

# HKFRS / IFRS UPDATE 2020/08

Updated November 2020

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## ACCOUNTING FOR RENT CONCESSIONS: LESSEE FAQs



### STATUS

Final

### EFFECTIVE DATE

Annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in IFRS financial statements not yet authorised for issue at 28 May 2020, and HKFRS financial statements at 4 June 2020.

### ACCOUNTING IMPACT

Significant optional operational relief for lessees in accounting for modifications to lease contracts as a consequence of COVID-19.

No amendments or relief provided to lessors.

### 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.

The HKICPA approved the equivalent amendments to HKFRS 16 on 4 June 2020.

### The amendments - lessees

HKFRS/IFRS 16 has been amended to:

- (a) Provide lessees with an optional exemption from the requirement to determine whether a COVID-19-related rent concession is a lease modification; and
- (b) Require lessees that apply the exemption to account for COVID-19-related rent concessions as if they were not lease modifications.

The criteria that must be satisfied for a rent concession to qualify for the practical expedient are summarised in the flowchart in Section 3. An explanation of the criteria and the practical implications of applying the practical expedient follow afterwards.

## 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 the new leases standard in accounting for rent concessions. The requirements applying to lessors did not change substantially from the predecessor leases standard, 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.

This *Update* does not address the accounting requirements for lessors, however, please refer to our collection of HKFRS/IFRS publications on [BDO website](#) for further *HKFRS/IFRS Updates* and information on lessor accounting.

## Frequently asked questions (FAQs)

Where this publication indicates that there is more than one acceptable approach, entities are encouraged to communicate with their auditors their desired approach before concluding on the appropriate approach. Accounting for rent concessions has resulted in numerous questions. One of these questions is the boundary of HKFRS/IFRS 9 and HKFRS/IFRS 16. As noted in the September 2020 Meeting Minutes of the Financial Reporting Standards Committee (FRSC) of the HKICPA, the FRSC agreed that there is a potential inconsistency between the scope of HKFRS 16 and HKFRS 9 when there is a waiver of lease payments with partial extinguishment of lease liability (see FAQ 1.2). On 16 September 2020, the HKICPA staff organised a conference call with the IASB staff to seek clarification of the issue. At the time when this *Update* is published, the conference call results are not yet available on HKICPA website.

This *Update* includes responses to several FAQs BDO has encountered in practice as they relate to lessees. These FAQs are organised as follows:

- Section 1: lease modifications vs. applying the practical expedient
- Section 2: scope of the practical expedient
- Section 3: assessing compliance with the practical expedient criteria
- Section 4: how to apply the practical expedient
- Section 5: lessee illustrative examples

## LESSEE FREQUENTLY ASKED QUESTIONS

### Section 1: lease modifications vs. applying the practical expedient

FAQ 1.1: How do the accounting requirements for lease modifications applicable to lessees compare to the requirements if the practical expedient is elected?

Answer: many rent concessions will meet the definition of a lease modification, which is:

*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).*

Some rent concessions may be accounted for by a lessee by applying some of the derecognition requirements of HKFRS/IFRS 9 for financial liabilities rather than lease modification requirements. See FAQ 1.2.

If the practical expedient is applied to a rent concession, a lessee does not assess whether a rent concession is a lease modification (ie the lessee can elect to not apply the requirements for lease modification accounting, even if the rent concession meets the definition of a lease modification). The practical expedient does not specify how the rent concession should be accounted for other than that the lessee should account for the rent concession 'the same way it would account for the change applying HKFRS/IFRS 16 if the change were not a lease modification.'

In our view, accounting for the rent concession as if it were not a lease modification will often result in the lessee applying the requirements of HKFRS/IFRS 16.38(b). Paragraph 38(b) specifies how a lessee accounts for variable lease payments not included in the measurement of the lease liability (eg lease payments that vary because of changes in facts and circumstances occurring after the commencement date other than the passage of time).

The following table compares the requirements applicable to a lease if it is concluded that a rent concession is a lease modifications (HKFRS/IFRS 16.44-46) to the requirements of variable lease payments (HKFRS/IFRS 16.38(b)), which will often be how lessees account for the effects of rent concessions when the practical expedient is applied. Section 5 of this *Update* includes examples of how the practical expedient is applied to a number of common rent concessions.

	Practical expedient not applied – lease modification accounting (HKFRS/IFRS 16.44-46)	Practical expedient is applied – variable lease payment accounting (HKFRS/IFRS 16.38(b))
Effect on lease liability	Reduced to reflect the revised consideration	Reduced to reflect the revised consideration
Effect on discount rate	The total revised, remaining consideration is remeasured using an updated discount rate as at the effective date of the lease modification	No change in discount rate
Effect on right-of-use asset	The offsetting adjustment is recorded against the carrying value of the right-of-use asset	No effect
Effect on profit or loss	None as at the time of modification; will result in modified finance expense and depreciation in subsequent periods	The offsetting adjustment is recorded in profit or loss. Depending on the facts and circumstances, this can be immediate or over the period of the rent concession

FAQ 1.2: How does a lessee account for rent forgiveness if the practical expedient is not elected or available? For example:

- 1) The lessor waives 50% of accrued and unpaid rental payments for April-June 2020 on 1 July 2020; or
- 2) The lessor waives 25% of rental payments for August-September 2020 on 1 July 2020.

Answer: a forgiveness of a portion of the lease liability may be interpreted as meeting the definition of a lease modification in HKFRS/IFRS 16:

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).

This is because the consideration in the lease has changed. Therefore, applying the lease modification requirements would result in the lease liability being reduced using a revised discount rate and the adjustment being recorded to the right-of-use asset (see FAQ 1.1). This outcome is similar to the effect of applying the practical expedient to rent concession #3A in Section 5 of this *Update*.

