



IFRS 16 *Leases* Overview and COVID-19 pandemic considerations

8 September 2021

Agenda



- ❑ Overview of IFRS 16
- ❑ Identify the guidance provided in IFRS 16 for lessees and lessors related to changes to lease arrangements
- ❑ Identify the amendment to IFRS 16 Covid-19-related rent concessions – amendment to IFRS 16
- ❑ How a lessee may account for such concessions
- ❑ Disclosure requirements
- ❑ Impact on the Lessor



Overview of IFRS 16



- ▶ On 13 January 2016, the International Accounting Standards Board (IASB) issued IFRS 16 Leases that replaced IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases—Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.
- ▶ It changed how the definition of a lease is applied and requires the use judgement in defining leases among other aspects

Overview of IFRS 16 – What Changed?



What changed for the lessee?



Single on balance sheet accounting model for all leases leading to a balance sheet gross up

Changes to systems, processes, and controls to store key data, perform calculations, and process accounting entries

Disclosures under the standard will in comparison to IAS 17 which means that you may require more data

What has changed for the lessor?



Lessor accounting is substantially unchanged – continue to have both operating and finance leases accounted for similar to IAS 17

Disclosures under standard will vary in comparison to IAS 17

Overview of IFRS 16 – Changes



Lessee's FSs

- Income Statement:
 - Accelerated lease expense recognition
 - Ratios: EBITDA, interest cover
- Balance Sheet:
 - Increase in assets (the right of use)
 - Increase in liabilities (the obligation to meet lease payments)
 - Ratios: leverage, among others
- Cash flow:
 - Payments of the principal portion of the lease liability will be presented within financing activities
 - Interest payments will depend on the accounting policy election

Lessor's FSs

- Little or no change

Overview IFRS 16 - Scope



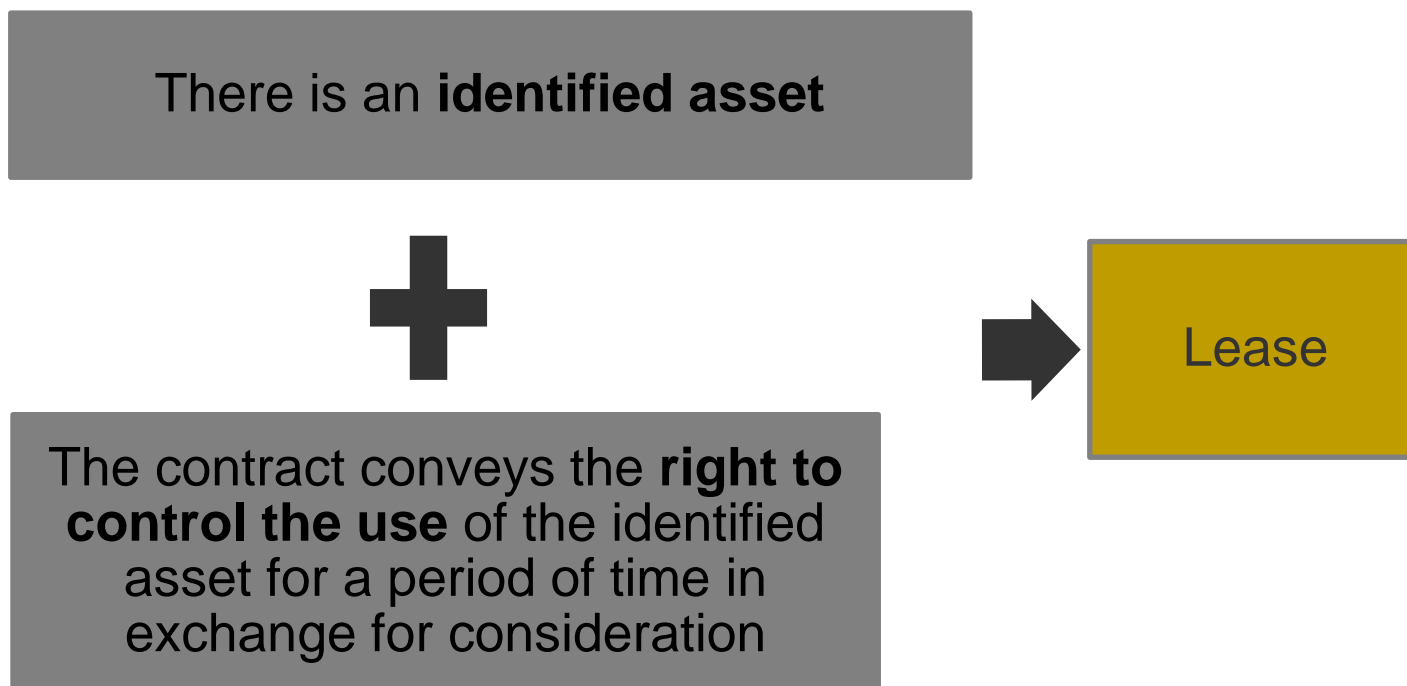
Leases of all assets, including the right-of-use assets in a sublease except:

