



IFRS 16 Leases updates

October 2020



IFRS 16 Leases

Intro

Welcome you to IFRS 16 *Latest developments*, a snapshot of the recent amendments to IFRS 16 Leases, as well as some other relevant topics.

- Due to Covid-19 many lessors have granted rent concessions to their lessees. In the first part of this publication we analyse the challenges lessees and lessors may face when accounting for these concessions, and the IASB's response in alleviating some of them.
- Covid-19 has numerous accounting impacts. We bring your attention to the potential effect on the carrying value of Right of Use Assets under IFRS 16 and impairment considerations.
- Lastly, a non-Covid-19-related update: the IASB continues its IBOR reform project and has issued an Exposure Draft proposing to amend, amongst others, IFRS 16.

If you wish to discuss any of these topics, please contact EA PDD.



IFRS 16 Leases

IASB's response to Covid-19-related rent concessions

IFRS 16 Leases – IASB’s response to Covid-19-related rent concessions

Summary

The IASB has issued *Covid-19-Related Rent Concessions*, which amends IFRS 16 Leases, to simplify the accounting of Covid-19-related rent concessions by lessees. Prior to this amendment the IASB also issued educational material on this topic.

Background

- Due to the impact of Covid-19, many lessees are being offered **rent concessions** by their lessors.
- Rent concessions may take different forms, such as **rent deferrals or rent holidays**.
- IFRS 16’s definition of a **lease modification** includes a change in the consideration for a lease.

What challenges would modification accounting create for lessees?

- Lessees may find difficulty in **determining** whether their specific rent concessions are **lease modifications or not**.
- To account for the modification of a lease, a **revised liability** (and corresponding **adjustment to the right-of-use (“ROU”) asset**) needs to be calculated
- This involves using a **revised discount rate**, which creates operational challenges for many lessees (especially in the Retail sector).
- Additionally, if current discount rates are lower than historical rates this could lead to a **larger liability** despite the rent concession (and an increased ROU asset, which is then subject to the impairment considerations discussed later).
- Many lessees, especially in the Retail, Hospitality and Leisure sectors, have a **large volume of leases** that may be affected.

What has the IASB’s response been?

- On 28 May the IASB issued *Covid-19-Related Rent Concessions*, which amends IFRS 16. Under the amendment lessees may elect **not to assess** whether certain Covid-19-related rent concessions are lease modifications and **account for these rent concessions as if they were not lease modifications**.
- The rent concessions need to **meet certain criteria** in order to be subject to this practical expedient.
- **No changes to lessor** accounting have been made.
- The IASB also issued **educational material** on this topic on 10 April.

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Educational material issued by the IASB (10th April)

The educational material* emphasises that “the accounting required by IFRS 16 for a change in lease payments depends on whether that change meets the definition of a lease modification”. Determining this may prove challenging, especially for entities with large volumes of leases.

Definition of lease modification: a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease

Steps to account for a change in lease payments

1 Determine whether there has been a change in either the scope of or the consideration for the lease

- **Change in scope:** the guidance states that a rent holiday or rent reduction alone is not a change in scope of a lease.
- **Change in the consideration** for a lease: the guidance states that the **overall effect of any change in the lease payments** needs to be considered. For example, if a lessee does not make lease payments for a three-month period, the lease payments for periods thereafter may be increased proportionally in a way that means that the consideration for the lease is unchanged.

2 Consider whether the change was part of the original terms and conditions of the lease

- **Terms and conditions of the contract**
- **Relevant facts and circumstances** (e.g. contract, statutory or other law or regulation applicable to lease contracts).

If the change in the lease payments is the consequence of a clause in the original contract or applicable law or regulation, then there is no IFRS 16 lease modification.

3 Apply appropriate accounting

- Apply **lease modification accounting** if the change in lease payments results from a lease modification. (*)
- If the change in lease payments does not result from a lease modification, the change will generally be accounted for as a **variable lease payment in P&L for the lessee and recognition of lower income for lessors** of operating lessees.

* Please note that this guidance was issued by the IASB before the amendment to IFRS 16 was finalised. Therefore, lessees have now the option to apply the practical expedient, subject to meeting certain conditions (see following slides)

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Educational material issued by the IASB (April 2020)

There are additional accounting considerations derived from changes in lease payments that entities need to take into account

Other accounting considerations:

1 Partial lease liability extinguishment

- Consider whether the **derecognition** criteria in IFRS 9 is met for cases where the change in lease payments results in **the extinguishment of a part of a lessee’s obligation specified in the contract.**

2 Impairment of assets

- Lessees need to assess whether their ROU assets may be impaired under IAS 36, i.e. the reason for the lessee obtaining a rent concession may indicate that the assets are impaired (see slide 10 for further details).
- Lessors will need to evaluate whether items of property, plant and equipment subject to operating leases are impaired under IAS 36 rules, as well as take into account the IFRS 9 requirements for any potential impairment of lease receivables.

