



IMPLICATIONS OF COVID-19 FOR LESSORS (IFRS 16 *LEASES*)

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BACKGROUND

On 28 May 2020, the IASB issued amendments to IFRS 16, which provide relief for lessees in accounting for rent concessions granted as a direct consequence of COVID-19. The global pandemic has resulted in many different types of concessions being agreed between lessors and lessees, including rent deferrals, rent abatement/forgiveness and many other types of relief. The IASB decided to amend IFRS 16's requirements for lessees to simplify the lessee accounting requirements for rent concessions. BDO has released [IFR Bulletin 2020/11](#), which discusses the amendments to IFRS 16 applicable to lessees.

ACCOUNTING IMPACT

Lessors must apply the existing requirements of IFRS in accounting for leases. As opposed to requirements applicable to lessees, IFRS 16 was not amended to provide a practical expedient to lessors.

LESSORS

The IASB did not amend the accounting requirements for lessors. Despite every concession provided to a lessee having a corresponding effect on the lessor, the IASB noted that the circumstances differ for lessors. In addition, any changes made to lessor accounting could have had unintended consequences because they could have introduced differences between the accounting for lease and non-lease components. Therefore, lessors must apply the existing requirements of IFRS in accounting for rent concessions. The requirements applying to lessors did not change substantially from IAS 17 (the predecessor standard to IFRS 16), however, the types of concessions being agreed to as a result of the global pandemic have raised numerous issues that many lessors have not previously had to account for.

A practical consequence of the IASB not extending a practical expedient to lessors is that lessors must analyse each concession provided to a lessee to determine whether it meets the definition of a lease modification (see FAQ 1.5).

FREQUENTLY ASKED QUESTIONS (FAQs)

Accounting for rent concessions and other financial reporting implications for lessors has resulted in numerous questions. This publication includes responses to several FAQs BDO has encountered in practice as they relate to lessors. For further information on the general requirements of IFRS 16 as applicable to lessors, please refer to IFRS 16 In Practice, which is available at BDO's [IFRS Microsite](#).

Where this publication indicates that there is more than one acceptable approach, it will also be important to consider the views of local regulatory authorities before concluding on the appropriate approach.

These FAQs are organised as follows:

- Section 1: operating leases FAQs
- Section 2: operating leases - modification FAQs
- Section 3: finance lease - FAQs

SECTION 1 - OPERATING LEASE FAQs

FAQ 1.1: the effects of COVID-19 have significantly increased the risk that a lessee will not be able to make lease payments as required by the lease. What approaches are permitted for the recognition of operating lease income when the collectability of lease payments is uncertain?

Unlike IFRS 15, IFRS 16 does not require some threshold of collectability to be assessed before operating lease income may be recognised. Although an operating lessor will typically recognise operating lease income on a straight line basis in accordance with IFRS 16.81, IFRS does not contain specific requirements that apply when there is collection uncertainty. Consequently multiple approaches may be viewed as being acceptable.

Approach 1

An approach that was often followed in accordance with the predecessor standard to IFRS 16, IAS 17, was to continue to recognise operating lease income and test operating lease receivables for impairment (see FAQ 1.2). The recognition of operating lease income would cease when the lease contract is no longer in force, for example, if the lessor exercises its contractual right to evict a tenant on account of payment delinquency.

Support for this approach in accordance with the requirements of IFRS 16 links to IFRS 16.81 (above) and the fact that IFRS 16 does not require a collectability criterion to be met in order for operating lease income to be recognised. In addition, because IFRS 16 contains requirements for income recognition, it is not appropriate to analogise to another IFRS or GAAP using the hierarchy in IAS 8.

BDO's view is that this is the most supportable of the views set out in this Q&A.

Approach 2

An alternative would be to recognise operating lease income to the extent that the lessor believes it is collectible. Support for this approach comes from the lack of specific requirements in IFRS 16 for collectability. In addition, it would result in any asset that was recognised meeting the definition of an asset in the Conceptual Framework, whereas continuing to recognise income on a straight line basis could, at a time of very significant uncertainty over collectability, result in a receivable being recognised that does not meet the IFRS definition of an asset.

