



# IFRS 16 Leases

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# Agenda

- Overview of IFRS 16
- Key aspects of IFRS 16
- Covid-19-Related Rent Concessions



# Overview of IFRS 16



- IFRS 16 outlines accounting principles for all leases.
- Introduced Right-of-use asset accounted for under IAS 16
- Lease liability measured at amortised cost
- Practical expedient for lessees (short-term & low-value leases)
- Effective for periods beginning on or after 1 January 2019
- May 2020 amendments provide additional expedient on COVID-19 concessions

# Key aspects of IFRS 16

- ROU asset
- Lease liability
- Lease term



# Single lease accounting model



## Balance sheet

**Asset** = 'Right-of-use' (ROU) of underlying asset

**Liability** = Obligation to make lease payments

## P&L

**Lease expense**

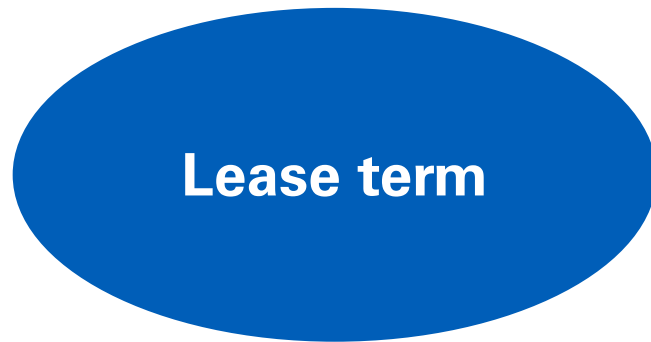
Depreciation

+ Interest expense

# Measuring the lease liability



**Key inputs**



# Measuring the right-of-use (ROU) asset



ROU asset

=

Lease liability

+

Initial direct costs

+

Prepaid lease payments

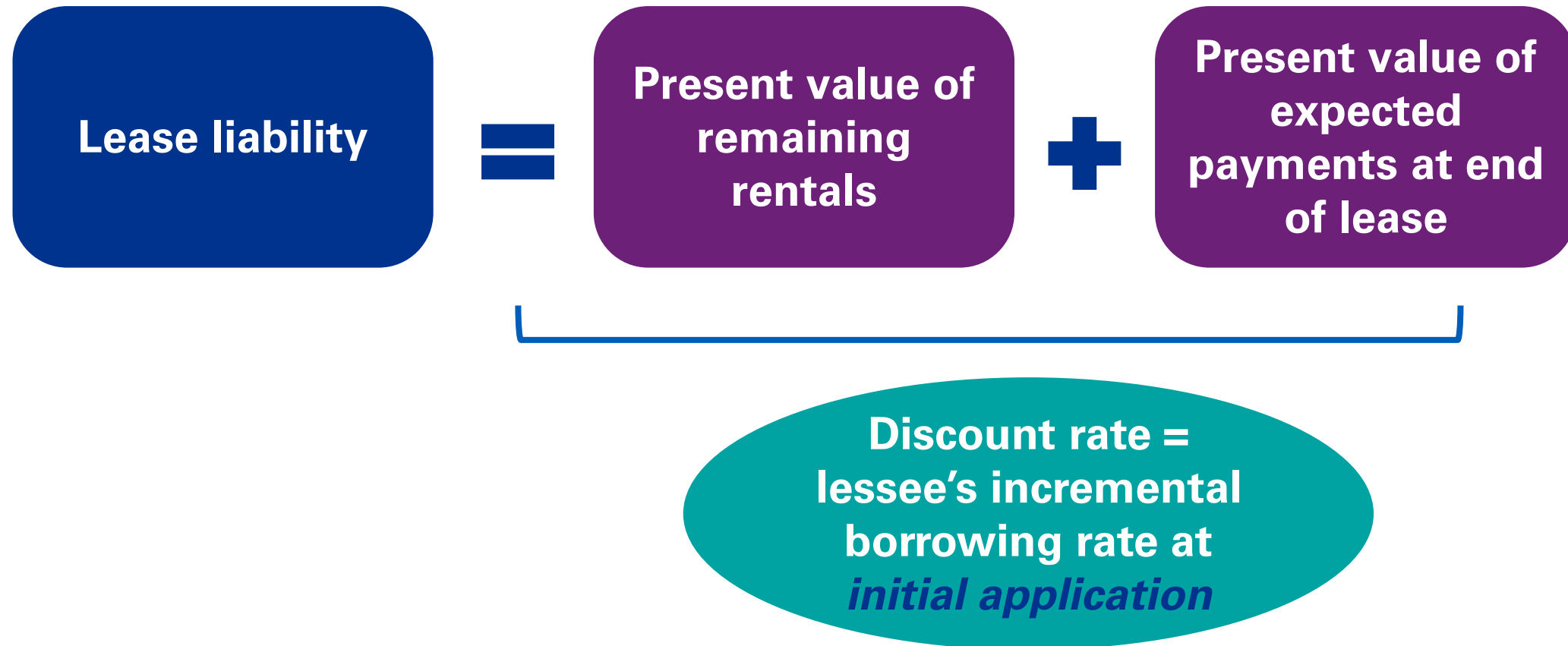
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Costs to dismantle or restore (IAS 37)