It may also be appropriate to consider the full or partial forgiveness of a lease liability as being within the scope of the derecognition requirements of HKFRS/IFRS 9 applicable to financial liabilities. This is because HKFRS/IFRS 9.2.1(b)(ii) states that lease liabilities measured in accordance with HKFRS/IFRS 16 are subject to the derecognition requirements in HKFRS/IFRS 9.3.3.1.

Therefore, it may be appropriate for rent forgiveness to be accounted for based on the derecognition requirements of HKFRS/IFRS 9.3.3.1 rather than the lease modification requirements of HKFRS/IFRS 16 because rent forgiveness results in the derecognition of a financial liability with no other changes in scope for the lease. This conclusion may be applied to both of the examples noted in this question, as both examples result in a recognised lease liability being partially derecognised.

If the derecognition requirements of HKFRS/IFRS 9.3.3.1 are applied, the lessee would derecognise the lease liability (or a portion thereof) at the point in time when the derecognition criteria are satisfied (i.e. when the lessor discharges the lessee's obligation to pay the forgiven rent). The reduction in the liability would not require a new discount rate to be determined, and the effect of the reduction in the lease liability would be recorded as a gain in profit or loss.

## Section 2: scope of the practical expedient

### FAQ 2.1: Do lessees have to apply the practical expedient?

Answer: No, the application of the practical expedient is optional. Therefore, lessees have a choice of:

1. Not applying the practical expedient, and therefore assessing whether rent concessions meet the definition of a lease modification and applying the relevant requirements of HKFRS/IFRS 16; or
2. Applying the practical expedient consistently to leases with 'similar characteristics and in similar circumstances' (see FAQ 2.2).

### FAQ 2.2: Can the practical expedient be applied on a lease-by-lease basis?

Answer: No. The amendments to HKFRS/IFRS 16 do not explicitly specify whether the practical expedient may be applied on a lease-by-lease basis. However, all accounting policies relating to leases in the scope of HKFRS/IFRS 16 are subject to the requirement in HKFRS/IFRS 16.2, which requires an entity to apply HKFRS/IFRS 16 consistently to contracts with 'similar characteristics and in similar circumstances'. This point is confirmed in the basis for conclusions to the amendments (HKFRS/IFRS 16.BC205C).

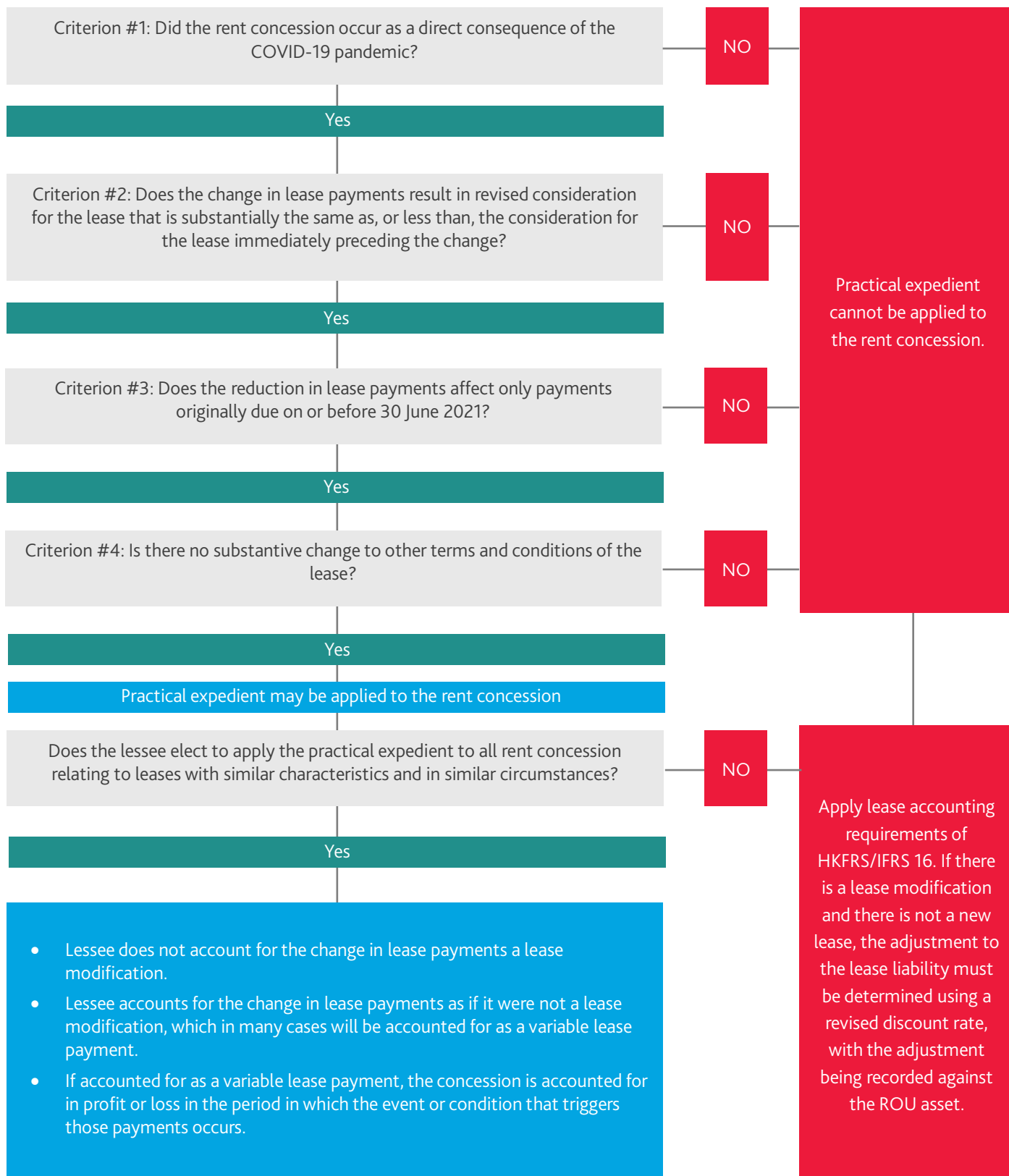
Therefore, an entity should apply (or not apply) the practical expedient consistently for similar leases. If an entity applies the practical expedient to some types of leases but not others that meet the criteria for its application, then additional disclosure is required (see FAQ 4.6).

