A PRACTICE AID FROM BDO'S NATIONAL ASSURANCE PRACTICE

Accounting for Lease Concessions Related to COVID-19

JUNE 2020

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THIS PRACTICE AID

This Practice Aid includes background information related to the Coronavirus Disease 2019 (referred to as COVID-19), the resulting concessions provided by lessors to lessees, and questions associated with the accounting for such concessions. It includes details on a Financial Accounting Standards Board (FASB) Staff Questions & Answers (Q&A), along with guidance and examples on how to implement the Q&A. The approaches discussed and illustrated in this Practice Aid do not purport to represent the only acceptable approaches, and actual approaches used may depend on the specific facts and circumstances of lease concessions. The Practice Aid also provides other important considerations for lessees and lessors about the impact that COVID-19 may have on other aspects of lease accounting. While the FASB Staff Q&A addresses Accounting Standards Codification (ASC) 840, *Leases*, and ASC 842, *Leases*, this Practice Aid focuses only on ASC 842. This Practice Aid also briefly discusses International Accounting Standards Board (IASB) activities and some of the key differences between FASB guidance and IASB guidance. The guidance in this Practice Aid should not be analogized to other transactions.

Background

During these challenging and uncertain times in which lessees affected by COVID-19 negotiate with their landlords to postpone or avoid making rent payments, the FASB Staff provided relief on the accounting for such concessions.

Because of the disruption caused by the Coronavirus Disease 2019 (also referred to as COVID-19), it is expected that many lessors will provide (or that many lessees will request) rent concessions. These rent concessions may take various forms and may include free (or reduced) rent, deferral of rent payments interest free, or cash payments to the lessee when operations of the lessee are interrupted or are significantly affected by COVID-19. The uncertainty about COVID-19 could also result in consecutive concessions; for example, first a rent deferral followed by a partial rent abatement in a subsequent period.

Whether a lessor concession is a modification, or a concession stipulated in the original lease contract depends on:

- The enforceable rights and obligations of the lessee and lessor in the original lease contract; for example, whether there is a force majeure or similar provision, and if so, what the terms of such provisions are; and
- The applicable laws of the jurisdiction in which the lease contract is governed.

Accordingly, the evaluation will depend on whether the lease contract or applicable law provides for changes to payments when particular events occur or circumstances arise, and whether the COVID-19 pandemic is one such event or circumstance. Such analysis may require legal assistance. This evaluation also must be performed on a lease-by-lease basis.

The potential large volume of contracts to be assessed under either ASC 842 or ASC 840 may be particularly burdensome, complex and challenging for many entities to determine whether each lease contract (or applicable law) provides enforceable rights and obligations related to those lease concessions.

If a concession is considered beyond the enforceable rights and obligations of the contract, under ASC 842 such concession will typically be accounted for as a modification of the original contract (i.e., not as a separate contract). This is because the modification will not grant the lessee any additional right of use. The modification of an existing lease will, therefore, generally require the lessee to remeasure and reallocate the remaining consideration in the contract; remeasure the lease liability using an updated discount rate; reassess lease classification; and update its accounting for the lease accordingly. A lessor is also required to reassess lease classification using updated assumptions to account for a lease concession accounted for as a modification.

Considering the anticipated large volume of concessions to evaluate and the challenges in making such evaluation, help was needed, and the FASB Staff responded. At its April 8, 2020 Board meeting, the FASB Staff discussed a technical inquiry it received related to rent concessions; specifically, whether concessions related to the effect of COVID-19 are required to be accounted for in accordance with the lease modification guidance in ASC 842 or ASC 840. The FASB Staff provided its views during that meeting and issued an FASB Staff Q&A shortly after based on stakeholder outreach it had performed.

The FASB Staff Q&A and related implementation questions will be addressed in the next sections.

FASB Staff Q&A

The FASB Staff issued a Q&A on April 10, 2020 on the accounting for lease concessions related to the effects of the COVID-19 pandemic under ASC 842, *Leases* (and ASC 840, *Leases for entities that have not yet adopted ASC 842*). The FASB Staff Q&A is available here.