For example, on 1 January 2019, lessee and lessor enter into a contract for the lease of retail space for a lease term of 5 years, with lease payments of CU 100 per month paid in advance. The lessee makes all payments due under the terms of the contract from January 2019 - March 2020. From 1 April 2020, the lessor expects there is significant uncertainty that it will be able to collect CU 100 per month. The lessee indicates they will only be able to pay CU 40 for April 2020. Lessor believes only CU 40 will be collectible due to the significant financial difficulties the lessee is experiencing due to the effects of COVID-19.

Approach	Journal entries for April 2020
Approach 1 - accrue gross lease income and record ECL	To record gross lease income:
	DR operating lease receivable 100
	CR operating lease income 100
	To record ECL:
Approach 2 - accrue to the extent collectible	DR expected credit loss 60
	CR operating lease receivable 60
Approach 2 - accrue to the extent collectible	DR operating lease receivable 40
	CR operating lease income 40

FAQ 1.2: how does a lessor account for operating lease receivables subsequent to initial recognition?

Subsequent to the recognition of operating lease income, the receivable arising from the lease contract is subject to the impairment requirements of IFRS 9, therefore, expected credit losses (ECL) must be recognised. The expected credit loss requirements apply to all types of receivables that arise from applying the lessor requirements of IFRS 16. Specific to operating type leases, these include:

- Amounts currently receivable (e.g. CU 100 of rent due for a particular month); and
- Receivables that arise from the ‘smoothing’ of operating lease income. For example, if the timing of cash payments in an operating lease is deferred (e.g. an initial 6 months ‘rent-free period’), then a lease receivable will be recorded during that period, despite cash not being contractually due until a later period.

In both cases, the ECL requirements of IFRS 9 apply, as these are ‘operating lease receivables recognised by a lessor’ (IFRS 9.2.1(b)(i)). The impairment requirements of IAS 36 apply to the underlying assets that are subject to the lease in an operating type lease (e.g. a right-of-use asset, property plant and equipment, etc.).

IFRS 9 permits an accounting policy choice for lessors in how they account for ECL relating to lease receivables. This accounting policy choice may be made separately for operating and finance lease receivables.

A lessor may choose to:

- (a) Recognise ECL in accordance with IFRS 9’s ‘default’ ECL requirements, which requires the recognition of either a 12-month or lifetime ECL depending on whether the receivable’s credit risk has increased significantly since initial recognition; or
- (b) Always recognise lifetime ECL.

Always recognising lifetime ECL means that lessors do not need to track the change in credit risk of lease receivables, which simplifies measurement, and in many cases, 12-month and lifetime ECL may result in the same figure for short-term receivables, such as many operating lease receivables.

The effects of COVID-19 may increase the amount of ECL recognised relating to lease receivables, due to the disruptive effects of the pandemic (e.g. shutdown of operations, reduced consumer spending, etc.). In measuring ECL, lessors must estimate the credit losses as the difference between:

- (a) All contractual cash flows that are due to the entity in accordance with the contract; and
- (b) All the cash flows that the entity expects to receive (i.e. the cash shortfalls), discounted at the original effective interest rate.

In many cases, the effective interest rate of an operating lease receivable will be zero, as most operating lease receivables are short-term in nature and do not accrue interest.

In estimating the cash shortfalls, lessors must consider how they expect both their own actions and actions taken by lessees will affect the cash flows to be received by the lessor. For example, if a lessor expects that it will enter into concessions with lessees (e.g. reductions in rent), then this should be considered in estimating the cash shortfalls.

This means that, despite a concession not being effective as at the date that a lessor measures ECL, the lessor must consider the actions it expects to take, and the effect of those actions on cash flows. For example, the cash flows a lessor would receive will differ depending on whether a lessor exercises a right that it may have to evict a tenant due to delinquency in payment versus the cash flows a lessor would receive if it enters into a rent concession to increase the chances that a lessee will remain economically viable in the long-term.

