

**Sue Lloyd  
Chair  
IFRS Interpretation Committee  
Columbus Building  
7 Westferry Circus  
Canary Wharf, London E14 4HD  
United Kingdom**

**Agenda Item Request: Accounting for rent concessions by lessors and lessees  
(IFRS 9, IFRS 16)**

Dear Ms Lloyd,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that enhances the protection of investors and promotes stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. In the context of ESMA's supervisory convergence work in the area of financial reporting, I would like to raise with you an issue related to the application of IFRS 9 *Financial Instruments* and IFRS 16 *Leases*. ESMA has identified diversity in the application of the requirements of IFRS 9 and IFRS 16 in relation to the accounting treatment of reductions of lease payments (rent concessions) that result in connection with the forgiveness of a (part of a) lease liability.

Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee (IFRS IC) considers clarifying the relevant accounting requirements. A detailed description of the case is set out in the appendix to this letter. We would be happy to further discuss this matter with you.

In case you have any questions or comments regarding this letter, I suggest you contact Evert van Walsum, Head of the Investors and Issuers Department ([Evert.vanWalsum@esma.europa.eu](mailto:Evert.vanWalsum@esma.europa.eu)).

Yours sincerely,

Anneli Tuominen

## APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

### 1 Description of the issues

1. Occasionally, in certain situations, reductions in lease payments (rent concessions) are granted to lessees by lessors without changing other terms of the lease contract. Since the onset of the COVID-19 pandemic, the number of such payment reductions has increased significantly. There is currently diversity in the accounting for rent concessions for operating leases on the lessor's side and for all types of leases on the lessee's side.

#### a) Lessor accounting

##### i) Accounting treatment of a voluntary forgiveness of lease payments

2. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified diversity as to how lessors account for rent concessions in case of a voluntarily forgiveness of lessees' past lease payments. Some lessors treat this forgiveness as a lease modification and therefore apply paragraph 87 of IFRS 16, which requires accounting for modification as a new lease from the effective date of the modification. This treatment leads to an effective allocation of the loss resulting from the rent concession over the remainder of the lease term.
3. Other lessors, however, apply instead the derecognition requirements of IFRS 9 to their lease receivables in these circumstances, which results in the recognition of an immediate loss equal to the receivable's carrying amount in the period when the concession is granted.

##### ***View 1: Treatment as lease modification under IFRS 16***

4. Proponents of view 1 argue that a voluntary reduction of lease payments granted by the lessor – if material – meets the definition of a lease modification in IFRS 16. Appendix A of IFRS 16 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. A forgiveness of the past lease payments (not required by law or foreseen in the contract) meets this definition.
5. In accordance with paragraph 87 of IFRS 16, the contract modification shall be accounted for as a new lease from the effective date of the modification.
6. Considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease, the granted concession is spread over the remaining term of the contract, reducing future lease payments.
7. Applying paragraph 81 of IFRS 16, lease payments from operating leases shall be recognised as income on a straight-line-basis (except if another basis is more representative) which generally represents the pattern in which benefit from the use of the underlying asset is diminished. Therefore, the effect of a rent concession will be spread over the remaining lease term reducing future lease income.

**View 2: Derecognition of the operating lease receivable according to IFRS 9**

8. On the other hand, proponents of view 2 note that, while in accordance with paragraph 2.1(b) of IFRS 9 rights and obligations under leases to which IFRS 16 applies are in general excluded from the application scope of IFRS 9, subsection (i) of this paragraph states that operating lease receivables are subject to derecognition and impairment requirements of IFRS 9.
9. They also observe that the IASB's educational guidance "IFRS 16 and covid-19" released on 10 April 2020, includes a section highlighting the application of requirements of IFRS 9 as follows: *"If a change in lease payments results in the extinguishment of a part of a lessee's obligation specified in the contract (for example, a lessee is legally released from its obligation to make specifically identified payments), the lessee would consider whether the requirements for derecognition of a part of the lease liability are met applying paragraph 3.3.1 of IFRS 9 Financial Instruments."*
10. Regarding lessors' lease receivables, paragraph 3.2.3 of IFRS 9 requires derecognition of a financial asset when the contractual rights to the cash flows from this financial asset expire. According to paragraph 3.2.12 of IFRS 9, 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.
11. Under this accounting treatment, the concession would be recognised as a loss in the income statement, with a corresponding reduction to the lease receivable in the period in which the reduction is contractually agreed. The lessor will continue to recognise the unchanged amount of lease income over the lease term.