ELECTION FOR LEASE CONCESSIONS RELATED TO COVID-19

The FASB Staff noted in Question 1 that the lease modification guidance in ASC 840 and ASC 842 contemplates routine changes in terms and conditions of lease contracts negotiated between lessees and lessors, but not changes rapidly executed on a global scale that arise as a result of COVID-19. Accordingly, for concessions related to COVID-19, the FASB Staff observed that an entity can decide to not analyze each contract to determine whether enforceable rights and obligations for concessions exist. Instead, an entity can elect to account for lease concessions related to the effects of COVID-19 either:

- As if the concession arises from the enforceable rights and obligations of the contract, regardless of whether the concession explicitly exists in the contract. That is, the entity accounts for the concession as if it is not a lease modification, or
- As if the concession represents a lease modification for which the entity applies the modification guidance in either ASC 842 or ASC 840.

However, the FASB Staff stated in Question 2 that because this is an election, an entity is not precluded from applying the lease modification guidance in ASC 842 or ASC 840 (as discussed in the Background section) to determine the appropriate accounting.

LEASE CONCESSIONS QUALIFYING FOR THE ELECTION

The FASB Staff noted in Question 1 that the election is available for concessions related to the effects of COVID-19 that do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. For example, the election is available for concessions that result in the total payments required by the modified contract being substantially the same as or less than total payments required by the original contract. The FASB staff expects that reasonable judgment will be exercised in making those determinations.

RENT DEFERRALS WITH NO SUBSTANTIVE CHANGES IN CONSIDERATION

The FASB Staff noted in Question 1 that a deferral of payments affects the timing, but the amount of consideration is substantially the same as required in the original contract. Accordingly, the FASB Staff observed that there were at least two acceptable approaches (noting no preference in the approach selected) to account for rent deferrals with no substantive changes to the consideration in the original contract:

- Account for the concession as if no changes to the lease contract were made.
- Account for the deferred payments as variable lease payments.

We discuss these two approaches in more detail later.

UNIT OF ACCOUNT FOR THE ELECTION

The FASB Staff noted in Question 3 that an entity is not required to account for all lease concessions related to the effects of COVID-19 either (a) as if the enforceable rights and obligations to those concessions existed in the original contract or (b) in accordance with the lease modification guidance in ASC 842 and ASC 840. However, the FASB Staff stated that entities should apply ASC 842 consistently to leases with similar characteristics and in similar circumstances in accordance with paragraph 842-10-10-1 and that reasonable judgment should be used to apply that paragraph.

DISCLOSURES

The FASB Staff noted in Question 4 that an entity should provide disclosures about material concessions granted (lessors) or received (lessees) and the accounting effects to enable users to understand the nature and financial effect of the lease concessions related to the effects of COVID-19.

Implementing the FASB Staff Q&A

PROCESSES AND INTERNAL CONTROLS

Entities that elect to not evaluate whether a concession is a modification under the FASB Staff Q&A should have appropriate processes and internal controls in place to ensure that (1) concessions qualify for the election, (2) the election is applied consistently to all concessions with similar characteristics (for example, that all concessions that are solely deferral of payments to future periods are accounted for similarly), and that (3) the appropriate disclosures are provided.

We believe there are several key steps an entity should consider in implementing the election provided in the FASB Staff Q&A:

1. Decide whether to elect to not analyze each contract for concessions received (lessees) or granted (lessors).
2. Assess whether concessions received (lessees) or granted (lessors) qualify for the election.
3. Elect to either (a) apply the lease modification guidance, or (b) not apply the lease modification guidance, to concessions.
4. Ensure the election and approach used is applied consistently for lease concessions with similar characteristics and in similar circumstances.
5. Report and disclose

SCOPE OF THE ELECTION

The FASB Staff Q&A states that the "election is available for concessions related to the effects of the COVID-19 pandemic that do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. For example, this election is available for concessions that result in the total payments required by the modified contract being substantially the same as or less than total payments required by the original contract. The FASB staff expects that reasonable judgment will be exercised in making those determinations."

UNDISCOUNTED VERSUS DISCOUNTED CASH FLOW ANALYSIS

The FASB Staff Q&A does not prescribe whether the analysis performed to determine whether the total payments required by the modified lease are substantially the same as or less than the total payments in the original lease should be based on discounted or undiscounted cash flows. We believe an entity can do either a discounted or undiscounted cash flow analysis, but the method selected should be applied consistently to all lease concessions.