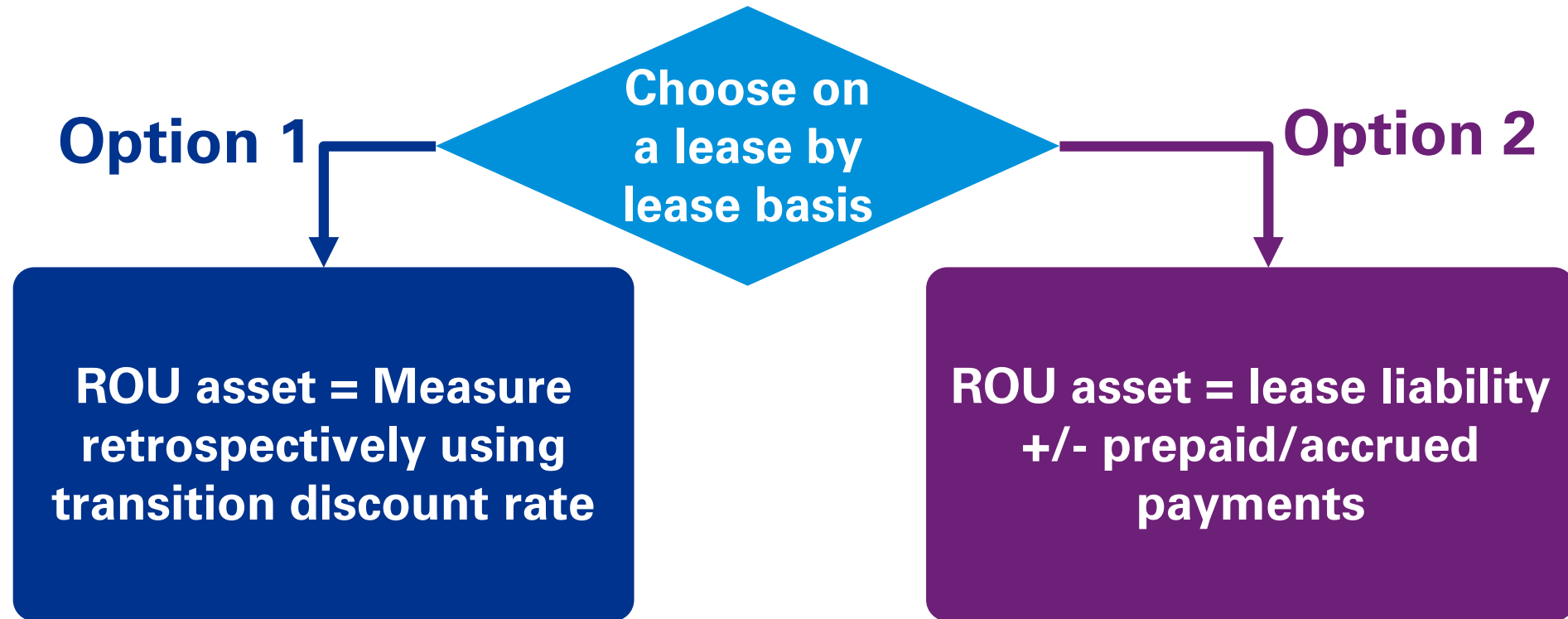
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Lease incentives