ECL is an ‘expected value’, meaning that it considers multiple potential scenarios, therefore, a lessor might probability-weight the likelihood that it will enter into lease concessions or take other actions that will affect the cash shortfalls.

FAQ 1.3: the effects of COVID-19 have caused many lessors to restrict access to underlying assets (e.g. real estate, offices, retail locations, etc.). As a result, can lessors change the basis over which they recognises operating lease income?

IFRS 16.81 states that:

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.

Lessors will have developed an accounting policy for leases prior to the effects of COVID-19. In practice, most operating lease income is recognised on a straight-line basis, as this generally represents the pattern in which benefit from the use of the underlying asset is diminished. It is rare that another basis of recognition is more representative.

For a lessor to change its accounting policy, it would have to satisfy the requirements of IAS 8.14(b), which requires that a change in accounting policy that is not required by an IFRS must 'results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.'

Rarely would a change in the pattern of recognition of operating lease income due to COVID-19 satisfy this requirement. For example, suspending the recognition of operating lease income because the underlying asset's availability to the lessee has been diminished due to government imposed lockdown would generally not better represent the pattern in which the benefit from the use of the underlying asset is diminished. This is because the lessee still has the right to direct use of the asset based on the lease contract during a period of lockdown or restriction; those rights are simply modified by changes in local law or regulation.

FAQ 1.4: the effects of COVID-19 have caused many lessors to restrict access to underlying assets (e.g. real estate, offices, retail locations, etc.). Can lessors suspend or modify the basis for depreciating the underlying asset (e.g. a building when tenants are not permitted to access it due to government lockdown)?

Generally, no. IAS 16.50 requires the depreciable amount of an asset to be allocated on a systematic basis over its useful life. IAS 16.55 requires that (emphasis added):

*...Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. Therefore, **depreciation does not cease when the asset becomes idle** or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero when there is no production.*

Therefore, the use of an underlying asset, such as a building, being diminished due to the effects of COVID-19 does not justify or result in the cessation of depreciation.

FAQ 1.5: what is a lease modification?

IFRS 16, Appendix A defines a lease modification as:

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 (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Therefore, in determining whether a lease modification has occurred and the requirements applicable to operating lease modifications should be applied (see Section 2), a lessor must determine whether the change in consideration results from the original terms and conditions of the lease.

This assessment is important, because the requirements of IFRS 16 differ significantly depending on whether a change in consideration results from a lease modification or the original terms and conditions of a lease. See FAQs 1.6 and 2.1.

For example, lessee and lessor enter into a contract for the lease of retail space for a lease term of 5 years, with lease payments of CU 100 per month. Consider the following three variations on the fact pattern:

Fact Pattern	Lease Modification?
Scenario A - original lease contract contains a clause that if the shopping centre is shut down due to government imposed intervention, then the lessee will receive a 75% discount on lease payments for as long as the shopping centre remains closed.	This is not a lease modification because the change in consideration results from the original terms and condition of the lease. The lessor does not account for the change in consideration as a lease modification. See FAQ 1.6.
Scenario B - original lease contract does not contain the clause as noted in Scenario A. Instead, the lessor negotiates with the lessee that the lessor will forgive 75% of monthly lease payments for the next 3 months.	This is a lease modification because the change in consideration does not result from the original terms and conditions of the lease. The lessor accounts for the change in consideration as a lease modification. See FAQ 2.2.
Scenario C - original lease contract does not contain the clause as noted in Scenario A. The local government passes a law requiring lessors to reduce lease payments by 75% for the next 3 months.	This is not a lease modification because the original lease contract is unchanged. The lease contract is subject to the laws and regulations in the applicable jurisdiction, therefore, a change in lease payments due to a change in laws and regulations are considered to be part of the original terms and conditions of the lease. This is so even if the effect of those changes in laws and regulations were not previously contemplated.