## Section 3: assessing compliance with the practical expedient criteria

### FAQ 3.1: What are the criteria that must be satisfied in order for a rent concession to be accounted for using the practical expedient?

Answer: HKFRS/IFRS 16.46A-46B specify four criteria that must all be satisfied in order for a lessee to be able to apply the practical expedient to a rent concession. The criteria are summarised in the flowchart following this question, with FAQs on each criterion following the flowchart.

### FAQ 3.1: CRITERIA FOR APPLYING THE PRACTICAL EXPEDIENT



### Section 3: assessing compliance with the practical expedient criteria (continued)

FAQ 3.2, Criterion #1: Can reductions in lease payments for assets other than real estate (eg heavy equipment, machinery, etc.) satisfy this condition?

Answer: the practical expedient may be applied to any rent concession that relates to a lease within the scope of HKFRS/IFRS 16 and which satisfies the criteria, therefore, it can be applied to leases for underlying assets other than real estate as long as all criteria are met.

FAQ 3.3, Criterion #1: Can reductions in lease payments that are linked to other conditions (eg commodity prices being below a specified price in each month/quarter) satisfy this criterion?

Answer: No. Reductions in lease payments that are linked to commodity or other prices are not a 'direct consequence' of COVID-19. Decreases in asset prices may be a consequence of the effects of the pandemic, however, in our view, they would not satisfy this condition. Additionally, if the contingent reduction in lease payments is not restricted to lease payments originally due on or before 30 June 2021 (for example, the concession applies as long as oil prices remain below a specified amount), the rent concession also fails criterion #3.

FAQ 3.4, Criterion #2: Is the 'revised consideration' criterion assessed based on nominal (ie undiscounted) or discounted cash flows? In other words, does 'consideration' take into account the time value of money?

Answer: the amendments are unclear as to whether 'revised consideration' must be evaluated based on nominal (ie undiscounted) or discounted cash flows and, if discounted cash flows can be used, the basis on which the present value calculation should be performed (eg which discount rate should apply and whether total consideration in the lease is evaluated or only remaining consideration as at the time of the rent concession).

The basis for conclusions to the amendments notes that a change that is more than an insubstantial increase in total payments could not result solely from a COVID-19 related rent concession, except to the extent the increase reflects the time value of money. Therefore, if the nominal cash flows have increased, it would appear to be appropriate for entities to assess criterion #2 by determining whether the increase reflects the time value of money. Other increases in consideration, such as penalties that are included in the deferral, would cause this criterion to not be satisfied.

As an example, if a rent concession defers 3 payments of monthly rent of CU100 for a period of 12 months, the lessor and lessee may agree to increase the nominal cash flows to say, CU105 per month. If the lessee concludes that this increase in the nominal consideration is only to compensate the lessor for the time value of money, then this criterion is satisfied.

Increases in nominal cash flows when lease payments are deferred may be more common in jurisdictions with higher rates of inflation where the time value of money is more significant, and when the deferral of payments is for more than an insignificant period.

FAQ 3.5, Criterion #2: If a rent concession modifies lease payments by adjusting them to be variable payments (eg increasing the amount of rent that is based on a percentage of sales generated by a retail location), is this criterion satisfied?

Answer: the amendments are unclear as to whether 'revised consideration' includes all lease payments (eg fixed lease payments, variable lease payments that depend on an index or rate and variable lease payments that do not depend on an index or rate, such as a percentage of sales generated in each month). In our view, an acceptable approach is consider the revised consideration to include all consideration expected to be payable by the lessee under the revised terms of the lease agreement.

Therefore, in assessing whether a rent concession results in revised consideration that is substantially less than the original lease, an entity should consider whether the rent concession is expected to result in a reduction in total consideration payable. In many instances, we would expect this to be the case, as shopping centres and retailers in general are experiencing reduced sales levels because of the pandemic, meaning that a change from fixed rentals to amounts calculated as a percentage of sales revenue would be expected to result in reduced rentals. Additionally, it is unlikely that a lessee would agree to such a rent concession if they did not expect it to result in a reduction in total consideration.

The application of the practical expedient to a fact pattern including this type of rent concession is included in rent concession #4 in section 5.

FAQ 3.6, Criterion #3: If some of the reduction in payments extends past payments originally due on 30 June 2021, is the rent concession divided into the portion that does satisfy the criteria to use the practical expedient and the portion that does not?

Answer: No. To qualify for the practical expedient, the rent concession must reduce only lease payments originally due on or before 30 June 2021. This criterion is assessed for the rent concession as a whole, and it is written as a strict rule, therefore, a rent concession that reduces lease payments in any way past 30 June 2021 will disqualify the rent concession from the application of the practical expedient.

For example, if a rent concession resulted in reduced lease payments from 30 June 2020 to 31 August 2021, the entire rent concession would fail this criterion and the practical expedient would be unavailable. Rent concessions are not permitted to be 'sub-divided' into a portion that satisfies the criterion (ie 30 June 2020 – 30 June 2021) and a portion that does not satisfy the criterion (1 July 2021 – 31 August 2021). The criterion is assessed for the rent concession in its entirety. Similarly, if a rent concession was split into two separate legal agreements that were entered into at the same time, those two legal agreements would be combined for accounting purposes and accounted for as a single rent concession.

FAQ 3.7, Criterion #3: If a rent concession is 'open ended', will it fail to satisfy this criterion? For example, if the lessor agrees to reduce rent on a 'month-by-month' basis based on trading conditions.