# Lease liability - modified retrospective

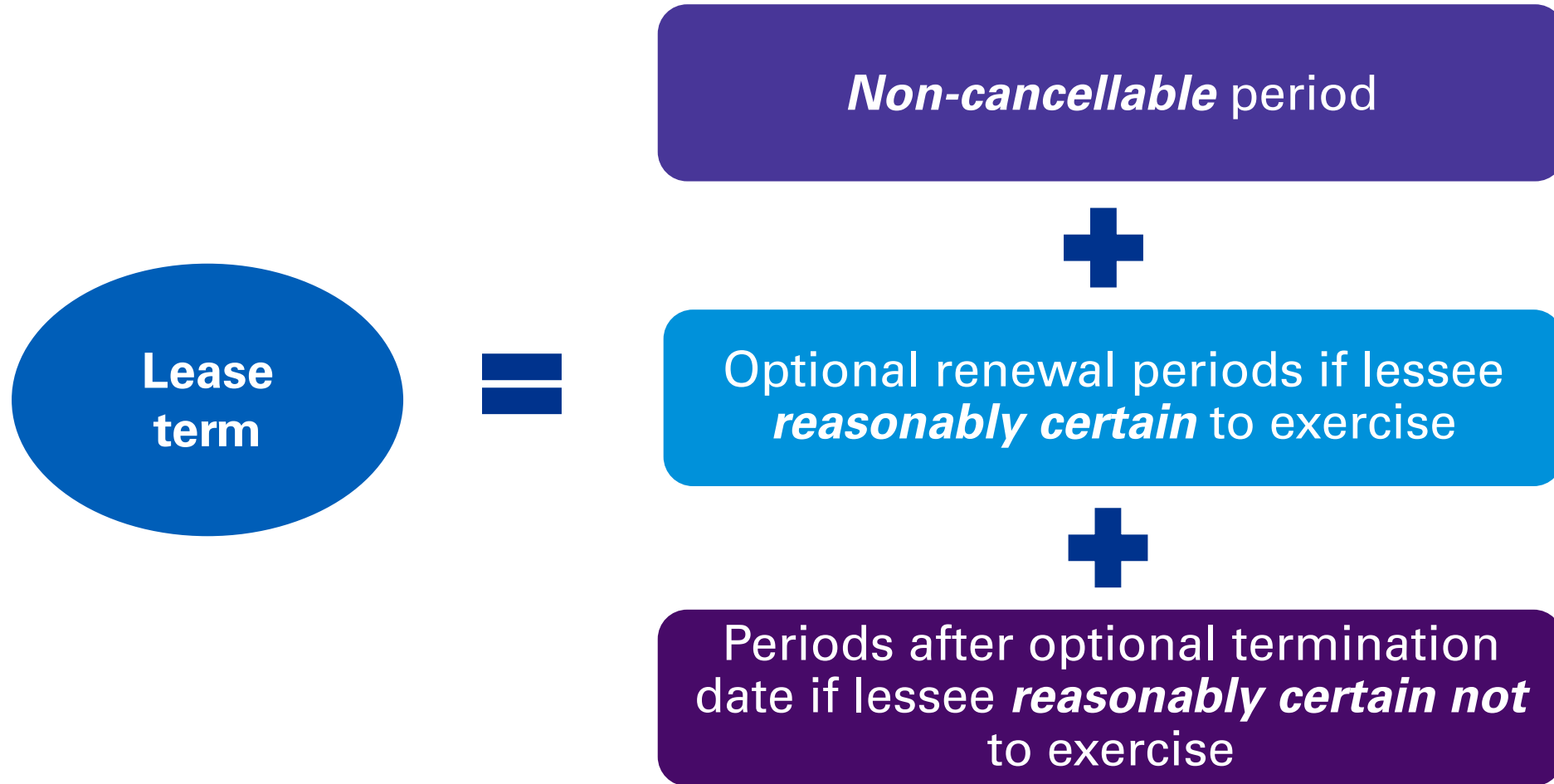


# Right-of-use (ROU) asset - modified retrospective



**Apply IAS 36 at *initial application***

# Lease term



# Example - determining lease liability



Six year lease  
of office space  
on 1 Jan 2018



KES 10,000,000 per annum  
payable in advance (every  
1 January). Rent increases  
by 5% every year.



No renewal  
option



Discount  
rate: 12% on  
1 Jan 2019

# Example - Right of use asset workings



Year	Payments (KES)	Discount Factor (12%)	Net Present Value	Depreciation expense	ROU Asset at end of year
	<b>a</b>	<b>b</b>	<b>c=(axb)</b>	<b>e=(d/5)</b>	
2019	10,500,000	1.0000	10,500,000	9,267,000	37,067,999
2020	11,025,000	0.8929	9,843,750	9,267,000	27,800,999
2021	11,576,250	0.7972	9,228,516	9,267,000	18,534,000
2022	12,155,063	0.7118	8,651,733	9,267,000	9,267,000
2023	12,762,816	0.6355	8,111,000	9,267,000	-
<b>Totals</b>			<b>(d) 46,334,999</b>		

# Example - Lease liability and interest expense



Year	Payments <sup>*</sup> (KES)	Discount factor	Net present value	Interest expense	Lease liability end of year
2018	<b>a</b>	<b>b</b>	<b>c=(axb)</b>	<b>12%</b>	<b>(d) 46,334,999</b>
2019	10,500,000	1.0000	10,500,000	4,300,200	40,135,199
2020	11,025,000	0.8929	9,843,750	3,493,224	32,603,423
2021	11,576,250	0.7972	9,228,516	2,523,261	23,550,434
2022	12,155,063	0.7118	8,651,733	1,367,445	12,762,816
2023	12,762,816	0.6355	8,111,000	-	-

**(d) 46,334,999**

\* Lease payment relate to amounts paid to the lessor (not government or 3<sup>rd</sup> parties) hence should exclude VAT and service charge. IFRS 16 however allows room to include non-lease components e.g. service charge when unable to split and a disclosure be made in the accounting policy for leases.