Some lease contracts contain clauses that may trigger changes to existing terms and conditions, including lease payments, if uncertain future events occur. An example of this are 'force majeure' clauses, which may apply if certain unexpected events occur, which interfere with the ability of one or both parties to a contract to fulfil their contractual obligations. Such clauses vary among different jurisdictions and therefore need to be assessed at an individual contract level as to whether such clauses mean that the effects of unexpected events on a lease are covered by existing terms and conditions of a contract or are a lease modification.

FAQ 1.6: how does a lessor account for a change in consideration that is not a lease modification?

If a change in consideration is not a lease modification (e.g. Scenarios A and C in FAQ 1.5), a lessor would account for these payments as if they were part of the original terms and conditions of the lease. IFRS 16 does not contain specific requirements for how a lessor recognises the effect of variable lease payments, however, IFRS 16.90(b) requires disclosure of 'income relating to variable lease payments that do not depend on an index or rate', implying that such payments are included in profit or loss, similar to the requirement for lessees.

Therefore, lessors will generally reflect variable lease payments that do not depend on an index or rate in profit or loss in the period in which the event or condition that triggers those payments occurs.

For example, in Scenario A in FAQ 1.5, the lessor would reflect the reduction in operating lease income in each of the periods where the reduction is triggered by the shopping centre remaining closed. Therefore, if monthly operating income would have otherwise been CU 100 per month, the lessor would record CU 25 (CU 100 - 75% reduction) of operating lease income.

SECTION 2 - OPERATING LEASES: MODIFICATION FAQs

FAQ 2.1: how does a lessor account for changes in operating lease payments that are presently due and receivable?

The derecognition and impairment requirements of IFRS 9 apply to finance lease receivables and operating lease receivables recognised by lessors, therefore, if a lessor forgives or partially forgives operating lease receivables, the requirements of IFRS 9 should be considered.

IFRS 9.3.2.3(a) requires that a financial asset (e.g. an operating lease receivable) be derecognised when the contractual rights to the cash flows from the financial asset expire. Therefore, if a lessor forgives or partially forgives lease payments, then the derecognition requirements of IFRS 9 apply, assuming that the forgiveness is not conditional.

IFRS 9.3.2.12 requires that on derecognition of a financial asset, the difference between the carrying amount (measured at the date of derecognition) and the consideration received) shall be recognised in profit or loss.

Therefore, a lessor must first apply the ECL requirements of IFRS 9 (see FAQ 1.2) before applying IFRS 9.3.2.12.

Although the forgiveness of lease receivables appears to be in the scope of IFRS 9, it could also be interpreted to be a lease modification (see FAQ 2.2), because the forgiveness results in revised consideration for the lease in total.

Applying the derecognition requirements of IFRS 9 to operating lease receivables results in the effect of the forgiveness (net of any related ECL provision) being recorded in profit or loss when the operating lease receivable satisfies the derecognition criteria in IFRS 9.3.2.3(a), whereas applying lease modification requirements results in the forgiveness being spread forward over the remaining lease term.

In our view, either approach is acceptable, as long as an entity applies that approach consistently and discloses its accounting policy appropriately.

The following two examples demonstrate how an IFRS 9 approach and an IFRS 16 approach may be applied to a common fact pattern.

FAQ 2.1: how does a lessor account for changes in operating lease payments that are presently due and receivable?

Example A - change in operating lease payments that are presently due and receivable (IFRS 9 approach)

Lessor entered into a lease with Lessee on 1 January 2019 for a lease term of 5 years. Monthly operating lease payments are CU 100 per month (CU 100 * 60 months = CU 6,000 total consideration).

On 1 May 2020, Lessee had not paid March and April 2020 rent.

