

Beyond the GAAP

MAZARS' NEWSLETTER ON ACCOUNTING
STANDARDS

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EDITORIAL

As the first major financial reporting deadline for 2020 draws near, the COVID-19 epidemic seems to be slowing – at least in some parts of the world. However, there is still a high level of uncertainty, meaning it will be tricky to make judgements, calculate estimates, and identify assumptions to be used. Drawing up the interim financial statements for 2020 will therefore be something of a challenge, despite the assistance provided by regulators and standard-setters.

With this in mind, our latest COVID-19 supplement summarises ESMA's Public Statement on the implications of the epidemic for interim financial statements, and the principles to follow in order to present appropriate information within and outside the financial statements.

Although this document does not modify the existing standards – unlike the amendment to IFRS 16, just published by the IASB and also summarised in this issue – it is particularly useful for its guidance on how best to explain the impact of the crisis on entities' performance.

Happy reading!

Edouard Fossat

Carole Masson

IASB publishes IFRS 16 amendment on COVID-19-related rent concessions

On 24 April 2020, the IASB published an exposure draft of a proposed amendment to IFRS 16, which would allow lessees to elect not to assess whether a COVID-19-related rent concession is a lease modification.

Due to the extreme urgency of the issue, the comment period was limited to 14 days and ended on 8 May.

On 15 May, the IASB met again to redeliberate the proposed amendment in the light of feedback received, and decided to finalise the proposals with just a few minor changes.

The amendment was published in its final form on 28 May, marking an end to a project that was rushed through at high speed in order to enable companies to implement it as soon as possible.

In this special issue, we review the background to the topic as well as the content of the final amendment, which is freely available on the IASB website here: <https://www.ifrs.org/news-and-events/2020/05/iasb-issues-amendment-to-ifrs-standard-on-leases/>.

The EU endorsement process will also be expedited, so that the amendment can be applied in the 2020 interim financial statements. At the time of writing, the amendment has not yet been endorsed.

1. Why was this amendment necessary?

The COVID-19 health crisis has led or will lead many lessors to grant rent concessions to their lessees. These are particularly prevalent in the retail sector. These concessions may in some cases be encouraged or even required by governments.

Rent concessions may take a number of forms, including rent holidays or rent reductions for a period of time, possibly followed by increased rent payments in future periods.

Under IFRS 16, the accounting impacts of changes in lease payments mainly depend on whether the changes in question meet the definition of a contract modification.

A contract modification gives rise, for the lessee, to an adjustment of the lease liability, taking account of the revised lease payments discounted at the appropriate rate (usually the lessee's incremental borrowing rate) at the contract revision date, and a corresponding adjustment to the right-of-use asset. Thus, the impact of a contract modification for the lessee will be spread over the remainder of the lease term through depreciation of that right-of-use asset.


The analysis required in order to assess whether a change in rental payments represents a contract modification appears particularly complex and would be a major challenge for stakeholders during the COVID-19 pandemic.


This challenge is due to the combination of the two following difficulties:

- firstly, the difficulty of assessing whether rent concessions amend the lease. This assessment requires preparers to determine whether the change in rental payments was included in the initial contract conditions. Such an assessment may be particularly complex in light of the high volume of leases (legal formalism, and the juridical environment specific to each). Similarly, determining whether an event as singular as a pandemic falls within the scope of contractual and/or legal terms is not necessarily straightforward. For example, a lease, a law or a regulation applicable to a contract may contain force majeure clauses which have never addressed the specific circumstances of a pandemic. In this case, it may thus be difficult to conclude that rent concessions result from the strict application of the contractual clauses or of the relevant legal provisions, rather than from renegotiation;
- next, the difficulty of applying the accounting treatment required in the event of contract modifications: while it is neither complex nor onerous to account for a contract modification individually, the volume of leases concerned would demand significant resources, at a time when lessees are likely to have other, more important worries due to the pandemic.

The IASB therefore decided to amend IFRS 16, to make things “simpler” for companies by permitting a practical expedient.

2. What does the amendment permit lessees to do?

 The new amendment to IFRS 16 permits lessees, and only lessees, to elect not to assess whether a COVID-19-related rent concession is a lease modification.



The amendment only covers rent concessions directly related to COVID-19, and furthermore, they must meet the following conditions:

- 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;
- the lease payments were originally due on or before 30 June 2021;
- there is no substantive change to other terms and conditions of the lease.

It goes without saying that the wording of the final amendment necessitates the use of judgement, particularly when determining whether the revised consideration is substantially the same as or less than previously, if the terms of the rent concession are complex (which may be the case if e.g. fully or partially variable lease payments replace fixed lease payments, requiring the entity to estimate the lease payments over the period covered by the change); when the concession covers lease payments due both before and after 30 June 2021; or when determining whether changes to other terms and conditions of the lease are substantive.