- low value assets e.g. IT equipment like computers and furniture
- short-term leases i.e. 12 months or less
- Leases to explore for or use non-regenerative resources
- Leases of biological assets
- Service concession arrangements
- Licences of intellectual property granted by a lessor
- Rights held by a lessee under certain licensing agreements (e.g., films, patents, copyrights, video recordings)
- There is an IFRS 16 application policy choice for leases of intangible assets not covered in the exceptions above.

Overview IFRS 16- Definition of a lease



A contract (or part of a contract) is, or contains, a lease if:



This should be assessed at the inception of a contract

Overview IFRS 16 - Definition of a lease



Right to control the use of the identified asset

WHO ?
BENEFITS

Right to obtain substantially all the economic benefits

AND

Right to direct the use



Customer has the right to direct how and for what purpose the asset is used

OR

Relevant decisions about how and for what purpose the asset is used are predetermined **AND**

- ▶ The customer has the **right to operate** the asset, without the supplier having the right to change those operating instructions; **OR**
- ▶ The customer **designed** the asset in a way that **predetermines** how and for what purpose the asset is used



❑ Identified assets:

- Can be explicitly or implicitly specified in the contract
- Can be a capacity or portion of an identified asset if it is physically distinct e.g. a floor of a building
- **A capacity or portion that is not physically distinct is not an identified asset unless it represents substantially all of the capacity of the asset and thereby the customer has the right to obtain substantially all of the economic benefits from the use of the asset.**

Overview IFRS 16 - Definition of a lease



❑ **Substantive substitution rights:**

- Even if the asset is specified at the contract inception but the supplier has substantive substitution rights of the assets throughout the total period of use, the customer does not have the right to use the identified asset.

❑ **Substitution rights are substantive when both these conditions are met. The supplier:**

- Has the practical ability to substitute with alternative assets throughout the period of use without the customer preventing him
- will benefit economically from exercising the right to substitute the asset

❑ **Evaluation of a supplier's substitution rights is done at the contract inception**

Recognition and Measurements



Initial recognition and measurement	<ul style="list-style-type: none">▶ Initially measure right-of-use (ROU) asset¹ and lease liability at present value of lease payments
Subsequent measurement of lease liability	<ul style="list-style-type: none">▶ Accrete the lease liability based on the interest method using a discount rate determined at lease commencement²▶ Reduce lease liability by payments made
Subsequent measurement of ROU asset	<ul style="list-style-type: none">▶ Depreciate ROU asset, based on IAS 16 <i>Property, Plant and Equipment</i>▶ Alternative measurement of ROU asset under IAS 16 and IAS 40 <i>Investment Property</i>
Profit and loss	<ul style="list-style-type: none">▶ Generally 'front-loaded' expense for individual lease▶ Separate interest and depreciation

1 Initial measurement of the ROU asset would also include the lessee's initial direct costs (IDCs), prepayments made to the lessor less lease incentives received from the lessor, if any, and restoration, removal and dismantling costs.