# COVID-19 Related rent concessions

*Amendment to IFRS 16 issued on 28 May 2020 applicable to annual periods beginning on or after 1 June 2020 with earlier application permitted*

# Lease concessions



- Under IFRS 16 *Leases*, rent concessions often meet the definition of a lease modification. The accounting for lease modifications can be complex. For example, the lessee may be required to recalculate lease liabilities using a revised discount rate and adjust right-of-use assets.
- The International Accounting Standards Board has issued amendments to IFRS 16 to simplify how lessees account for rent concessions. These amendments introduce a practical expedient for lessees – i.e. a lessee is not required to assess whether eligible rent concessions that are a direct consequence of the COVID-19 pandemic are lease modifications.
- The rent concession in the form of a one-off reduction in rent, would be accounted for as a variable lease payment and be recognised in profit or loss, without the need to assess whether the ROU asset needs to be adjusted.

# Lease concessions

- The practical expedient has been designed to be applied by lessees under limited circumstances – i.e. it applies only to rent concessions that are a direct consequence of the COVID-19 pandemic.
- Rent concessions are eligible for the practical expedient if they occur as a direct consequence of the COVID-19 pandemic and if all of the following criteria are met:
  - a) 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;
  - b) Any reduction in lease payments affects only payments originally due on or before 30 June 2021; and
  - c) There is no **substantive change** to the other terms and conditions of the lease.

# Scope of practical expedient

Is the rent concession a direct consequence of the COVID-19 pandemic?