Answer: if a lessor negotiates rent concessions on a month-by-month basis, then each contractual modification to the original terms of the lease is accounted for as a distinct unit of account because each month's rent concession is distinct from every other month's rent concession. That is, each rent concession agreed to in each month must be assessed against the practical expedient criteria and accounted for individually.

For example, if a lessor indicates to a lessee that it might reduce lease payments in each month depending on the lessor's assessment of trading conditions (eg foot traffic in a shopping centre, current economic forecasts, etc.), and the lessor will decide each month whether it will offer the lessee an adjustment to lease payments, then every month results in a distinct rent concession.

However, if the lessor agreed to a reduction in lease payments for the period during which foot traffic in a shopping centre remained below a specified level, this would not qualify for the practical expedient because the reduction in future lease payments is not time limited to periods ending 30 June 2021.

FAQ 3.8, Criterion #4: What are some examples of other substantive changes, which would result in this criterion not being satisfied?

Answer: substantive changes that would result in this criterion not being satisfied require judgment to assess. In our view, the analysis should include consideration of whether the lessor is requiring the lessee to accept other changes in the lease contract that compensate the lessor for the concession.

For example, if a lessor agrees to reduce July – September 2020 rent for a lessee by 25% in exchange for the lessee extending the lease by another 2 years, this lease extension would be another substantive change that would violate this criterion. Note that, depending on the facts and circumstances, some legal extensions of the lease term may not cause this criterion to fail if the lease term as defined by HKFRS/IFRS 16 remains the same. See FAQ 3.10.

Another example of a substantive change that would result in violation of criterion #4 would be a change that increases the scope of the lease in a manner other than the lease term. An example would be a rent concession in exchange for the lessee agreeing to rent an additional 2,000 square feet on the same floor as its existing leased office space.



FAQ 3.9, Criterion #4: Can a lease concession include a change to the lease term but still result in this criterion being satisfied?

Answer: not all changes in the lease term will disqualify a rent concession from applying the practical expedient.

HKFRS/IFRS 16.BC205D(c) clarifies the Board's conclusion, and notes that a three-month rental holiday before 30 June 2021, followed by three additional months of substantially equivalent payment at the end of the lease would not constitute a substantive change to other terms and conditions of the lease. A staff paper from the IASB's 15 May 2020 meeting discusses this example and notes that the IASB intended to capture within the scope of the practical expedient a simple concession that essentially replaces the period of the rent concession with an equivalent period at the end of the lease and with substantially equivalent payments.

The application of the practical expedient to a fact pattern including this type of rent concession is included in rent concession #2 in section 5.

FAQ 3.10, Criterion #4: If a concession modifies the non-cancellable period of a lease, but the lease term as defined by HKFRS/IFRS 16 remains unchanged, does this result in failure to satisfy criterion #4? For example, a lease may have had a fixed term plus a lessee option to extend the lease term. At the time the concession is agreed to, the lessee agrees that it will exercise the option at the time of the concession. Therefore, the non-cancellable period of the lease has increased. However, in previous reporting periods and as at the date of the lease concession, the lessee included the period covered by the lessee option in the lease term as defined in HKFRS/IFRS 16, then the 'accounting' lease term would not have changed.

Answer: in our view, as the 'lease term' as defined by HKFRS/IFRS 16 would not have changed in this instance, including as at the date on which the lease concession was entered into, this change to the lease contract would not result in failure to satisfy criterion #4.

If the lease term (for accounting purposes) is extended as part of the rent concession, and the extension is not covered by FAQ 3.9 above, it is extremely unlikely that the rent concession with satisfy criterion #4.

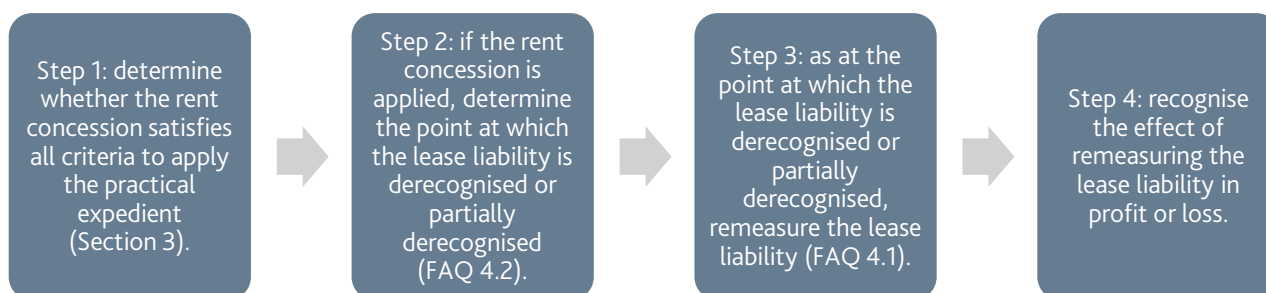




## Section 4: how to apply the practical expedient

Following the FAQs in this section are a number of examples, which illustrate how the practical expedient is applied to a number of different types of rent concessions.

The general approach to be applied when accounting for a rent concession using the practical expedient is summarised as follows:



**FAQ 4.1:** If a rent concession satisfies all the criteria required in order to apply the practical expedient, how is it applied?

Answer: FAQ 1.1 discusses the requirements of HKFRS/IFRS 16 applicable to lease modifications compared to the requirements of HKFRS/IFRS 16 applicable to rent concessions accounted for by applying the practical expedient.

As discussed in FAQ 1.1, the typical accounting for a rent concession will be to treat it as a 'negative variable payment', which results in the adjustment to the lease liability being recorded 'in the period in which the event or condition that triggers those payments occurs' (HKFRS/IFRS 16.38(b)). In our view, the 'event or condition' that triggers the adjustment to the lease liability is when the derecognition criteria of HKFRS/IFRS 9 are satisfied in relation to the portion of the lease liability being derecognised. This is because lease liabilities are within the scope of HKFRS/IFRS 9's derecognition requirements applicable to financial liabilities.