Lessor first records ECL relating to the CU 200 of operating lease receivables for March and April 2020, which is assumed to be CU 75:

DR expected credit loss	75	
CR operating lease receivable		75

Lessor then enters into negotiations with Lessee and agrees to reduce March and April 2020 rent to CU 50 due to the effects of the pandemic. The Lessee then pays the other outstanding lease receivables. The forgiveness of rent is unconditional. The lessor uses an IFRS 9 approach, as noted in this FAQ.

The net carrying value of the operating lease receivable is now CU 125 (CU 200 - CU 75). Lessor then applies IFRS 9.3.2.12 to derecognise the remaining operating lease receivable that has been unconditionally forgiven:

DR profit or loss	25	
CR operating lease receivable		25

CU 25 is the amount required to bring the net carrying value of the operating lease receivable to CU 100 (CU 125 - CU 25), which is equal to the amount of the operating lease receivable that has not been forgiven by the Lessor (CU 50 * 2 months). When the Lessor collects the remaining outstanding rent (CU 50 * 2 = CU 100) shortly thereafter:

DR cash	100	
CR operating lease receivable		100

Example B - change in operating lease payments that are presently due and receivable (IFRS 16 approach)

Same fact pattern as Example A except the lessor uses an IFRS 16 approach, as noted in this FAQ.

Lessor first records ECL on 30 April 2020 relating to the CU 200 of operating lease receivables for March and April 2020, which is assumed to be CU 75:

DR expected credit loss	75	
CR operating lease receivable		75

The net carrying value of the operating lease receivable is now CU 125 (CU 200 - CU 75). On 1 May 2020, following negotiations with Lessee, Lessor then applies IFRS 16.87 to account for the modification of the operating lease. Before accounting for the modification, the Lessor reverses the previously recorded expected credit losses. This is because the amount of the receivable forgiven is an accrued lease payment, and IFRS 16.87 requires 'prepaid or accrued lease payments relating to the original lease' to be considered part of the lease payments for the new lease.

DR operating lease receivable	75	
CR expected credit loss		75

FAQ 2.1: how does a lessor account for changes in operating lease payments that are presently due and receivable?

When the Lessor collects the remaining outstanding rent (CU 50 * 2 = CU 100) shortly thereafter:

DR cash	100	
CR operating lease receivable		100

The remaining receivable of CU 100 is considered a lease incentive relating to the new lease, because the rent forgiven adjusts the total consideration for the new lease. To recognise the remaining forgiven CU 100 of previously accrued rent as a lease incentive:

DR lease incentive	100	
CR operating lease receivable		100

After these entries have been recorded, a CU 100 lease incentive asset remains, which is included in the determination of operating lease income from May 2020 - December 2023.

Lease income for the 'new lease' is recorded for May 2020:

DR operating lease receivable	100	
CR operating lease income		100

The recognised lease incentive is amortised against operating lease income (CU 100 lease incentive / 44 months = 2.28 per month).

DR operating lease income	2.28	
CR lease incentive		2.28

On a net basis, CU 97.72 is recognised each month over the remaining term of the new lease (100 per month * 44 months remaining - 100 lease incentive) / 44 months remaining.

FAQ 2.2: how does a lessor account for changes in operating lease payments relating to future periods?

If changes in operating lease payments meet the definition of a lease modification (see FAQ 1.5), then IFRS 16.87 applies:

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Therefore, as at the effective date of the modification (i.e. the date when both parties agree to a lease modification), the total revised consideration for the remaining lease, plus prepaid or accrued lease payments (see FAQ 2.3), is reallocated to and recognised over the remaining lease term.

Example - change in operating lease payments relating to future periods

Lessor entered into a lease with Lessee on 1 January 2019 for a lease term of 5 years. Monthly operating lease payments are CU 100 per month (CU 100 * 60 months = CU 6,000 total consideration).

On 1 May 2020, Lessor agrees to reduce May - December 2020 rent to CU 50 due to the effects of the pandemic. Therefore, remaining revised consideration is CU 4,000 (CU 50 * 8 months in 2020 + CU 100 * 36 months from 2021 - 2023).

FAQ 2.2: how does a lessor account for changes in operating lease payments relating to future periods?