2 As long as a reassessment and a change in the discount rate have not occurred.

Lessee Accounting

Example 1



Scenario

ACA Limited enters into a 3-year lease of a branch office space in a commercial building. The arrangement provides the following:

Annual payments	Year 1 – CU 10,000
	Year 2 – CU 12,000
	Year 3 – CU 14,000

Discount rate	4.235%
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Present value of lease payments	CU 33,000
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Lessee Accounting

Example 1 (continued)



	Initial (CU)	Year 1 (CU)	Year 2 (CU)	Year 3 (CU)
Cash payments		10,000	12,000	14,000
Lease expense recognised:				
Interest expense		1,398	1,033	569
Depreciation expense		<u>11,000</u>	<u>11,000</u>	<u>11,000</u>
Total periodic expense		<u>12,398</u>	<u>12,033</u>	<u>11,569</u>
Balance sheet:				
ROU asset	33,000	22,000	11,000	-
Lease liability	(33,000)	(24,398)	(13,431)	-



COVID-19 pandemic Considerations:

- **Impairment**
- **Rent Concessions**

Year end considerations – Reduction in the use of Real Estate



IAS 36 requires an entity to assess at each reporting date if there are any indicators of impairment

Change in management's intended use of an ROU asset

Significant changes to the use

OR

Expected changes to the use

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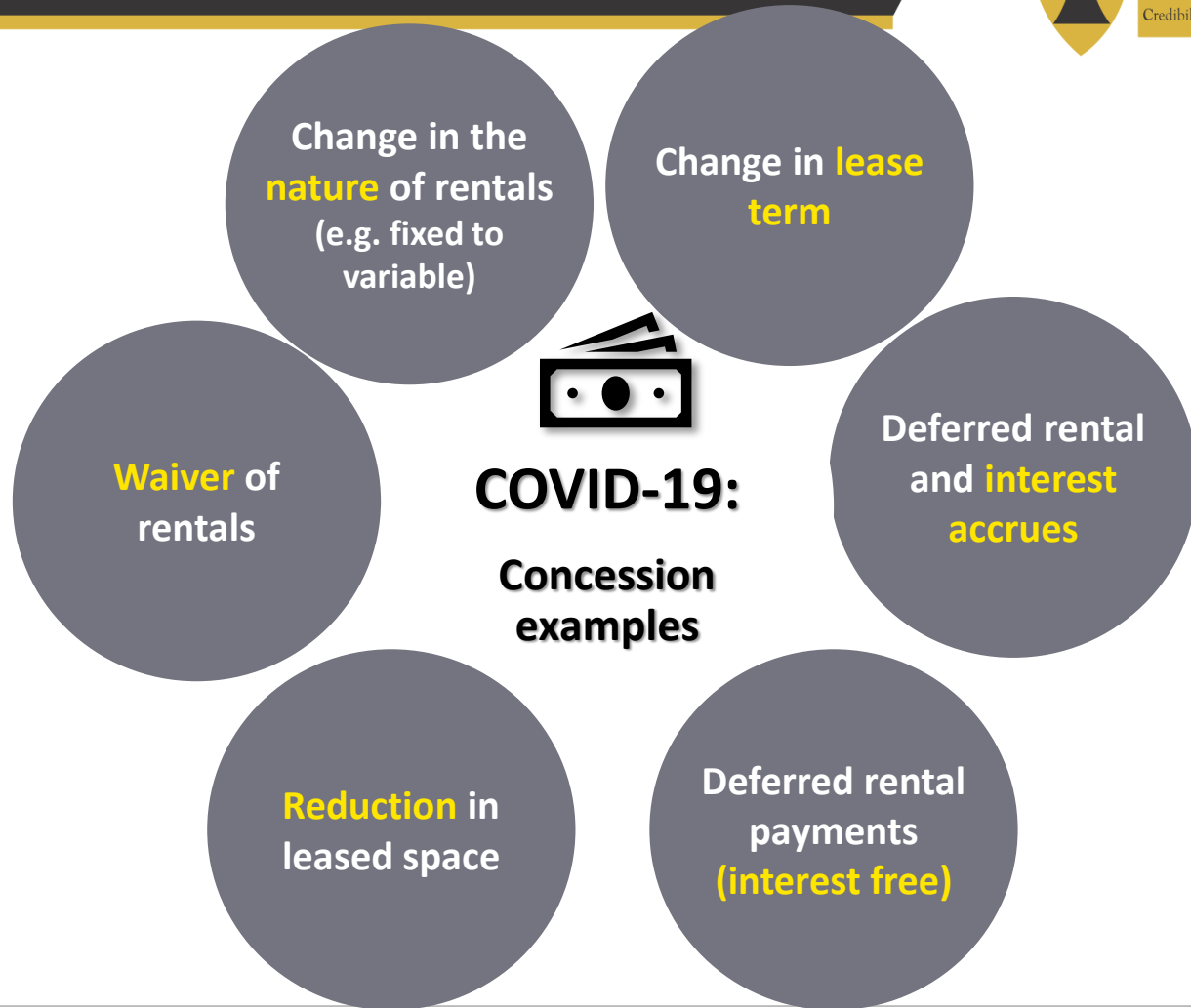
Internal indicator