HKFRS/IFRS 9.3.3.1 (emphasis added):

*An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, **it is extinguished — ie when the obligation specified in the contract is discharged or cancelled or expires.***

Therefore, when a rent concession is effective, that is, when it extinguishes a portion of the lease liability, the effect of the rent concession is recorded. The effect is recorded by comparing (1) and (2):

- (1) The present value of the lease liability immediately prior to the rent concession extinguishing or partially extinguishing the lease liability in accordance with HKFRS/IFRS 9.3.3.1; and

- (2) The present value of the lease liability immediately after the rent concession, which represents the present value of the revised consideration.

The lease liability is adjusted to reflect the difference between (1) and (2) with the offsetting entry being recorded in profit or loss. The present value calculations are performed using an unchanged discount rate (see FAQ 4.3).

Comparing (1) and (2) above will result in a difference in instances where the nominal consideration in a lease is unchanged, but lease payments are deferred. For example, if a lessor agrees to collect unpaid rents due for April, May and June 2020 evenly over the 12 months from July 2020 – June 2021, this will result in a revision to the lease liability. This is because the present value of 3 months of rent presently due compared to the present value of 3 months of rent to be collected over the next 12 months is not the same. See rent concession #1 in section 5 for an illustration of this calculation.

**FAQ 4.2:** When is the lease liability remeasured as discussed in FAQ 4.1?

Answer: the lease liability is remeasured when the the derecognition requirements in HKFRS/IFRS 9.3.3.1 are satisfied, as noted in FAQ 4.1 (when a portion of the lease payments is forgiven) or when a deferral of lease payments becomes effective.

Depending on the precise terms and conditions of a rent concession, a rent concession may be accounted for at one point in time or over a number of periods.

For example, on 1 July 2020, if lessor grants a lessee a 25% unconditional reduction in lease payments for July, August and September, the derecognition requirements of HKFRS/IFRS 9.3.3.1 are satisfied on 1 July 2020. This is because on 1 July 2020, the lessee's obligation to pay 25% of July-

September rent is discharged. See rent concession #3A in Section 5.

In contrast, on 1 July 2020, if a lessor grants a lessee a 25% reduction in lease payments for July, August and September that is conditional on foot traffic in the shopping centre being 25% lower than the prior year in each individual month, then the derecognition criteria are not satisfied on 1 July 2020. This is because the lessee still owes the lessor the original lease payments until the condition (the monthly reduction in foot traffic) is satisfied. Therefore, assuming the reduction in foot traffic occurs in each month, the lessee remeasures the lease liability by derecognising 25% of its monthly lease payment at the end of each month when the derecognition criteria of HKFRS/IFRS 9.3.3.1 are satisfied. See rent concession #3B in section 5.

**FAQ 4.3: Does the lessee have to determine a revised discount rate when the lease liability is remeasured?**

Answer: No. When applying the practical expedient and remeasuring the lease liability as discussed in FAQ 4.1, the lessee uses an unchanged discount rate. This is because HKFRS/IFRS 16.40 requires a revised discount rate be used when there is a change in the lease term as a result of a modification or there is a change in the assessment of an option to purchase an asset, and HKFRS/IFRS 16.45(c) requires a revised discount rate be used when a lease is modified. As the practical expedient requires a lessee to not apply the requirements applicable to lease modifications, a revised discount rate is not used.

**FAQ 4.4: How is the lease liability accounted for in periods before a rent concession is agreed to? For example, if a lessee misses several months of payments, but no contractual penalties or interest are due, do the missed payments attract additional 'compound' interest due to HKFRS/IFRS 16.36?**

Answer: HKFRS/IFRS 16.36(a) requires the lease liability to be accounted for subsequent to initial recognition by 'increasing the carrying amount to reflect interest on the lease liability'. It does not elaborate further on how this should be done, and it does not require the use of the effective interest rate method, which is applicable to financial assets and liabilities classified at amortised cost in accordance with HKFRS/IFRS 9.

In our view, if the total consideration is not increased (because the lessor does not charge interest on late or missed payments), the missed payments should not result in additional interest being recorded beyond what would have been recorded if the payments had been made. That is, the total lease payments do not change due to a payment being missed, therefore, the amortisation table supporting the lease

liability does not need to be recalculated.

The application of the practical expedient to a fact pattern including this fact pattern is included in rent concession #5 in section 5.

**FAQ 4.5: How are the transitional requirements of the amendment applied?**

Answer: the amendments are effective for annual reporting periods beginning on or after 1 June 2020, with earlier application permitted. Unlike most amendments, application is also permitted in financial statements of earlier periods not yet authorised for issue at 28 May 2020 for IFRS financial statements and 4 June 2020 for HKFRS financial statements.

When the amendments are adopted, they are required to be applied retrospectively, with the cumulative effect being recognised in equity at the beginning of the annual reporting period in which the lessee first applies the amendments. Consequently, comparative information is not restated.

For example, if, as at 31 May 2020, an entity prepare IFRS financial statements and was still preparing its financial statements for the annual period ended 31 March 2020, it could apply the amendments and utilise the practical expedient for rent concessions that occurred as at 31 March 2020 or earlier, assuming they satisfied the criteria.

This means that the amendments may be applied to rent concessions that occurred prior to the amendments to HKFRS/IFRS 16 being published, as long as an entity is preparing financial statements that have not yet been completed once the amendments are applicable to the entity.

Entities that apply the practical expedient are not required to disclose the quantitative information required by HKAS/IAS 8.28(f).