Therefore, from 1 May 2020 onward, Lessor recognises CU 4,000 / 44 months = CU 90.90 per month as operating lease income. For example, to accrue May 2020 operating lease income, Lessor records (assuming Lessee pays in advance):

DR cash	50 (equal to revised consideration for May - December 2020)
DR lease receivable	40.90 (difference between operating lease income and cash)
CR operating lease income	90.90 (operating lease income, as calculated above)

FAQ 2.3: how does a lessor account for unamortised lease incentives as at the time of the lease modification and on a go forward basis?

Lessors may provide lease incentives to lessees, often at the commencement of a new lease. For example, allowances for leasehold improvements, reimbursements of certain costs, etc. Included in the definition of 'lease payments' is that they include fixed payments less any 'lease incentives', therefore, when a lessor recognises operating lease income in accordance with IFRS 16.81, the effect of these lease incentives are typically spread over the lease term.

For example, if a lessor provides a lessee with CU 500 in cash to make leasehold improvements at the commencement of a lease, the lessor will account for the payment as an asset (e.g. DR asset, CR cash) and amortise that asset as an adjustment of operating lease income over the lease term. As IFRS 16.87 requires lease modifications to operating leases to be accounted for as 'new leases' as at the effective date of the modification (see FAQ 2.2), the question arises as to how these assets recorded as at the commencement of the original lease should be accounted for in the 'new lease'.

In our view, these assets should be included in the calculation of operating lease income in the 'new lease'. That is, the assets should continue to amortise over the lease term of the new lease. This is because IFRS 16.87 states (emphasis added):

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

The asset recorded relating to lease incentives may be considered a 'prepaid lease payment', as a lease incentive is an adjustment in the total consideration for the lease.

FAQ 2.4: how does a lessor account for a change in the timing of lease payments when the nominal cash flows are unchanged? For example, deferring April, May and June 2020 rent by amortising the unpaid amounts 1/12th per month from July 2020 - June 2021?

Generally, when a lessor determines how to recognise operating lease income over the lease term, the resulting calculation does not reflect the time value of money. For example, in FAQ 2.3, the original lease term is for 5 years commencing on 1 January 2019 with monthly lease payments of CU 100. The Lessor recognises operating lease income of CU 100 per month, despite the fact that the present value of the latter lease payments are less than the earlier lease payments.