TOTAL PAYMENTS VERSUS REMAINING PAYMENTS

The FASB Staff Q&A does not address whether the analysis performed to determine if a concession qualifies should be performed comparing before and after the concession: (1) the total payments due for the entire lease term, or (2) the remaining payments due for the remaining lease term. We believe an entity may perform the assessment by comparing the cash flows before and after the concession using either the total payments due for the entire lease term, or the remaining payments due for the remaining lease term. The method selected should be applied consistently to all lease concessions.

However, care should be given to determine that a concession qualifies for the election. We note the primary basis for the analysis is that the election is available for concessions related to the effects of the COVID-19 pandemic that do not result in a substantial increase in the rights of the lessor or the obligations of the lessee, and that reasonable judgment should be exercised in making the assessment. Accordingly, the evaluation comprises both a qualitative and quantitative analysis based on the specific facts and circumstances of each lease concession. For example, a lessor providing a lessee affected by COVID-19 a rent deferral of three months in exchange for an extension of the lease term by three months may qualify for the election assuming the change in total payments is substantially the same or less. In contrast, a lessor providing a lessee affected by COVID-19 a rent deferral of three months in exchange for an extension of the lease term for one year or more may not qualify for the election even if the change in total payments is substantially the same or less. Professional judgment will be required in performing the assessment based on the specific facts and circumstances of each lease concession.

CONSECUTIVE CONCESSIONS

Considering the uncertainty associated with the COVID-19 pandemic and the economic effects it could have on entities, it is possible that consecutive concessions may be provided by a lessor to a lessee for the lease of an underlying asset. For example, a lessor of a retail store to a lessee may initially agree to provide the lessee a three-month rent deferral with no other substantive changes to the consideration in the original contract. However, as the COVID-19 pandemic progresses and the financial condition of the lessee deteriorates, the lessor may provide additional concessions. In those situations, we believe an entity should apply the contract combination guidance in ASC 842-10-25-19 to determine whether the concessions should be evaluated as one combined concession or as separate concessions. Professional judgment will be required in performing this assessment.

LEASE CLASSIFICATION

The FASB Staff Q&A does not state whether the election and approaches discussed apply to only a specific lease classification. However, we believe the election and approaches discussed in the FASB Staff Q&A can be applied to all lease classifications, not just operating leases.

SHORT PAYMENTS

A unilateral decision by a lessee to not make rent payments when otherwise due is not considered a concession to which the guidance in the FASB Staff Q&A can be applied. Therefore, if a lessee in response to COVID-19 does not pay rent when due (or only pays a portion of the rent otherwise due), lessee’s and lessor’s accounting generally should not change until the parties approve changes to the rent payments, unless such absence (or reduction) of rent payment was contemplated in the original lease contract.

APPLICATION OF THE ELECTION

The FASB Staff Q&A states that "for concessions related to the effects of the COVID-19 pandemic, an entity will not have to analyze each contract to determine whether enforceable rights and obligations for concessions exist in the contract and can elect to apply or not apply the lease modification guidance in Topic 842 and Topic 840 to those contracts."

ENTITY DOES NOT APPLY LEASE MODIFICATION GUIDANCE

APPROACH SELECTED

The FASB Staff Q&A does not prescribe the approach to apply when an entity elects to not apply the lease modification guidance. Accordingly, we believe the following approaches may be acceptable depending on the nature of the concession provided:

- Account for the concession as variable lease payments; for example, a lessee and lessor would account for a rent abatement/forbearance as a negative variable lease payment in the impacted period(s), while any future repayments would be treated as a positive variable lease payment.
- Account for the concession as the resolution of a contingency (for lessees only); that is, a lessee would remeasure the lease on the balance sheet but would not reassess lease classification, nor update the discount rate for the lease. Any resulting difference in the carrying amount of the lease liability would generally be recognized as an adjustment to the carrying amount of the right-of-use (ROU) asset.

An entity should also be consistent in its approach selected for lease concessions with similar characteristics and in similar circumstances.

RENT DEFERRALS

The FASB Staff Q&A specifically discusses payment deferrals and provides two acceptable approaches (with no preference on the approach selected):

- Account for the concession as if no changes to the lease contract were made. This means that lessee's and lessor's accounting for the lease would be unaffected in the income statement. On the balance sheet, a lessee would debit its lease liability and credit a payable account for the period in which payment is deferred and debit the payable account when the payment is subsequently made. A lessor would similarly adjust its lease receivable to reflect the change in timing of payments.
- Account for the concession as variable lease payments. This means that a lessee and lessor would account for the concession as a negative variable lease payment in the periods that payments are deferred, and as additional positive variable lease payments in the periods in which the previously deferred payments are due or receivable.