RoU/LI useful life

Residual value

Lease term

Examples of Concessions





Practical expedient: Rent concessions as a direct consequence of COVID-19?

No modification assessment necessary

Conditions

- The revised consideration is **substantially the same as, or less than**, the consideration for the lease immediately preceding the change
- Rent concession only affects **payments originally due on or before 30 June 2022**
- There is **no substantive change** to other terms and conditions of the lease

Lessees only

**Optional
not required**

**How to account
for this**

Accounting for rent concessions that are not accounted for as lease modifications



- ▶ The amendment does not give explicit guidance on how to account for rent concessions when the practical expedient is applied
- ▶ There are several approaches, including:

Consistent application

- a) Accounting for the concession in the form of forgiveness or deferral of lease payments as a negative variable lease payment
- b) Accounting for the concession in the form of forgiveness or deferral of lease payments as a resolution of a contingency that fixes previously variable lease payments
- c) Accounting for the concession in the form of a deferral of lease payments as if the lease is unchanged

Example 2

Lessee accounting for deferral of lease payments



XYZ leases space in a shopping mall from Lessor Z. The entity makes three fixed lease payments of CU600 semi-annually in arrears. The contract runs from 1 January 2020 to 30 June 2021 and the discount rate is 5%. As a direct result of COVID-19 on 1 July 2020, Lessor Z agrees to defer the payment originally due on 31 December 2020 to 30 June 2021. There are no other changes to the lease terms and conditions. The entity concludes that the requirements of the IFRS 16 amendment are met because:

- a) The rent concession is granted as a direct consequence of COVID-19
- b) There is no substantive change in the lease payments
- c) The reduction in lease payments affects only payments due on or before 30 June 2021
- d) There are no other changes to the terms and conditions of the contract

Example 2

Lessee accounting for deferral of lease payments-possible approaches (continued)



Approach 1 – account for the deferral as a negative variable lease payment

- ▶ Lease liability immediately before the concession:

Present value (PV) of 2 remaining lease payments discounted at 5% = CU1,157 (600/(1.05)^{1/2}+600/1.05)

- ▶ Lease liability immediately after the concession:

PV of lease payments discounted at 5% = CU1,143 (1,200/1.05)

- ▶ To record the reduction in the lease liability of CU14 (CU1,157 - CU1,143):

Dr. lease liability 14

Cr. profit or loss 14

- ▶ Depreciation of the right-of-use asset continues over the remaining lease term

Example 2

Lessee accounting for deferral of lease payments - possible approaches (continued)



Approach 2 – account for the deferral as the resolution of a contingency

- ▶ Calculation as in approach 1 but the reduction in lease liability of CU14 is:

Dr. lease liability 14

Cr. right-of-use asset 14

- ▶ Depreciation of the right-of-use asset continues over the remaining lease term

Approach 3 – account for the deferral as if the lease is unchanged

- ▶ The entity continues to account for the lease liability and right-of-use asset using the rights and obligations of the existing lease
- ▶ The CU600 due on 31 December 2020 will remain on the balance sheet until 30 June 2021 but will not accrue interest during the deferral period
- ▶ The interest expense for the six months to 30 June 2021 will remain the same as the original schedule
- ▶ Depreciation of the right-of-use asset continues over the remaining lease term