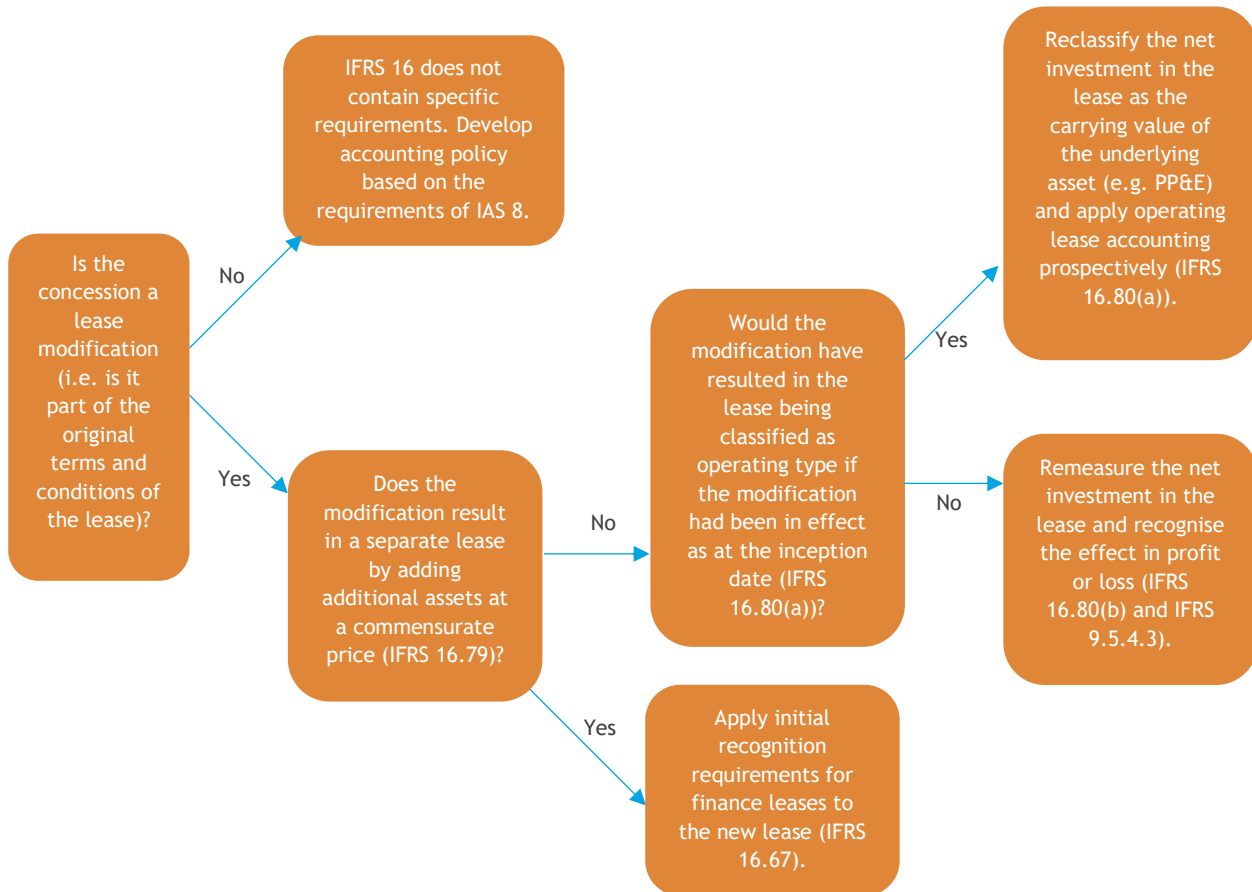
If a lessor grants a concession that affects the timing of payments, but not the nominal cash flows, and the concession is a lease modification, then the change in timing will not result in a change in operating lease income. This is because, as noted above, the allocation of total consideration to the discrete periods in the lease term does not generally consider the time value of money.

Therefore, in the example noted in this question, deferring April - June 2020 rent and amortising it 1/12th per month from July 2020 - June 2021 would not result in a change in operating lease income recognised on a monthly basis. The lease concession may affect the ECL recorded by the lessor, as allowing the lessee additional time to pay the total consideration may reduce total credit losses (see FAQ 1.2).

SECTION 3 - FINANCE LEASES: FAQs

FAQ 3.1: how does a lessor account for a lease modification to a finance lease?

The requirements of IFRS 16 applicable to lessors when accounting for a modification to a finance lease are summarised as follows:



Therefore, if a lease modification is not accounted for as a separate lease, then the effect of the lease modification will depend on whether the lease modification would have resulted in the lease still being classified as a finance lease if that modification had been in effect at inception.

For example, if the lease modification resulted in reduced consideration, and this change would have resulted in the lease being classified as an operating lease as at the inception of the lease, then no immediate effect in profit or loss is recorded, as the net investment in the lease is reclassified as property, plant and equipment and operating lease accounting commences on a prospective basis.

On the other hand, if the reduction in consideration would have resulted in the lease remaining as a finance lease, the effect of the lease modification is immediately recorded in profit or loss. This is because IFRS 16 requires IFRS 9.5.4.3 to be applied in this case. IFRS 9.5.4.3 requires the recalculation of the gross carrying amount based on the present value of the renegotiated or modified contractual cash flows, discounted using the original effective interest rate. If the rent concession reduces consideration (either by forgiving it or deferring the payment of consideration), then applying IFRS 9.5.4.3 will result in the lessor recording a loss, as the present value of the receivable will decrease.



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