There could be other approaches to account for rent deferrals. For example, a lessee may in some cases account for rent deferrals as the resolution of a contingency resulting in the remeasurement of the lease on the balance sheet with no reassessment of lease classification or update of the discount rate for the lease.

ENTITY APPLIES THE LEASE MODIFICATION GUIDANCE

If a lease concession is accounted for as a modification, it will typically be accounted for as a modification of the original contract under ASC 842 (i.e., not as a separate contract). This is because the modification generally will not grant the lessee any additional right of use. In those situations, the entity will:

- Remeasure the consideration and, if there is a lease component and at least one nonlease component, reallocate the remaining consideration in the contract unless:
    - If a lessee, it made the accounting policy election to not separate lease and nonlease components described in paragraph 842-10-15-37, or
    - If a lessor, it made the accounting policy election in accordance with paragraph 842-10-15-42A and met the conditions for not separating the components in the contract;
- Reassess lease classification in accordance with paragraph 842-10-25-1, and
- Update the accounting for the lease accordingly:
    - If a lessee, remeasure the lease liability and the carrying amount of the right-of-use asset as appropriate consistent with the guidance in paragraphs 842-10-25-11 through 25-14,
    - If a lessor, consistent with the guidance in paragraphs 842-10-25-15 through 25-17 based on whether lease classification changed.

Lease Concessions Not Accounted for As Modifications – Application Examples

RENT DEFERRAL EXAMPLE

- Lessee entered into a lease agreement for retail space with Lessor. The lease term is from January 1, 2019 to December 31, 2024.
- Lessee pays $1,000 in arrears at the end of each month, with a 2% increase annually.
- Lessee pays its rent on time for the periods from January 2019 through March 2020.
- Starting in March 2020, the effects of COVID-19 cause Lessee to experience a significant decrease in store sales and to temporarily close the store based on a local mandate.
- Lessee approaches Lessor early April 2020 to discuss potential rent concessions, and Lessor agrees to defer rents due in April, May and June 2020 to October, November and December 2020, respectively.
- The lease is classified as an operating lease. There are no nonlease components, initial direct costs or lease incentives.

LESSEE INITIAL ACCOUNTING

- Lessee's discount rate for the lease was 5%.
- The initial balance of the lease liability and ROU asset was $65,094 on January 1, 2019. At March 31, 2020, the carrying amount of the lease liability and of the ROU asset are $53,777 and $53,067, respectively.
- Lessee recognizes straight-line lease expense of $1,051 monthly from January 2019 through March 2020.

LESSEE ACCOUNTING FOR THE CONCESSION

- Lessee elected to not analyze each contract for concessions consistent with the FASB Staff Q&A.
- Lessee evaluates the concession and determines that it qualifies for the election. This is because the concession is related to the effects of COVID-19 and the rights of Lessor and obligations of Lessee are substantially the same before and after the concession (the total payments are substantially the same).

SCENARIO 1 - LESSEE ELECTS TO ACCOUNT FOR THE CONCESSION AS IF THERE WERE NO CHANGES TO THE LEASE CONTRACT

In this scenario, Lessee accounts for the concession, as follows:

- Lessee continues to recognize straight-line lease expense of $1,051 monthly (i.e., there are no changes in the income statement).
- Lessee does not remeasure the lease liability and ROU asset. However, Lessee records the rent payments otherwise due in April, May and June 2020 separate from the lease liability in another payables account (otherwise, interest will continue to accrue on those deferred payments and the carrying value of the lease liability will not reduce to zero at the end of the lease term).
- Lessee reduces the other payables account previously credited in April, May and June 2020 when the payments are made in October, November and December 2020.

SCENARIO 2 - LESSEE ELECTS TO ACCOUNT FOR THE CONCESSION AS VARIABLE LEASE PAYMENTS

In this scenario, Lessee accounts for the concession, as follows:

- Lessee continues to recognize straight-line lease expense of $1,051 monthly.
- However, in each period in which rent is deferred (i.e., April, May and June 2020), Lessee recognizes negative variable lease expense of $1,020 (the amount otherwise due) with a corresponding reduction in the lease liability. Total lease expense recognized in each of those periods will be $31 (i.e., $1,051 less $1,020).
- In each period in which the previously deferred rent is now due (i.e., October, November and December 2020), Lessee recognizes additional variable lease expense of $1,020. Total lease expense recognized in each of those periods, therefore, will be $2,071 (i.e., $1,051 plus $1,020).

