Rent forgiveness: Impairment, derecognition or modification?

The IFRIC published an agenda decision dealing with the interaction between IFRS 9 and IFRS 16 in the case of a specific rent concession. The concession in question involves forgiving the lessee's obligation to make certain lease payments. While the lessor's position is clear, the lessee's is more contentious.

In October 2022 the IFRS Interpretations Committee ("IFRIC') published an agenda decision on accounting for rent concession involving forgiveness. This article briefly considers their decision.

Rent forgiveness arrangement

The lessor accounted for the lease in question as an operating lease. The lessee recognised an ROU asset and lease liability.

The lessor releases (forgives) the lessee from its obligation to make certain lease payments. These payments consist of a combination of:

- Amounts that are contractually due but remain unpaid. The lessor recognised a lease receivable for these amounts.
- Amounts that are not yet due.

The request to the IFRIC was twofold:

- How should the lessor apply the expected credit loss (ECL) model in IFRS 9 before the concession is granted, when it is being anticipated?
- How should the concession be accounted for under IFRS 9 and IFRS 16?

Application of the ECL model

The IFRIC indicated that the impairment rules in IFRS 9 clearly apply to operating lease receivables. They require an entity to recognise a loss allowance for expected credit losses on a lease receivable. A credit loss is any difference between the contractual cash flows due to an entity and those that the entity expects to receive. If an entity anticipates forgiveness of the obligation to make the lease payments, this is an outcome to consider (albeit perhaps on a probability-weighted basis) as part of reasonable and supportable information.

Lessor: Derecognition or modification?

The derecognition rules in IFRS 9 apply to lease receivables. To the extent that the lessee is released from obligations reflected in the receivable, the derecognition principles in IFRS 9 apply. The ECL allowance is adjusted accordingly.

The concession also meets the definition of a modification (a change in consideration for a lease that was not part of the original terms). The lessor must account for the modification as a new lease. Paragraph 87 of IFRS 16 specifically requires the lessor to consider accrued lease payments as part of the lease payments for the new lease. This requirement seems to have contributed to some uncertainty that prompted the question to the IFRIC. The IFRIC concluded that the payments reflected in the receivable are not accrued lease payments as contemplated in paragraph 87. They do not explicitly provide a reason for this view; broadly, the reasoning seems to be that amounts accounted for under IFRS 9 should not be considered accrued lease payments. This achieves the sensible outcome of not double counting the effect of forgiveness.

Lessee: Derecognition or modification?

The IFRIC concluded that there is more than one way for the lessee to account for this type of concession. Due to the potential overlap between IFRS 9 and IFRS 16, the IFRIC recommended that the IASB consider a narrow-scope scope amendment.

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