Yes

Is the revised consideration for the lease substantially the same as, or less than, the consideration immediately preceding the change?

Yes

Does the rent concession reduce *only* lease payments originally due on or before 30 June 2021?

Yes

Are there other substantive changes to terms and conditions of the lease?

No  **Apply the expedient**

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

- ❖ ABC Ltd leased retail stores and a head office building in Nairobi's CBD. COVID-19 cases were first identified in Mid-March 2020 and ABC observed decreasing sales in its stores from 23<sup>rd</sup> March 2020. Kenyan government introduced lockdown measures in April 2020 and at this point ABC closed its stores to customers.
- ❖ ABC agreed a rent concession for the head office building in January 2020 relating to refurbishment activities undertaken by the landlord that disrupted access to the building. In May and June 2020, It also agreed a further rent concessions for the retail stores.



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

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

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



## Example 2 - Deferral of rent payments by extending the lease term

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



# Discussion - Example 2 Deferral of rent payments by extending the lease term

- The revised consideration in the lease is substantially the same as the original – i.e. the condition in paragraph 46B(a) of IFRS 16 is met.
- The rent concession only reduces lease payments originally due before 30 June 2021 – so the condition in paragraph 46B(b) of IFRS 16 is met.
- There is a change in the lease terms and conditions by extending the term by three months. **X** concludes this change in the lease term is not substantive. The condition in paragraph 46B(c) of IFRS 16 is met.
- Because the rent concession is a direct consequence of COVID-19 and all three conditions in paragraph 46B of IFRS 16 are met, **X** concludes that the rent concession is eligible for the practical expedient.

## Example 3 - Accounting for forgiveness of rent

- Z entered into a lease contract with Lessor L to lease retail space for five years on 1 January 2018. Rental payments are 100,000 payable quarterly in advance. Z's incremental borrowing rate at commencement of the lease is 5%.
- Z's business is severely impacted by the COVID-19 and on 1 June 2020, L agrees to provide Z with an unconditional rent concession that allows Z to forego payment of its rent due on 1 July of 100,000 (one quarter rent free).
- Z is considering whether the rent concession is eligible for the practical expedient under IFRS 16.46B.
- Z notes that the rent concession is unconditional and so the event that triggers the variable lease payment is Z and L agreeing the rent concession on 1 June 2020.

# Discussion -Example 3 accounting for forgiveness of rent

- Z continues to use the retail space and the right-of-use asset is not impaired. Z will account for the rent forgiveness as follows:
  - DR: Lease liability 100,000 and CR: Income statement 100,000**
- Z continues to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5% and hence record a debit to interest expense and a corresponding credit to the lease liability.
- After accounting for the impact of the rent concession, Z's lease liability represents the present value of all future lease payments owing to L, discounted at the unchanged incremental borrowing rate.
- Z has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020.
- In addition, Z continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.

# What is forgiveness of rent is conditional?

- If the lessee will receive the benefit of the rent concession at each payment date only if it has complied with other conditions or if the government continues with lockdown, then:
  - ❖ The lessee recognises the benefit of the rent concession as a variable lease payment in profit or loss **as and when the conditions are met.**
- The amount of the variable lease payment recognised will equal the nominal (cash) amount of the rent reduction – i.e. there will be no discounting effect.
- Conditionality arises if a concession is dependent on a specific circumstance occurring – e.g. where the rent forgiveness extends from month to month only if temporary COVID-19 lockdown measures remain in force for that month.

# Deferral of lease payments

- Another common type of rent concession being negotiated during the COVID-19 pandemic is the deferral of lease payments. The concession granted may involve the reduction of lease payments in some periods with an increase in payments in other periods.
- When a rent concession involves deferred lease payments only, the lessee accounts for the change by recognising the impact in the period when no payment is made by continuing to reduce the lease liability.