OTHER APPROACHES

The above two scenarios are examples only of acceptable approaches. For example, the lessee could also account for the deferral of payments as the resolution of a contingency resulting in the remeasurement of the lease on the balance sheet with no reassessment of lease classification or update of the discount rate for the lease.

LESSOR INITIAL ACCOUNTING

- Because the lease is an operating lease, Lessor continues to recognize the underlying asset on its balance sheet and continues to depreciate it.
- Lessor determines collection of the lease payments is probable at the commencement date and, therefore, recognizes straight-line lease income of $1,051 monthly from January 2019 through March 2020.

LESSOR ACCOUNTING FOR THE CONCESSION

- Lessor elected to not analyze each contract for concessions consistent with the FASB Staff Q&A.
- Like Lessee, Lessor evaluates the concession and determines that it qualifies for the election.
- Lessor determines collection of the lease payments continues to be probable at the date of the concession.

SCENARIO 1 - LESSOR ELECTS TO ACCOUNT FOR THE CONCESSION AS IF THERE WERE NO CHANGES TO THE LEASE CONTRACT

In this scenario, Lessor continues to recognize straight-line lease income of $1,051 monthly (i.e., there are no changes in the income statement). Lessor simply adjusts its lease receivable to reflect the deferral of some of the payments.

SCENARIO 2 - LESSOR ELECTS TO ACCOUNT FOR THE CONCESSION AS VARIABLE LEASE PAYMENTS

In this scenario, Lessor accounts for the concession as follow:

- Lessor continues to recognize straight-line lease income of $1,051 monthly.
- However, in each period in which rent is deferred (i.e., April, May and June 2020), Lessor recognizes negative variable lease income of $1,020 (the amount otherwise receivable) with a corresponding reduction in the lease receivable. Total lease income recognized in each of those periods will be $31 (i.e., $1,051 less $1,020).
- In each period in which the previously deferred rent is now due (i.e., October, November and December 2020), Lessor recognizes additional variable lease income of $1,020. Total lease income recognized in each of those periods, therefore, will be $2,071 (i.e., $1,051 plus $1,020).

RENT FORGIVENESS EXAMPLE

- Lessee entered into a lease agreement for retail space with Lessor. The lease term is from January 1, 2019 to December 31, 2024.
- Lessee pays $1,000 in arrears at the end of each month, with a 2% increase annually.
- Lessee pays its rent on time for the periods from January 2019 through March 2020.
- Starting in March 2020, the effects of COVID-19 cause Lessee to experience a significant decrease in store sales and to temporarily close the store based on a local mandate.
- Lessee approaches Lessor early April 2020 to discuss potential rent concessions, and Lessor agrees to reduce rent by 50% for April, May and June 2020 assuming the local mandate is still in place through June 2020.
- The lease is classified as an operating lease. There are no nonlease components, initial direct costs or lease incentives.

LESSEE INITIAL ACCOUNTING

- Lessee's discount rate for the lease was 5%.
- The initial balance of the lease liability and ROU asset was $65,094 on January 1, 2019. At March 31, 2020, the carrying amount of the lease liability and of the ROU asset are $53,777 and $53,067, respectively.
- Lessee recognizes straight-line lease expense of $1,051 monthly throughout the lease term.

LESSEE ACCOUNTING FOR THE CONCESSION

- Lessee elected to not analyze each contract for concessions consistent with the FASB Staff Q&A.
- Lessee evaluates the concession and determines that it qualifies for the election. This is because the concession is related to the effects of COVID-19 and the total payments required after the concession are less than the total payments required by the original contract.

SCENARIO 1 - LESSEE ELECTS TO ACCOUNT FOR THE CONCESSION AS VARIABLE LEASE PAYMENTS

In this scenario, Lessee accounts for the concession, as follow:

- Lessee continues to recognize straight-line lease expense of $1,051 monthly.
- However, in each period in which rent is partially forgiven (i.e., the months in which the local mandate still is in effect), Lessee recognizes negative variable lease expense of $510 (50% of the amount due in those periods, which is $1,020), with a corresponding reduction in the lease liability. Total lease expense recognized in each of those periods affected by the local mandate, therefore, will be $541 (i.e., straight-line rent of $1,051 less $510 of rent forgiven), excluding any proration for when the mandate expires.