Lessees would apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances. It would mean in practice that any change in lease payments resulting from COVID-19-related rent concessions would be accounted for as if the change were not a lease modification. Thus, the impact of the rent concession would be recognised in profit or loss for the period, and not over the residual term of the lease. There would be no impact on the right-of-use asset and its depreciation pattern should normally be unchanged.

Although the amendment has only just been published, questions are already arising around its application in practice, particularly as regards the timing of revenue recognition. For example: should rent concessions granted by the lessor be recognised immediately, or spread over the period in question? Such questions are all the more pertinent given that the exemption covers rent concessions on lease payments due up to 30 June 2021, which may thus affect more than one reporting period. It is a shame that the IASB did not go into more detail, or provide illustrative examples. In the absence of any clarifications in the amendment, the timing of revenue recognition in profit or loss will probably depend on whether the rent concessions are conditional or unconditional. If a rent concession is unconditional it should be recognised immediately in profit or loss, whereas if a concession is conditional upon the occurrence of a specific event, it may not be possible to recognise it until this uncertainty is resolved.

The amendment is applicable for reporting periods beginning on or after 1 June 2020, and early application is permitted.

It is applicable retrospectively, but comparative figures do not need to be restated (the impact shall be recognised, where necessary, as an adjustment to the opening balance of retained earnings, or other component of equity, for the reporting period in which the amendment is first applied). The disclosures in paragraph 28 (f) of IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* are not required. Thus, a lessee is **not** required to disclose, for the current period and each prior period presented, either the amount of the adjustment for each affected line item in the financial statements, or the amount of the adjustment for basic and diluted earnings per share.

In any case, retrospective applicability is largely academic: it will only apply to entities whose reporting period does not coincide with the calendar year and which were granted rent concessions for the start of 2020 before their closing date, but were unable to apply the amendment at the time as the final version had not yet been published.

Finally, it should be noted that the amendment requires entities that apply the practical expedient to disclose this in the notes. They should also disclose the amount recognised in profit or loss to reflect changes in lease payments that arise from COVID-19-related rent concessions.

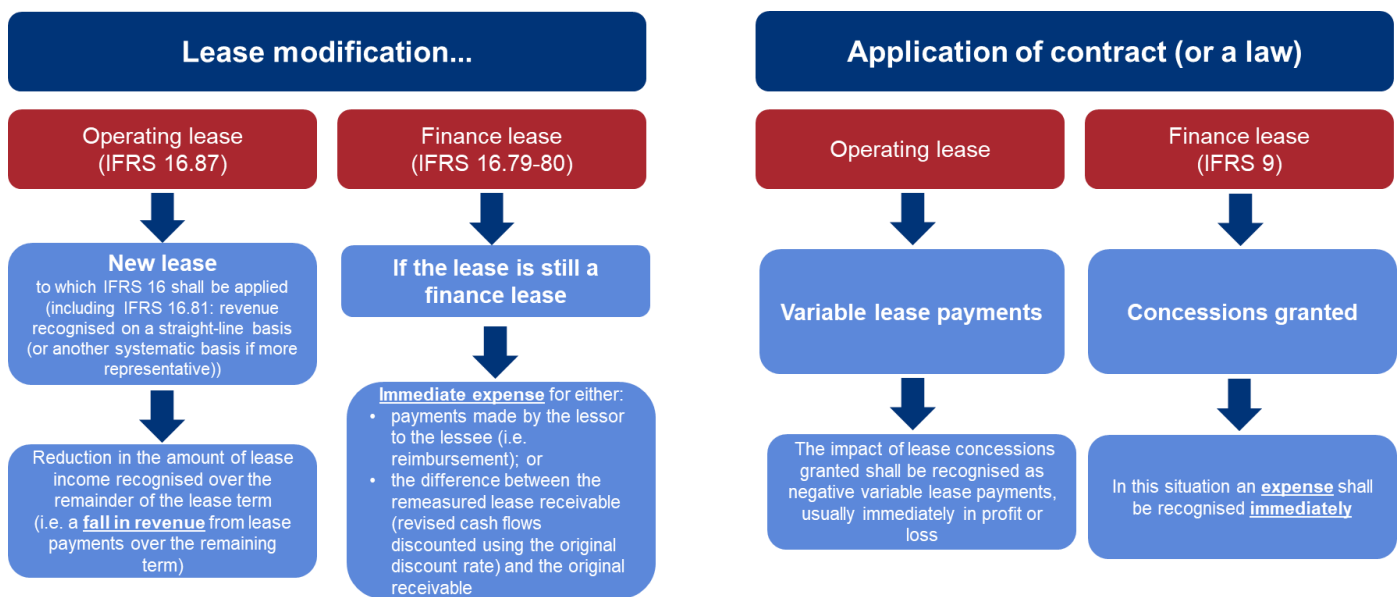
3. What does the amendment permit lessors to do?