3 Disclosures

- Both lessees and lessors need to take into consideration the disclosure requirements in IFRS 16 and other IFRSs so that all the necessary information about the **impact of Covid-19 in their financial position, financial performance and cash flows** is provided to the users of their financial statements.

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Amendment to IFRS 16 (28th May) – Lessees

Qualifying criteria

Lessees may elect to apply a practical expedient if the rent concession meets the following criteria. In this case, lessees won’t have to assess whether the rent concession is a modification and won’t have to apply modification accounting.

- The rent concession needs to be a **direct consequence of Covid-19**;
- The **revised consideration** for the lease 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** (even though subsequent increases can fall beyond that date); and
- There is no substantive change to other terms and conditions of the lease.

Other aspects

- **Effective date:** Lessees shall apply the amendment for annual reporting periods beginning on or after 1 June 2020 (available for interim reports as well), with earlier application permitted (including in financial statements not yet authorized for issue at 28 May 2020).
- **Transition:** The amendment is to be applied retrospectively, with the cumulative effect of initially applying the amendment recognised as an adjustment to the opening balance of retained earnings (or other component of equity) at the beginning of the annual reporting period in which the amendment is first applied.
- Disclosures: where the expedient has been applied, a lessee needs to disclose:
 - That the practical expedient has been applied to **all rent concessions meeting the criteria** or, if not applied to all, information about the **contracts to which it has been applied**; and
 - The amount recognised in **P&L to reflect changes in lease payments that arise from rent concessions** to which the lessee has applied the practical expedient.

In the reporting period in which a lessee first applies the amendment, it is not required to disclose the quantitative information required by paragraph 28(f) of IAS 8.

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Amendment to IFRS 16 (28th May) – Lessors

Challenges for lessors

The amendment to IFRS 16 issued by the IASB does not reflect any changes for lessors. Some notable challenges for lessors therefore exist within the context of Covid-19:

- Lessors still need to assess the lease changes and whether these fall within existing clauses (e.g. force majeure), and determine whether they constitute lease modifications, potentially for large volumes of contracts.
- Lessors will need to determine whether variable lease payment accounting or spreading the effect of rent concessions is to be applied.
- Income recognition while not receiving cash might cause problems for lessors (e.g. future distributions).
- Other accounting considerations, such as when to recognise variable lease payments, interaction between revenue recognition and impairment requirements, etc.

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Impairment of assets

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Impairment of assets

One of the potential impacts of Covid-19 may be the loss in value of leased assets, leading to recognition of impairment losses.

Background

- IFRS 16 requires lessees to recognise a ROU asset for most leases and establishes that a lessee shall apply IAS 36 Impairment of Assets to determine whether the ROU asset is impaired and to account for any impairment loss identified.
- One of the impacts of Covid-19 may be the devaluation of some ROU assets. Following IAS 36, where there is an indicator of impairment, lessees will need to assess the recoverable amount of their leased assets (for the individual asset or as part of the cash generating unit (“CGU”) to which it relates, depending on the level of assessment required) and recognise an impairment loss if it falls below its carrying amount.

Challenges/aspects to consider

- Determine whether an assessment for impairment needs to be done at the CGU or individual asset level.
- Ensure that appropriate future estimates of cash flows have been used and that the right of use assets are included in the carrying amount of the CGU (where testing is performed at that level).
- Ensure that an appropriate discount rate has been used for IAS 36 purposes.
- Consider whether sensitivity disclosures are required under IAS 36 or whether additional disclosures are needed to clarify any areas of judgement and estimation uncertainty under IAS 1.

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IBOR Reform

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IBOR Reform

The IASB has issued the Exposure Draft *Interest Rate Benchmark Reform – Phase 2* proposing to amend IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16.

IBOR Reform – IFRS 16

- The IASB issued on 9th April 2020 an Exposure Draft (“ED”) with proposals to amend certain accounting standards as a consequence of Phase 2 of the Interest Rate Benchmark Reform (the “**IBOR Reform**”). This phase is focused on the issues that the entities’ financial reporting may encounter **during the reform** (in contrast with the issues affecting financial reporting before the reform, which were addressed in Phase 1 of the project).
- Amongst the proposals, the ED proposes to amend **IFRS 16 Leases** in respect of lease modifications that are the **direct consequence of the IBOR reform**. In this cases, and as [long](#) as the modification is made on an **economically equivalent basis**, the entity would be able to apply **paragraph 42** of IFRS 16, i.e. the entity would remeasure the lease liability [as](#) a reassessment event rather than as a modification.
- It is important to note that **if there are other modifications** done to the lease at the same time as the modification due to the IBOR reform, this **practical expedient would not apply** to any of the modifications (including the IBOR-related one).
- Effective date: annual reporting periods beginning on or after **1 January 2021**, with earlier application permitted, subject to EU endorsement (where relevant).

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