SCENARIO 2 - LESSEE ELECTS TO ACCOUNT FOR THE CONCESSION AS THE RESOLUTION OF A CONTINGENCY

Assume the same facts as above, except that Lessor agrees to reduce rent by 50% for April, May and June 2020 (i.e., there is no condition on the local mandate still being in effect through June). One acceptable approach that Lessee may apply is to account for the concession as the resolution of a contingency. Because there are no nonlease components, Lessee would remeasure the consideration in the contract for the change in payments and remeasure the lease liability with a corresponding adjustment to the ROU asset. Lessee would not reassess lease classification nor update the discount rate for the lease. However, Lessee's approach should be consistent with similar lease concessions.

Other Considerations

ELECTION NOT MADE OR CONCESSION DOES NOT QUALIFY

An entity that decides not to avail itself of the FASB Staff Q&A election (or that has concessions that do not qualify for the election) must determine whether the concession or other changes granted were stipulated in the original contract (and applicable laws governing the lease contract). This evaluation is performed on a lease-by-lease basis. If it is determined that the concession was not contemplated in the original contract, the entity would apply the lease modification guidance as discussed on page 9 of this Practice Aid.

OTHER LESSEE ACCOUNTING CONSIDERATIONS

REMEASUREMENT EVENTS

A lessee considers all relevant contractual provisions of a lease in determining the lease term at the commencement date, including renewal and termination options. Only those options that are reasonably certain of exercise by the lessee (or that the lessor controls) affect the initial measurement of the lease. A lessee then typically reassesses the lease term or a lessee purchase option when there is a lease modification not accounted for as a separate contract, when a significant event or a change in circumstances that is within the lessee's control occurs, when the lessee elects to exercise an option previously not deemed reasonably certain of exercise (for example, a termination option), or when the lessee elects not to exercise an option it previously deemed reasonably certain of exercise (for example, a renewal option). In the current environment, lessees should exercise care in monitoring and timely identifying all events and changes in circumstances requiring a reassessment of the lease term or a lessee purchase option and remeasurement of the lease. Note that events or changes in circumstances indicating that a right-of-use asset is not recoverable would not in isolation result in a remeasurement of the lease absent significant events or changes in circumstances that are within the lessee's control.

AMORTIZATION OF RIGHT-OF-USE ASSET

While an underlying asset may be used on a reduced basis or may not be in current use (for example, a retail store is currently closed either voluntarily or through a government mandate), we generally believe that a lessee should continue to amortize the ROU asset consistent with the guidance in ASC 360 on temporarily idled property, plant and equipment.

ROU ASSET IMPAIRMENT AND ABANDONMENT

Lessees should monitor whether there are any indications of right-of-use asset impairment; for example, a retail store that a lessee leases with an expected significant decrease in future cash flows from sales, or a warehouse leased on a long-term basis for which a lessee's plans may change (such as abandonment). Right-of-use assets are tested by lessees for impairment in accordance with ASC 360-10 on property, plant or equipment. Even if a right-of-use asset is not impaired, a lessee may have to reassess (shorten) the useful life of the asset as appropriate (for example, when the right-of-use asset is part of a larger asset group that is not impaired, but the entity plans on abandoning the underlying asset before the end of the initial lease term). In the current environment, lessees should exercise care in monitoring and timely identifying triggering events requiring impairment testing and reassessment of useful lives. Also, while charges that are considered lease payments (whether fixed or variable) are excluded from the guidance in ASC 420 on exit or disposal cost obligations, if the lease contract includes nonlease components and the lessee elected to separate the lease and nonlease components, the lessee should accrue the portion of fixed payments and estimated variable payments allocated to the nonlease components on the cease-use date of an underlying asset subject to a lease.

OTHER LESSOR ACCOUNTING CONSIDERATIONS

OPERATING LEASES

A key tenet of lessors' accounting for operating leases on a straight-line basis relates to a lessor's assessment that collection of the lease payments plus any amounts to satisfy a residual value guarantee is probable. This assessment is performed at the commencement date and throughout the lease term. If collection is not probable, lease income is limited to the lesser of (a) the income recognized on a straight-line basis, plus variable lease payments, and (2) lease payments collected by the lessee, including variable lease payments. In the current environment, lessors should exercise additional care in performing this collectability assessment to confirm that accounting for an operating lease on a straight-line basis continues to be appropriate.

