-19 pandemic. Subsequent changes in the credit risk of the lessee are accounted for under the impairment guidance that applies to the net investment in the lease (i.e. Topic 326 for companies that have adopted it; Topic 310 for all others). [842-30-25-6, 35-3]



### Question 125\*\*\*

#### If Topic 842 or Topic 840 provides guidance on the 'as if' model of accounting to apply, must a company follow that guidance?

**Background:** In addition to detailed lease modification guidance, Topic 842 also provides guidance to account for some contingency scenarios that are arising in COVID-19 rent concession negotiations.

For example, assume that, together with a COVID-19 related rent concession, the non-cancellable period of the lease is shortened from 10 years to 7 years. While we believe this scenario was not envisaged by the FASB staff for its guidance, we believe some may consider the change eligible for the practical expedient because the rights of the lessor and the obligations of the lessee are *decreasing*.

**Interpretive response:** Yes. If Topic 842 or Topic 840 provides guidance about how to account for the concession as if it was part of the original contract (i.e. as if the concession was a contemplated contingency therein), the company must follow that guidance (either Topic 842 or Topic 840, whichever applies to them). The practical expedient permits companies to elect to account for COVID-19 related rent concessions as if they were part of the enforceable rights and obligations of the contract (even if it would otherwise be accounted for as a modification); it does *not* permit a company to not apply guidance in Topic 842 or Topic 840 that follows from that election if such guidance exists (as in the background scenario).

Using the background example of a substantial lease term reduction to illustrate:

- For a lessee, Topic 842 countenances lease term changes arising from a contractual contingency, and such changes are accounted for in the same manner as any other lease term changes arising from a reassessment of the lease term or a lease term modification. [842-10-35-1(b), 842-20-35-4 – 35-5]
- For a lessor, when a lessee exercises a termination option it was previously reasonably certain *not* to exercise (which is the assumption if treating this change as if it was contemplated in the original contract), that is accounted for as a lease modification. [842-10-35-3]

Therefore, it would *not* be acceptable for the lessee to apply one of the approaches in Question 110 in lieu of what Topic 842 requires, or for the lessor not to apply modification accounting.

Companies should carefully consider whether Topic 842 or Topic 840 provides guidance about how to account for a particular concession under an 'as if' election. Consultation with your accounting advisors may be necessary.

## Change of the underlying asset

We do not believe a change of the underlying asset (e.g. moving from one leased space to another, or replacing one piece of leased equipment with another) is subject to the practical expedient. This is because the right to use the replacement underlying asset is a different lease than the one that



previously existed. Both parties will generally account for the termination (which may or may not occur immediately) of the old lease separately from the accounting for the new, different lease.

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## Question 130††

### What disclosures are required about COVID-19 related rent concessions?

**Interpretive response:** Question 4 of the staff Q&A states that ‘an entity should provide disclosures about material concessions received (lessees) or granted (lessors) and the accounting effects to enable users to understand the nature and financial effect of the lease concessions related to the effects of the COVID-19 pandemic.’ In addition, at the April 8, 2020 FASB meeting, the FASB chairman stated that because the practical expedient is likely to result in diversity in practice, clear disclosure by companies of their approach to accounting for these COVID-19 driven rent concessions is important. This point was reinforced in discussions with the SEC staff.

We believe companies receiving (lessees) or granting (lessors) material COVID-19 rent concessions should consider disclosing all of the following.

- The nature of COVID-19 concessions including, for lessees, material deferred rent amounts that will come due outside of what would have been normal course.
- Whether they are electing the practical expedient and, if so, which option (the ‘as if’ option or lease modification option). If different options are being elected for different circumstances (see [Question 20](#)), companies should disclose which option is being applied to which sets of circumstances.
- If electing the ‘as if’ option, how that option is being applied if there is more than one acceptable approach (e.g. which approach a lessee is applying to rent deferrals – see [Question 110](#)).

The preceding items should be disclosed in the company’s interim period financial statements if they were not disclosed in the company’s last annual financial statements. In addition, lessees and lessors with interim reporting requirements should consider whether additional lease-related disclosures are required to comply with Topic 270 (interim reporting) as a result of COVID-19 related rent concessions or short payments. [[270-10-45-12](#) – [45-13](#), [50-1](#), [50-3](#), [50-5](#)]

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## Question 140

### Can this practical expedient be applied to concessions granted before April 8, 2020?

**Interpretive response:** Yes. We believe the practical expedient *can* be applied to a concession granted before April 8, 2020 (the date the FASB staff guidance was provided) as long as:

- the concession meets the other requirements of the practical expedient discussed herein; and
  - the company has not already accounted for the concession in issued financial statements – e.g. issued first quarter 2020 financial statements in which a concession was already accounted for as a modification; such concession would not be eligible to be accounted for as if the concession was part of the original lease contract.
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## Question 150††

### Does the practical expedient apply to non-lease components?

**Interpretive response:** No. If a lessee or a lessor separates lease from non-lease components under Topic 842 (which it must do under Topic 840), we believe it should allocate the concession (e.g. the rent forgiveness) to the lease and non-lease component(s). It then applies the practical expedient to only the lease component. It applies other Topics to account for the concession related to the non-lease component(s).

If a lessor is combining lease and non-lease components under Topic 842, and accounting for the combined component as a single Topic 606 performance obligation (see section 4.4.1 of KPMG's Handbook, [Leases](#)), we believe the practical expedient does not apply to the combined component because it is being accounted for outside the scope of the leases guidance in Topic 842.



## Evolving information

The potential global and economic impacts of the coronavirus continue to evolve rapidly, and companies should monitor the situation. Companies are encouraged to maintain close communications with their boards of directors, external auditors, legal counsel and other service providers as the circumstances progress. Stay informed at [read.kpmg.us/coronavirus](http://read.kpmg.us/coronavirus)

For more information about the effects of the COVID-19 outbreak on lease accounting, see KPMG's Hot Topic, [Lease accounting impacts of the COVID-19 virus](#).

For more information about the lessee and lessor accounting requirements in Topic 842, see KPMG's Handbook, [Leases](#).

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