**View 3: Accounting policy choice to apply IFRS 9 or IFRS 16**

12. Proponents of view 3 believe that given the uncertainty as to which requirements apply to a voluntary reduction of past lease payments, entities have an accounting policy choice to apply either the requirements of IFRS 9 or IFRS 16.
  - ii) **Calculation of an impairment allowance for the lease receivable when the lease liability is expected to be forgiven**
13. ESMA and national enforcers have identified diversity as to how lessors estimate impairment losses when, at the end of the reporting period, they expect to forgive part or all of the outstanding lease receivable after that date. Diversity in how an expected future forgiveness of past lease payments is accounted for is also linked to issue (i) above.
14. Those who support view 1 presented above argue that the application of IFRS 16 guidance on accounting for lease modifications precedes the application of the impairment requirements to the lease receivable. In this case, paragraph 87 of IFRS 16 explicitly states that a lessor shall account for a modification to an operating lease from the effective date of the modification. Consequently, the expected forgiveness of past payments will not be included in the assessment of the expected credit losses on the lease receivable. Hence, when calculating the expected credit losses on the lease receivable, it should not be assumed that the concession may be granted. This argumentation is also shared by some proponents of views 2 and 3.

15. On the other hand, some other proponents of views 2 and 3 point out that the impairment requirements of IFRS 9, which are applicable to operating lease receivables according to paragraph 2.1(b)(i) of IFRS 9, stipulate the use of reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions (paragraph 5.5.17(c) of IFRS 9). In their opinion, expectations regarding forgiveness should be taken into account when calculating the impairment at the reporting date.

## **b) Lessee accounting**

16. ESMA and national enforcers also note that lessee accounting for a voluntary forgiveness of a lease liability granted by the lessor appears to be similarly unclear which results in diversity. This is particularly the case if the lessee does not take advantage of the optional relief from applying IFRS 16 lease modification requirements for rent concessions arising as a direct consequence of the COVID-19 pandemic<sup>1</sup>.

### ***View 1: Treatment as lease modification under IFRS 16***

17. Proponents of view 1 support the application of the guidance in IFRS 16 on lease modification accounting. In accordance with paragraph 45(c) of IFRS 16, this leads to a remeasurement of the lease liability by discounting the revised lease payments using a revised discount rate on the modification date (date of the liability's forgiveness).

### ***View 2: Derecognition of the lease liability according to IFRS 9***

18. Since paragraph 2.1(b)(ii) of IFRS 9 requires the derecognition principles of IFRS 9 to be applied to lease liabilities recognised by the lessee, proponents of view 2 argue that applying paragraph 3.3.1 of IFRS 9 to the lessee's lease liability, it shall be (partly) derecognised as a result of the voluntary forgiveness by the lessor and, therefore, no revision of the discount rate is required.

### ***View 3: Accounting policy choice to apply IFRS 9 or IFRS 16***

19. Proponents of view 3 believe that entities have an accounting policy choice to apply either IFRS 9 or IFRS 16.

## **2 Request**

20. ESMA seeks clarification on how a voluntary forgiveness of a lease liability granted by a lessor needs to be accounted by

- the lessor (see details in (a)(i) under section 1); and
- the lessee (see details in (b) under section 1).

Moreover, ESMA asks for clarification regarding the calculation of an impairment allowance for the lease receivable when the lease liability is expected to be forgiven (see details in (a)(ii) under section 1).

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<sup>1</sup> The optional relieve only affects payments originally due on or before 30 June 2021.

21. ESMA is of the view that the lack of clarity about whether the derecognition requirements of IFRS 9 or the guidance in IFRS 16 on lease modification accounting shall be applied leads to divergent practices of European issuers. Taking into account that those divergent practices have been identified in several European jurisdictions, ESMA considers that this matter is relevant across the EU with a material effect on the financial statements of the affected entities.