**FAQ 4.6: Do the amendments introduce any additional disclosure requirements?**

Answer: Yes. An entity that applies the practical expedient must disclose:

- (a) That it has applied the practical expedient to all rent concessions that meet the criteria, or if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see analysis above concerning the consistent application of the practical expedient); and
- (b) The amount recognised in profit or loss to reflect changes in lease payments that arise from COVID-19-related rent concessions. Therefore, rent concessions accounted for as negative variable lease payments in profit or loss must be

disclosed separately from the effect of other variable lease payments included in profit or loss (eg rent payable based on sales occurring at a retail location).

**FAQ 4.7:** How should the effect of accounting for a rent concession be presented in the statement comprehensive income by a lessee?

Answer: as discussed in FAQ 4.1, the effect of accounting for a rent concession using the practical expedient will result in a variable lease payment being recorded in profit or loss (HKFRS/IFRS 16.38(b)). HKFRS/IFRS 16 does not contain specific requirements for how such payments should be presented in the statement of comprehensive income. When HKFRS/IFRS 16 was amended to introduce the practical expedient, no additional presentation requirements were added, only certain disclosures (see FAQ 4.6).

Therefore, the general presentation requirements of HKAS/IAS 1, *Presentation of Financial Statements* apply. The following should be noted concerning the presentation of the effects of applying the practical expedient, which will result in gains being recorded in profit or loss:

- (a) Gains should not be presented as 'revenue', as they do not relate to 'income arising in the course of an entity's ordinary activities' (Appendix A – HKFRS/IFRS 15);
- (b) Gains are subject to the offsetting requirements of HKAS/IAS 1.32, which states that entities shall not offset items of income or expense, unless required or permitted by a HKFRS/IFRS. No HKFRS/IFRS requires or permits gains recognised as a result of applying the practical expedient to be offset against expenses;
- (c) If gains are significant, then entities should consider whether they warrant disclosure as a separate line item (HKAS/IAS 1.85); and
- (d) Determining the appropriate presentation of gains may depend on the nature of the concession that gives rise to the gain. For example, if a gain is recognised due to the deferral of lease payments (section 5, rent concession #1), it may be appropriate to present this gain as finance income, as it relates the entity's recognised liabilities. If a gain is recognised due to the forgiveness of lease payments (section 5, rent concessions #3A and 3B), it may be appropriate to present this gain in some other line item within operating activities, as it does not solely relate to a benefit arising from a financing transaction.

Judgment may be required if gains are significant. If material, entities should disclose their accounting policies relating to the presentation of such gains.

## Section 5: Lessee illustrative examples

- All of the illustrative examples use the same base fact pattern, except for rent concession #5.
- All figures are rounded to the nearest CU (currency unit), unless otherwise specified.
- All examples assume that the criteria required to apply the practical expedient are satisfied (see section 3).
- All examples illustrate the application of the four-step process for applying the practical expedient to rent concessions, which is summarised at the beginning of section 4.

### Base fact pattern

Lessee A entered into a lease within the scope of HKFRS/IFRS 16 on 1 January 2019 with Lessor B. The lease is for a retail location in a shopping centre. The lease was for a term of 3 years, with lease payments due monthly in advance (ie the first day of the month). Lease payments are CU100 per month. At the commencement date of the lease, lessee A measures the lease liability and corresponding right-of-use asset using an estimate of its incremental borrowing rate, which is 5%.

At the commencement date (1 January 2019), the lease liability is measured at CU3,350 (ie the present value of 36 monthly payments of CU100 made in advance, discounted at 5% per annum).

Lessee A makes all lease payments in accordance with the terms of the lease from 1 January 2019 to 30 June 2020. Therefore, on 1 July 2020, the lease liability is CU1,738 (ie the present value of 18 remaining monthly payments of CU100 made in advance discounted at 5% per annum).

Each of the following examples illustrates the application of the practical expedient to a different rent concession agreed to by Lessee A and Lessee B on 1 July 2020. Each rent concession has occurred as a direct consequence of the COVID-19 pandemic, which has significantly affected Lessee A's operations.

### Rent concession #1 – deferral of lease payments

Rent concession: on 1 July 2020, Lessee A and Lessor B agree to defer July, August and September lease payments of CU100. The total of CU300 will be amortised 1/12<sup>th</sup> per month from October 2020 – September 2021. Therefore, the revised consideration consists of monthly lease payments of CU125 (100 + (300/12)) from October 2020 – September 2021, and CU100 from October 2021-December 2021. Total nominal cash flows in the lease remain the same; only their timing has been affected.

#### Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient.
- Step 2: the lease liability is remeasured on 1 July 2020 because this is when the rent concession is effective (ie future lease payments have been unconditionally changed).
- Step 3:
  - Present value of lease liability prior to rent concession: CU1,738
  - Present value of lease liability after rent concession: CU1,729<sup>1</sup>
  - Difference between 'old' and 'new' liability: CU9
- Step 4: the lease liability is remeasured on 1 July 2020:
 

DR lease liability	CU9
CR profit or loss	CU9

The benefit recorded in profit or loss represents the time value of money, as the present value of the revised cash flows is less than the present value of the original cash flows. Lessee A will be required to determine a new amortisation table for the lease liability, as the timing of cash flows has changed compared to the original lease, which will result in a revised finance expense in each period subsequent to July 2020.

### Rent concession #2 – deferral of lease payments with proportionate increase at end of lease term

Rent concession: on 1 July 2020, Lessee A and Lessor B agree to defer July, August and September lease payments of CU100. The total of CU300 will be payable in January, February and March 2022, as the concession results in the lease term being extended by 3 months beyond the original 31 December 2021 end date. Total nominal cash flows in the lease remain the same; only their timing has been affected, along with an extension of the lease term equal to the period for which lease payments have been deferred. This rent concession was agreed to because Lessor A had to cease operations of its store in April, May and June 2020 due to a government mandated lockdown. This concession 'replaces' 3 months in which the lessee could not operate its store with 3 additional months for no additional consideration.

#### Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient. Note that this rent concession is an illustration of the fact pattern described in FAQ 3.9.
- Step 2: the lease liability is remeasured on 1 July 2020 because this is when the rent concession is effective (ie future lease payments have been unconditionally changed).
- Step 3:
  - Present value of lease liability prior to rent concession: CU1,738
  - Present value of lease liability after rent concession: CU1,716<sup>2</sup>
  - Difference between 'old' and 'new' liability: CU22
- Step 4: the lease liability is remeasured on 1 July 2020:
 

DR lease liability	CU22
CR profit or loss	CU22

The benefit recorded in profit or loss represents the time value of money, as the present value of the revised cash flows is less than the present value of the original cash flows. Lessee A will be required to determine a new amortisation table for the lease liability, as the timing of cash flows has changed compared to the original lease, which will result in a revised finance expense in each period subsequent to July 2020.

<sup>1</sup> Present value of CU0 payments in July-September 2020, CU125 payments from October 2020-September 2021, and CU100 payments from October 2021-December 2021, made in advance, discounted at 5% per annum.

<sup>2</sup> Present value of CU0 payments in July-September 2020 and CU100 payments from October 2020-March 2022, made in advance, discounted at 5% per annum.

The right-of-use asset as at 1 July 2020 is depreciated over the remaining 21 months (July 2020 – March 2022)

It is not appropriate to account for the rent concession in the following way:

- (1) Forgiveness of July–September 2020 rent (DR lease liability, CR profit or loss); and
- (2) Extension of lease term by 3 months in exchange for CU100 per month from January–March 2022 (DR right-of-use asset, CR lease liability).

This approach is not acceptable because it accounts for 'forgiveness' of rent applying the practical expedient in HKFRS/IFRS 16, and the extension of the lease term applying the lease modification accounting requirements of HKFRS/IFRS 16. Said another way, this approach accounts for these changes as separate units of account, despite the fact that both changes were negotiated together to achieve a single commercial objective from a single overall rent concession. All changes that result from a rent concession are required to be included the effect of applying the practical expedient.

#### Rent concession #3A – unconditional forgiveness of rent

Rent concession: on 1 July 2020, Lessee A and Lessor B agree that July – December 2020 rent will be reduced by 15%. The reduction is not conditional on any future events.

#### Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient.
- Step 2: the lease liability is remeasured on 1 July 2020 because this is when the rent concession is effective (ie future lease payments have been unconditionally changed).
- Step 3:
  - Present value of lease liability prior to rent concession: CU1, 738
  - Present value of lease liability after rent concession: CU1, 649<sup>1</sup>
  - Difference between 'old' and 'new' liability: CU89
- Step 4: the lease liability is remeasured on 1 July 2020:
 

DR lease liability	CU89
CR profit or loss	CU89

The benefit recorded in profit or loss represents the reduction in total consideration payable under the lease, as the present value of the revised cash flows is less than the present value of

the original cash flows. Lessee A will be required to determine a new amortisation table for the lease liability, as the timing of cash flows has changed compared to the original lease, which will result in a revised finance expense in each period subsequent to July 2020.

The entire benefit (ie the reduction in the lease liability) is recorded on 1 July 2020, as the partial derecognition criteria of HKFRS/IFRS 9.3.3.1 are satisfied at that date. This is because Lessee A's obligation to pay 15% of its rental payments for July – December 2020 are discharged unconditionally on 1 July 2020.

#### Rent concession #3B – conditional forgiveness of rent

Rent concession: on 1 July 2020, Lessee A and Lessor B agree that July – December 2020 rent will be reduced by 15% as long as foot traffic in the shopping centre is 15% lower in each month compared to the prior year. Each month is assessed against the same month in the prior year on an individual basis. If a reduction is to be given for a particular month (for which Lessee A will have paid in advance), the reduction of CU15 is applied to the cash payment that is due in advance for the following month.

#### Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient.
- Step 2: the lease liability is remeasured at the end of each month if the foot traffic in the shopping centre satisfies the condition. This is when the rent concession is effective (ie lease payments have been unconditionally changed).
- Step 3 (example for 31 July 2020):
  - It is unnecessary to compare the 'old' and 'new' lease liability, as the rent concession does not affect the present value calculation in the lease liability. The rent concession is that Lessee A owes CU85 instead of CU100 on 31 July 2020.
- Step 4: the lease liability is reduced on 31 July 2020:
 

DR lease liability	CU15
CR profit or loss	CU15

The benefit recorded in profit or loss represents the reduction in total consideration payable under the lease. Lessee A would record the same entry at the end of month from July – December 2020 assuming that the foot traffic criteria is satisfied. Lessee A cannot adjust the lease liability for August – December 2020 reductions in rent as the partial derecognition requirements of HKFRS/IFRS 9.3.3.1 are not yet satisfied.

<sup>1</sup> Present value of CU85 payments in July–December 2020, and CU100 payments from January 2021–December 2021, made in advance, discounted at 5% per annum.

Rent concession #4 – conversion of fixed lease payments to variable lease payments

Rent concession: on 1 July 2020, Lessee A and Lessor B agree that July – December 2020 rental payments will be based on 20% of sales generated at Lessee A's store. The CU100 fixed lease payments are unconditionally waived. Therefore, if Lessee A does not generate any sales from July – December 2020, Lessee A will not be required to make any lease payments to Lessor B. Lessee A expects to make sales of CU2,000 during the period from July – December 2020.

Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient. See FAQ 3.5.
- Step 2: the lease liability is remeasured on 1 July 2020 because this is when the rent concession is effective (ie future lease payments have been unconditionally changed).
- Step 3:
  - Present value of lease liability prior to rent concession: CU1,738
  - Present value of lease liability after rent concession: CU1,144<sup>1</sup>
  - Difference between 'old' and 'new' liability: CU594
- Step 4: the lease liability is reduced on 31 July 2020:

DR lease liability   CU594  
 CR profit or loss   CU594

The benefit recorded in profit or loss represents the reduction in total consideration payable under the lease. As noted below, the present value calculation for the 'new' liability included CU0 payments from July-December 2020. This is because Lessee A is no longer required to make fixed lease payments for this period, therefore, the derecognition requirements of HKFRS/IFRS 9.3.3.1 are satisfied on 1 July 2020.

