

Endorsement Criteria Assessment: *Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendment to IFRS 16)*

Introduction

Purpose

1. The purpose of this [draft] Endorsement Criteria Assessment (ECA) is to determine whether the UK's statutory requirements for endorsement and adoption of an amended standard are met.
2. The Amendment is the International Accounting Standards Board's (IASB) *Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendment to IFRS 16)* (March 2021 Amendment) published on 31 March 2021.

Background to the Amendment

3. In May 2020, the IASB published *Covid-19-Related Rent Concessions (Amendment to IFRS 16)* (May 2020 Amendment). It applied for annual reporting periods beginning on or after 1 June 2020, although earlier application was permitted. It was time limited and does not apply for rent forgiven after 30 June 2021.
4. Rent concessions that are lease modifications under IFRS 16, are recognised in profit or loss over the term of the lease and this requires recalculating the lease liability using a revised discount rate over the term of the lease. The May 2020 Amendment applied only to rent concessions, for example, rent holidays or rent reductions, that occur as a direct consequence of the covid-19 pandemic and met certain other conditions. If these conditions were met, lessees were permitted, by way of a practical expedient, not to assess whether a covid-19-rent concession is a lease modification under IFRS 16. Thereby, lessees that applied the practical expedient would recognise the amount of rent forgiven on or before 30 June 2021, in the profit or loss account in the year of the concession.
5. The European Union adopted the May 2020 Amendment before the end of the Implementation Period¹. Thus, the May 2020 Amendment is part of UK-adopted international accounting standards².
6. The March 2021 Amendment extends the date a lessee is permitted to apply the practical expedient to rent concessions that meet certain conditions, from on or before 30 June 2021, to on or before 30 June 2022. It is effective for annual reporting periods

¹ See Commission Regulation (EU) 2020/1434 of 9 October 2020: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1434&from=EN>

² See Regulation 4 of The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 No 685: <https://www.legislation.gov.uk/ukxi/2019/685/made>

beginning on or after 1 April 2021. Earlier application is permitted, including in financial statements not authorised for issue (or signed) at 31 March 2021.

UK Statutory requirements for endorsement and adoption

7. Paragraph 1 of Regulation 7 of The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 No. 685 requires that an international accounting standard³ only be adopted if:
- a) “the standard is not contrary to either of the following principles—
 - i. an undertaking’s accounts must give a true and fair view of the undertaking’s assets, liabilities, financial position and profit or loss;
 - ii. consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the accounts taken as a whole, so far as concerns members of the undertaking;
 - b) the use of the standard is likely to be conducive to the long term public good in the United Kingdom; and
 - c) the standard meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.”
8. This document assesses the criteria set out in paragraph 7 in the following order:
- a) Technical criteria assessment:
 - i. Whether the standard meets the criteria of relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management (Regulation 7(1)(c)); and
 - ii. Whether the standard is not contrary to the principle that an entity’s accounts must give a true and fair view (Regulation 7(1)(a)).
 - b) Whether use of the standard is likely to be conducive to the long term public good in the UK (Regulation 7(1)(b)).

³ This is defined in the Companies Act using Article 2 of the IAS Regulation “...‘international accounting standards’ shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related Interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB).”

Relevance, Reliability, Comparability and Understandability⁴

9. Information is **relevant** if it is capable of making a difference in the decision-making of users or in their assessment of the stewardship of management. The information may aid predictions of the future, confirm or change evaluations of the past or both.
10. Financial information is **reliable** if, within the bounds of materiality, it:
 - a) can be depended on by users to represent faithfully what it either purports to represent or could reasonably be expected to represent;
 - b) is complete; and
 - c) is free from material error and bias.
11. Information is **comparable** if it enables users to identify and understand similarities in, and differences among, items. Information about an entity should be comparable with similar information about other entities and with similar information about the same entity for another period.
12. Financial information should be readily **understandable** by users with a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information with reasonable diligence.

Rationale for the Amendments

13. The May 2020 Amendment introduced an optional practical expedient for a limited period for lessees that received rent concessions that occurred as a direct consequence of the covid-19 pandemic and also met all of the following conditions (paragraph 46B of IFRS 16):
 - 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 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and
 - c) there is no substantive change to other terms and conditions of the lease.
14. If these conditions were met, lessees were permitted not to assess whether a covid-19-related rent concession is a lease modification under IFRS 16. Thus, lessees would recognise the amount of rent forgiven on or before 30 June 2021, in the profit or loss account in the year of the concession. If the practical expedient was not available, those

⁴ These descriptions are based on the qualitative characteristic of financial statements in the *Framework for the Preparation and Presentation of Financial Statements* adopted by the IASB in April 2001. These qualitative characteristics became part of the criteria for endorsement and adoption of IFRS in the EU's IAS Regulation (1606/2002), and, subsequently, in SI 2019/685.

rent concessions that met the criteria for a lease modification under IFRS 16, would have been recognised in profit or loss over the term of the lease and this requires recalculating the lease.