# Deferral of lease payments - Example

- L (lessor) agrees to a rent deferral whereby Z's (lessee) advance payment originally scheduled for May 2020 of 2,000 is deferred, interest-free, and will instead be paid over the remaining 20 months of the lease term (100 per month, resulting in each remaining monthly payment equaling 2,100). To facilitate the rent concession, other non-substantive changes are made to the lease contract.
- Z determines that the rent concession is a direct consequence of the COVID-19 pandemic and qualifies for the practical expedient.
- The rent concession is unconditional, notwithstanding the fact that the duration and impact of the COVID-19 pandemic are unknown.
- Since the original rent payable in May 2020 has been deferred (not forgiven), Z does not account for a negative variable lease payment or a partial derecognition of the lease liability for the rent of 2,000 that is deferred.

# Deferral of lease payments - Example

- One acceptable approach is for Z to account for the rent deferral as if Z is entitled to the deferral under the existing terms and conditions of the lease. Z remeasures the lease liability using the revised timing of the lease payments and an unchanged discount rate of 6%. Z recognises the impact of the change in the present value of the lease liability in profit or loss on the date the rent concession is effective.
- Another acceptable approach is for Z to account for the rent deferral by adjusting the timing of the future cash flows and, in effect, bifurcating the lease liability into two portions – one portion (based on the original payment schedule) that remains subject to interest and one that is not (the 'interest-free' deferral). This is necessary for the lease liability to amortise to zero by the end of the lease term. Under approach 2, there is no measurement of the lease liability.

# Disclosures

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

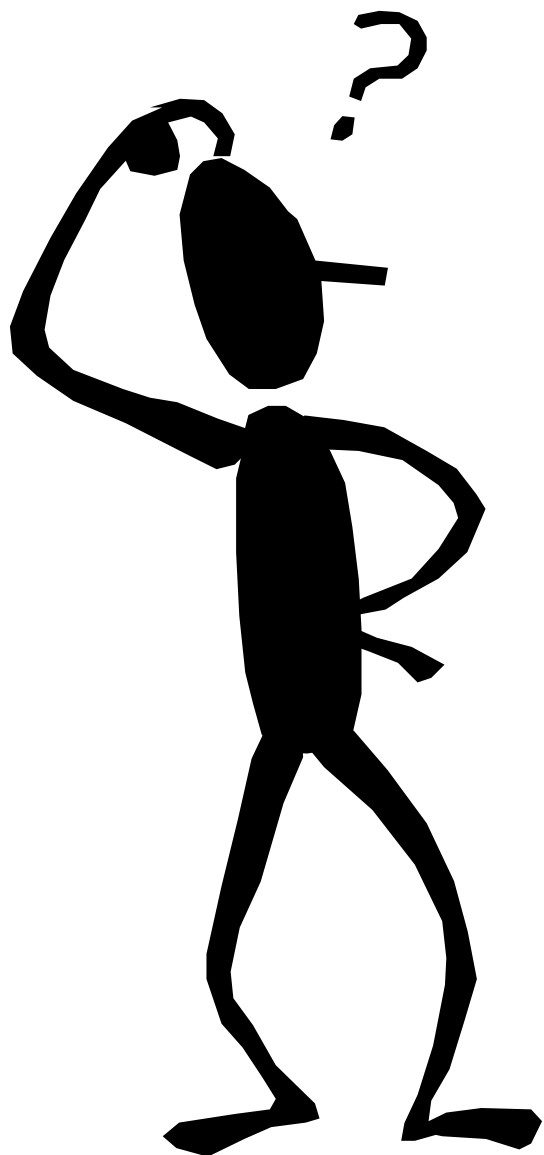
- That it has applied the practical expedient to all rent concessions that meet the conditions; or information about the nature of the leases and/or concessions to which it has applied the practical expedient if it has not applied the practical expedient to all rent concessions that meet the conditions.
- Amounts recognised in profit or loss for the reporting period to reflect changes in lease payments arising from rent concessions that meet the conditions of the practical expedient.
- If the rent concession results in the adjustment of the carrying amount of the lease liability, then the lessee discloses this as a non-cash change in lease liabilities when disclosing changes in liabilities arising from financing activities under IAS 7.

# TRAINING



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## Questions and discussions