Lessors with operating leases will also apply ASC 360 to determine whether its long-lived assets are impaired and to measure any impairment.

DIRECT FINANCING AND SALES-TYPE LEASES

Lessors will evaluate whether their net investment in leases associated with sales-type and direct financing leases should be impaired. Such assessment will depend on the accounting framework currently applicable to the lessor (e.g., whether the lessor adopted ASC 326 on credit losses). In the current environment, the level of judgment in assessing/determining impairments generally will increase.

EFFECTIVE DATE OF ASC 842 FOR PRIVATE COMPANIES AND CERTAIN NFPS

Considering the business disruption, resource constraints, dislocation, and other priorities that entities face with the COVID-19 pandemic, the FASB decided to defer the effective date of ASC 842 by an additional year for private companies and certain not-for-profit entities (NFPs). Specifically, for private companies and private NFPs, the leasing standard will be effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. For public NFPs that have not yet issued financial statements or made financial statements available for issuance as of June 3, 2020, the leasing standard will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption continues to be permitted. The final Accounting Standards Update can be accessed **here**.

IASB Activities

IASB AMENDMENTS

The IASB discussed COVID-19-related rent concession questions at a Board meeting and issued proposed amendments on April 24, 2020, which was open for public comment until May 8, 2020. The IASB held a supplementary meeting on May 15, 2020 to discuss feedback on the proposal. The IASB issued final amendments to International Financial Reporting Standards (IFRS) 16, *Leases*, on May 28, 2020. The amendments to IFRS 16 can be accessed here.

IFRS 16 provides guidance on how lessees should account for changes in lease payments, including concessions, and requires lessees to assess individual lease contracts to determine whether the concessions are to be considered lease modifications. If considered a lease modification, the lessee must remeasure the lease liability using a revised discount rate. Like applying ASC 842, applying these IFRS 16 requirements could be practically difficult especially if the number of COVID-19-related concessions is significant, and especially considering the many other challenges stakeholders face during the pandemic.

The amendments issued, therefore, give timely relief to lessees when applying IFRS 16 to COVID-19-related rent concessions by exempting lessees from having to assess whether such concessions are lease modifications. Instead, lessees will account for these concessions as if they were not lease modifications. Certain conditions, however, are required to qualify for the practical expedient. A lessee applying the practical expedient will be required to disclose the amount recognized in profit or loss to reflect changes in lease payments that arise from COVID-19-related rent concessions. The amendments do not provide similar relief to lessors, and as such, a lessor will continue to be required to determine whether any concessions granted meet the definition of a modification. The amendment is effective June 1, 2020, but lessees can apply the amendment immediately in any financial statements—interim or annual—not yet authorized for issue.

APPLYING THE AMENDMENTS

For additional information on the amendments to IFRS 16, including practical effect, illustrative examples, and a flowchart on how the practical expedient created by the amendments is evaluated, please click here.

OTHER IASB ACTIVITIES

The amendments to IFRS 16 supplement educational materials that the IASB published on April 10, 2020 and which can be accessed here. Education materials are intended to support the consistent application of IFRS requirements. The educational materials published in April 2020 provide a general description of the various requirements of IFRS 16 applicable to lease concessions, such as determining whether a change in payments is a lease modification, and how to account for changes in payments that are not lease modifications.

IASB PRACTICAL EXPEDIENT VS. FASB STAFF Q&A

There are several key differences between the IASB amendments and the FASB Staff Q&A. Accordingly, entities applying both IFRS and US GAAP should remain mindful of the differences in guidance. Some of the key differences include:

	FASB STAFF Q&A	IASB AMENDMENTS
Scope		
Entities	Applies to lessees and lessors.	Applies to lessees only.
Transactions	Available for concessions related to the effects of the COVID-19 pandemic that do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. For example, this election is available for concessions that result in the total payments required by the modified contract being substantially the same as or less than total payments required by the original contract. The FASB Staff expects that reasonable judgment will be exercised in making those determinations.	Applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions 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 June 30, 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before June 30, 2021 and increased lease payments that extend beyond June 30, 2021); and ▶ there is no substantive change to other terms and conditions of the lease.
Application		
Accounting Model	Account for lease concession either as a lease modification or as if the change was not a modification (i.e., as if enforceable rights and obligations for those concessions existed).	Account for lease concession as if the change was not a modification.

Contacts

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