15. The IASB concluded that the practical expedient would provide operational relief to lessees and that the lease liability recognised would reflect the present value of future lease payments owed to the lessor. The IASB introduced disclosures to mitigate any reduction in comparability arising from the optional nature of the May 2020 Amendment. A lessee was required to disclose the fact that it was applying the practical expedient to some or all eligible contracts, and the amount recognised in profit or loss to reflect changes in lease payments arising from the relevant rent concessions.
16. The March 2021 Amendment extends the availability of the optional practical expedient by a year—from payments due on or before 30 June 2021—to payments due on or before 30 June 2022. The practical expedient is conditional on the conditions set out in the May 2020 Amendments being met. The extension recognises that lessees are still facing health and economic challenges arising from the covid-19 pandemic and this relief would therefore still be helpful to lessees.

Assessment against technical criteria

17. The May 2020 Amendment acknowledged the many challenges lessees faced during the covid-19 pandemic and the intention was to provide relief to lessees when it was needed most.
18. Since the May 2020 Amendment, the covid-19 pandemic has continued globally. The extent of the impact of the pandemic on the health and economic outcomes mean that pandemic programmes and reliefs have been extended. By extending the optional practical expedient for a further year, the March 2021 Amendment ensures that the reliefs designed for this period continue to be accounted for in the same way.
19. The May 2020 Amendment was endorsed and adopted by the European Union using similar endorsement criteria to those stipulated by the UK legislation, as set out in paragraph 7 above.
20. The March 2021 Amendment introduces only one change, and that is to extend the availability of the practical expedient by a year. In all other respects, it is identical to the May 2020 Amendment. As a result, the assessment set out below expands on the original EU assessment only to the extent it is relevant to the UK specific conditions.

Relevance, Reliability and Understandability

21. The covid-19 pandemic and resulting economic and health conditions that gave rise to the May 2020 Amendment still exist. Therefore, consistent with the May 2020 Amendment, the application of the March 2021 Amendment will continue to provide relevant and reliable information.
22. Lessees that choose to apply the March 2021 Amendment are required to make additional disclosures. These disclosures provide information to users and investors to

help them understand the impact of covid-19-related rent concessions on their financial statements and thereby enhancing the understandability of the information.

Comparability

23. The May 2020 Amendment may have decreased comparability between those lessees that applied the practical expedient and those lessees that did not. The IASB introduced disclosure requirements in that Amendment to mitigate any potential detrimental effect. On balance, the continuation of the disclosure requirements in the March 2021 Amendment will similarly limit any loss of comparability between lessees.
24. Conversely, the extension of the practical expedient may improve comparability of accounting treatment over time for lessees that applied the May 2020 Amendment and wish to continue to apply the practical expedient.

Conclusion

25. Overall, we conclude that the March 2021 Amendment meets the criteria of relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management, as required by SI 2019/685 (see paragraph 7(c) above).

True and fair view

26. This section considers whether the March 2021 Amendment is not contrary to the principle that an entity's accounts must give a true and fair view.
27. A true and fair view is an overarching concept, to be applied to an entity's financial statements as a whole. Accounting standards provide for recognition, measurement, presentation and disclosure for transactions and events so that the financial statements fairly reflect the economic substance of those underlying transactions and events, hence providing a true and fair view.
28. The current position, introduced by the May 2020 Amendment, whereby lessees are able to apply the practical expedient where certain other conditions are met, combined with the required additional disclosures, is not considered contrary to the true and fair view principle.
29. The March 2021 Amendment introduces only one change, the extension of this current position for a further year due to the conditions that gave rise to that Amendment still existing. Consequently, the March 2021 Amendment is not considered contrary to the true and fair principle.

Conclusion

30. Overall, we conclude that application of the Amendments is not contrary to the principle that an entity's accounts/consolidated accounts must give a true and fair view as required by SI 2019/685 (see paragraph 7(a)).

UK public good

31. This section considers whether the Amendments are likely to be conducive to the long term public good in the UK. Regulation 7(2) of SI 2019/685 includes specific areas to consider for this assessment. They are:
- a) whether the use of the standard is likely to improve the quality of financial reporting;
 - b) the costs and benefits that are likely to result from the use of the standard; and
 - c) whether the use of the standard is likely to have an adverse effect on the economy of the UK, including on economic growth.