Example 2

Lessee accounting for deferral of lease payments - possible approaches (continued)



ABC leases space in a shopping mall from Lessor Z. The entity makes three fixed lease payments of CU100 per month in advance. For simplicity, the discount rate is 0% and at 30 June 2020 the remaining lease liability is CU2,000 for the remaining term to 28 February 2022. As a direct result of COVID-19 on 1 July 2020 Lessor B agrees to waive the next 3 months payments (CU300 in total). There are no other changes to the lease terms and conditions. The entity concludes that the requirements of the IFRS 16 amendment are met because:

- a) The rent concession is granted as a direct consequence of COVID-19
- b) There is no substantive change in the lease payments
- c) The reduction in lease payments affects only payments due on or before 30 June 2021
- d) There are no other changes to the terms and conditions of the contract

Example 2

Lessee accounting for deferral of lease payments-possible approaches (continued)



Approach 1 – account for the forgiveness as a negative variable lease payment

- ▶ The entity treats the concession as an event that triggers a negative variable payment

Dr lease liability 300

Cr Profit & loss 300

- ▶ Depreciation of the right-of-use asset continues over the remaining lease term

Approach 2 – account for the deferral as the resolution of a contingency that fixes previously variable lease payments

- ▶ The entity treats the concession as an event that triggers a negative variable payment

Dr lease liability 300

Cr Right of use 300

- ▶ Depreciation of the right-of-use asset continues over the remaining lease term



1. 2020 Amendment – for annual periods beginning on or after 1 June 2020, with early application permitted.
2. 2021 Amendment - for annual periods beginning on or after 1 April 2021, with early application permitted, including AFS not issued as at 31 March 2021.

- Retrospective application
- Adjustment to the opening balance of the retained earnings at the beginning of the annual period the amendment is applied.
- No restatement of comparatives

Example 3

Lessee accounting for deferral of lease payments



In June 2020, XYZ with a 31 December 2020 year end received a material lease concession that was not in scope of the 2020 amendment as the original due date of the affected lease payments included payments that were originally up to 30 June 2022. XYZ accounted for this concession in accordance with the lease modification guidance of IFRS 16.

On 1 April 2021, XYZ concludes that the relief as revised by the 2021 amendment can be applied to the June 2020 concession.

- a) The rent concession is granted as a direct consequence of COVID-19
- b) There is no substantive change in the lease payments
- c) The reduction in lease payments affects only payments due on or before 30 June 2022
- d) There are no other changes to the terms and conditions of the contract

If the relief is applied, the concession will be accounted for retrospectively, in the opening balance of the retained earnings, without changes to the comparatives!

Lessee Accounting where practical expedient is not applied



- ❑ If the rent concession does not meet the criteria for practical expedient, or the lessee chooses not to apply the practical expedient
- ❑ The lessee must assess whether the rent concession is a lease modification
 - Change is scope of the lease; or
 - Change in consideration
- ❑ If a rent concession is a lease modification account for it in accordance with IFRS 16



- ❑ A lessee that applies the practical expedient discloses that it has applied the practical expedient to all rent concessions that meet the conditions for the practical expedient. If not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient.
- ❑ The amount recognised in profit or loss to reflect changes in lease payments that arise from such rent concessions to which the lessee has applied the practical expedient.
- ❑ Cash flow effects of rent concessions regardless of whether a lessee applies the practical expedient.



- ❑ Lessor accounting for rent concessions is based on existing guidance
- ❑ Lessor must first assess whether the concession meets the definition of a lease modification
- ❑ Modification of an operating lease
 - a) Accounted for as a new lease from the effective date of modification
 - b) Impact of rent concessions is likely to be spread over the lease term
- ❑ Modification of an finance lease
 - Accounting depends on whether the modification is accounted for as a separate lease
- ❑ Consider recoverability of lease receivables
- ❑ Many lessees may face financial difficulties due to government mandated closure of businesses. Lessors will be required to assess recoverability of the IFRS 9's guidance on credit losses continues to be applicable to recognised lease receivables



Q & A