Variable lease payments that do not depend on an index or rate are included in profit or loss in the period in which the event or condition that triggers those payments occurs (HKFRS/IFRS 16.38(b)). Such payments are not included in the measurement of the lease liability, regardless of the fact that Lessee A expects to make CU2,000 of sales from July – December 2020, which would result in CU400 of variable lease payments.



<sup>1</sup> Present value of CU0 payments in July-December 2020, and CU100 payments from January 2021-December 2021, made in advance, discounted at 5% per annum.



**Rent concession #5 – forgiveness of accrued and unpaid rent**

Note: rent concession #5 uses the same base fact pattern as concessions #1-4, except that Lessee A did not make its lease payments in April, May and June as the effects of the pandemic put severe strains on its cash flows. All other case facts remain the same.

Rent concession: on 1 July 2020, Lessee A and Lessor B agree that 60% of April-June lease payments will be unconditionally forgiven if on 1 July 2020, Lessee A pays the remaining 40%.

Month	Opening liability	Payment	Interest	Ending liability
April 2020	2,015.11	(100)	7.98	1,923.09
May 2020	1,923.09	(100)	7.60	1,830.69
June 2020	1,830.69	(100)	7.21	1,737.90

This amortisation table assumes that Lessee A will make payments on their contractual due date, which is the first of each month in advance. However, Lessee A has not made payments required under the original contractual terms of the lease due to cash flow constraints arising from the pandemic. Lessee A failing to make contractually due payments is not a rent concession or a lease modification, because the

Measurement of the lease liability prior to rent concession

This section illustrates the answer to FAQ 4.4.

Before accounting for the rent concession, Lessee A must determine how it should account for the lease liability from 1 April – 30 June when it misses three CU100 lease payments. The amortisation table for the lease liability, under the original contractual terms of the lease, assuming payments would be made, was as follows (not rounded to the nearest CU for the purposes of the following two tables):

contractual terms of the lease have not been modified; Lessee A is simply not complying with them.

This raises the question as to whether Lessee A should record additional interest. Since Lessee A has missed payments, multiplying the discount rate (5%/12) by the liability figure in the three periods of missed payments would result in a revised amortisation table as follows:

Month	Opening liability	Payment	Interest	Ending liability
April 2020	2,015.11	-	8.40	2,023.51
May 2020	2,023.51	-	8.43	2,031.94
June 2020	2,031.94	-	8.47	2,040.40

Higher interest accrues than the original amortisation table as the lease liability is not being reduced by lease payments that are contractually due. This creates a 'mechanical' issue in that even if Lessee A makes a CU300 payment 1 July 2020 (assuming no rent concession is granted), the amortisation table would not 'run out' properly, as total consideration owing by Lessee A has not increased. This is because the lessor did not charge interest on the missed payments.

In our view, if lease payments are unpaid, but they do not result in additional consideration owing by the lessee to the lessor, the lessee may continue to accrue interest under the existing terms of the contract. This is because the contract has not been modified, and no additional consideration is owed. In each period in which Lessee A does not make its CU100 payment as required, the following journal entry is recorded:

DR lease liability 100  
CR other liability 100

This 'other liability' does not accrue interest, since as stated, no additional consideration in the form of interest on late/missed payments is owed by Lessee A to Lessor B.

This approach allows Lessee A to keep its original amortisation table unchanged during periods where payments are not made as contractually required. It should be noted that this approach relates to the general requirements of subsequent measurement of lease liabilities; it is not an exception related to the utilisation of the practical expedient. This is because the practical expedient is not applicable from April – June 2020, as no rent concession has been agreed to.

#### Measurement of the lease liability after the rent concession

##### Analysis:

- Step 1: assume the rent concession satisfies all the criteria to apply the practical expedient.
- Step 2: the lease liability is remeasured on 1 July 2020 because this is when the rent concession is effective (ie future lease payments have been unconditionally changed).

- Step 3:
  - It is unnecessary to compare the 'old' and 'new' lease liability, as the rent concession does not affect the present value calculation in the lease liability. The rent concession is that Lessee A owes only 40% of CU 300, which are presently due lease payments for April – June 2020, which are recorded within other liabilities as at 1 July 2020.
  - Therefore, the rent concession is 60% of CU300 = CU180.
- Step 4: the lease liability is reduced on 1 July 2020:

DR other liability	CU300
CR cash	CU120
CR profit or loss	CU180

The benefit recorded in profit or loss represents the reduction in total consideration payable under the lease. The calculations required to account for the rent concession do not require the use of present value techniques because the only lease payments affected are those that were presently due.

The reconciliation of the total lease liability, including the non-interest bearing 'other liability' figure as at 1 July 2020 is as follows:

Total lease liability, 1 July 2020, before rent concession	2,038 <sup>1</sup>
Forgiveness of 60% of April-June 2020 rent	(180)
Payment of 40% of April-June 2020 rent	(120)
Lease liability, 1 July 2020, after rent concession	1,738 <sup>2</sup>

The lease liability after accounting for the rent concession is equal to the present value of CU100 lease payments owing from July – December 2020, made in advance, measured using an unchanged discount rate of 5%.

Therefore, Lessee A is not required to determine a new amortisation table for its lease liability. This is because lease payments owing subsequent to the effective date of the rent concession are unchanged.

<sup>1</sup> Equal to the 30 June 2020 ending lease liability in the original amortisation table (CU1, 738), as calculated earlier in this example plus CU300 recorded in other liabilities, as noted above.

<sup>2</sup> Present value of CU100 payments in July-December 2020, made in advance, discounted at 5% per annum.

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