Improve the quality of financial reporting

32. The objective of the March 2021 Amendment is to extend the availability of the practical expedient by a year, as the covid-19 pandemic continues to present global economic challenges for governments and companies.
33. Initial feedback from some stakeholders indicates that they believe the March 2021 Amendment improves the quality of financial reporting by permitting the continuation of the original practical expedient (May 2020 Amendment)—issued as a limited practical expedient for a specific time period, with an expectation that the covid-19 pandemic would be overcome by 30 June 2021. Given the on-going nature of the pandemic, it is reasonable to extend availability of the practical expedient to lessees to ensure consistency in the treatment of similar covid-19-related rent concessions.
34. Furthermore, under the current economic conditions, it is helpful to users of financial statements to reflect the effect of these rent concessions in the periods in which they apply, rather than spreading them over the remaining life of the lease as would be required if they were treated as a lease modification, so that the extent of the relief received by a lessee is clearly understandable.
35. Some other stakeholders argue that practical expedients are not intended to improve financial reporting but instead consider that the underlying requirements of IFRS 16 are a technically appropriate way to account for lease modifications under IFRS. However, when IFRS 16 was developed, it did not envisage a global pandemic such as the one created by covid-19. Therefore, it was not written to account for such conditions. Consequently, the May 2020 Amendment and the March 2021 Amendment to IFRS 16 reflect a subsequent issue.

Conclusion

36. On balance, we conclude that similar to the May 2020 Amendment, the March 2021 Amendment will improve the quality of financial reporting by permitting the continuation of the original practical expedient (May 2020 Amendment) for another year, to rent forgiven on or before 30 June 2022, given the on-going nature of the covid-19 pandemic. It ensures consistency in the treatment of similar covid-19-related rent concessions.

Costs and benefits from using the Amendment

Introduction

37. This section considers the costs and benefits that are likely to result from the use of the March 2021 Amendment. The work undertaken to make this assessment is proportionate to the nature and scale of the March 2021 Amendment and to the population of entities that are affected by it.
38. The March 2021 Amendment is limited in scope because it:
 - a) applies only to lessees with covid-19-related rent concessions that also meet certain other conditions; and
 - b) is an extension of an existing practical expedient.

Costs and benefits for preparers

39. The March 2021 Amendment extends the availability of the practical expedient to lessees for a year. Preparers that already apply the practical expedient have already received the benefit of the operational simplification. Continuing to apply the practical expedient should not create any new cost for these preparers. However, the lack of availability of the extension may create additional costs for preparers that are currently using this practical expedient to represent the economic impact of the covid-19 related rent concessions in their financial statements.
40. For preparers that wish to apply the practical expedient for the first-time, the requirement to do so retrospectively may find the benefits of doing so only marginally outweigh the cost of implementing it and making the additional disclosures.
41. Initial feedback from some stakeholders indicates that they consider that both Amendments lead to benefits that exceed costs in the same proportion. Initial feedback from some other stakeholders shows that they consider that this may not be so evident for the second Amendment.

Costs and benefits for users

42. The March 2021 Amendment is a continuation of the relief given by the May 2020 Amendment, thus users are aware that some lessees have taken advantage of the practical expedient. The additional disclosure requirements will identify those lessees who choose to apply the latter Amendment.
43. We consider that the costs to users will therefore be minimal or nil due to the narrow-scope of the March 2021 Amendment and that it was available to lessees for the previous financial year.
44. Initial feedback from stakeholders we consulted did not specifically comment on whether there would be costs and benefits to users of the March 2021 Amendment. This reinforces our view that that narrow-scope and nature of this Amendment will not lead to additional costs for users.

Conclusion

45. On balance, the benefits of extending the availability of the practical expedient outweigh any additional costs because the additional disclosures highlight this exception to IFRS 16 whilst the effects of the covid-19 pandemic are still being felt. We conclude that the incremental cost of the March 2021 Amendment is minimal (or nil) for both preparers and users.

Likely effect on the economy of the UK

46. This section addresses whether the use of the March 2021 Amendment is likely to have an adverse effect on the UK economy, including on economic growth.
47. As explained above, the March 2021 Amendment is applicable to a limited number of entities. That is, to lessees that have covid-19-related rent concessions that also meet certain other conditions.
48. Furthermore, the March 2021 Amendment only extends the availability of the pre-existing practical expedient in the May 2020 Amendment. The extension was driven by the continuation of the covid-19 pandemic which is still creating health and economic challenges for lessees.
49. Initial feedback from most stakeholders we consulted were either not aware of any likely adverse effect on the UK economy or considered that there would be no adverse effect arising from the March 2021 Amendment.

Conclusion

50. We conclude that the March 2021 Amendment is not likely to have an adverse effect on the economy of the UK, including on economic growth.

Overall conclusion on the UK long term public good

51. In paragraphs 32–50 we conclude that the March 2021 Amendment:
- a) will generally improve financial reporting in a similar way to the May 2020 Amendment, by permitting the continuation of the original practical expedient (May 2020 Amendment) for another year, to rent forgiven on or before 30 June 2022, given the on-going nature of the covid-19 pandemic. It ensures consistency in the treatment of similar covid-19-related rent concessions;
 - b) will lead to benefits that exceed the costs; and
 - c) is not likely to have an adverse effect on the economy of the UK, including on economic growth.
52. Overall, therefore, we conclude that the March 2021 Amendment is likely to be conducive to the long term public good in the UK as required by SI 2019/685.