Despite requests made by various commenters, the IASB has not extended the above practical expedient to lessors.

Thus, unlike lessees, they are still required assess whether a COVID-19-related rent concession is a lease modification.

They cannot apply the appropriate accounting treatment to rent concessions granted to lessees until they have carried out this assessment. The accounting treatment will depend on whether the lease is an operating lease or a finance lease.

The diagram below shows the situations that are most likely to arise for lessors.



In most cases, the assessment is likely to result in the conclusion that rent concessions granted to lessees are lease modifications, resulting from renegotiation. Furthermore, in most cases the rent concessions are likely to relate to operating leases.

Thus, the lease modification shall be accounted for as a new lease (applying IFRS 16.87), to which all the requirements of IFRS 16 on lessor accounting shall apply, notably paragraph 81, which specifies that revenue from operating leases shall be recognised on a straight-line basis. This will mean that lower lease revenue is recognised over the remainder of the term of the modified lease, as the rent concessions granted to lessees will be spread over the remaining lease term.

Key points to remember

- The practical expedient **only applies to lessees**, and means that any change in lease payments resulting from COVID-19-related rent concessions shall be accounted for **as if the change were not a lease modification**.
- The practical expedient shall be applied **consistently** to contracts with **similar characteristics** and in **similar circumstances**.
- The practical expedient only applies to rent concessions **that result directly from the COVID-19 pandemic and that meet certain conditions**, including occurrence within a specific limited period (i.e. only concessions on lease payments originally due up to 30 June 2021).
- The practical expedient applies to periods **beginning on or after 1 June 2020, with the option of early application**.
- The practical expedient is applicable **retrospectively, without restatement of the comparative figures** (i.e. impact in the opening equity of the first year of application).
- The amendment **does not permit any practical expedient for lessors**, who are thus still required to assess whether each rent concession granted to a lessee is a lease modification. In most cases, lessors shall apply the provisions of IFRS 16 on lease modifications (i.e. the rent concessions shall be spread over the remaining term of an operating lease, resulting in a reduction in lease revenue).
- The amendment will be **subject to an accelerated endorsement process at European level**, so that it is – hopefully – endorsed in time so as to be applied **in the 2020 interim financial statements**.



ESMA publishes recommendations for 2020 half-yearly financial reports in the context of COVID-19

On 20 May 2020, ESMA issued a Public Statement setting out recommendations for the presentation of half-yearly financial reports (and accompanying communications, notably the half-yearly management report) in the context of COVID-19.

In this feature, we present the key points of ESMA's statement.

1. The importance of 2020 half-yearly financial reports in a crisis context

ESMA has issued this public statement in order to emphasise the need for maximum possible transparency regarding the impacts of the crisis.

The interim financial reporting for 2020 should provide investors with useful and up-to-date information that will help them to understand the current and expected impact of the COVID-19 crisis on issuers' financial position, financial performance and cash flows. ESMA also emphasises the need to provide information on the identification of the principal risks and uncertainties to which issuers are exposed.

ESMA also highlights the essential role played by audit committees in particular in ensuring that interim financial reports is of high quality.

2. Timing of publication of half-yearly financial reports

Entities that wish to delay the publication of their half-yearly financial report, due to difficulties in meeting their planned deadline, may do so provided that they publish it within three months of the end of the financial period (in accordance with the Transparency Directive) and that they meet the requirements of the Market Abuse Regulation¹.

ESMA also reminds issuers to carefully consider the impact of events occurring after the end of the reporting period, and to provide any relevant disclosures in accordance with IAS 34 *Interim Financial Reporting*.

3. Additional information should be presented in half-yearly financial statements and management report

- Additional information expected to be presented in interim financial statements

ESMA reminds issuers that under IAS 34, the amount of information provided shall be proportionate to the objective of providing an update on the latest complete set of annual financial statements published. In light of the events related to the COVID-19 epidemic that have impacted the first half of 2020, ESMA expects this update to be particularly substantial for the 2020 half-yearly financial statements.


ESMA also notes that, in addition to the minimum disclosures required by IAS 34 for condensed interim financial statements, entities may need to provide additional information that is normally only required under IFRSs in a complete set of annual financial statements, in order to provide relevant information on the impacts of the COVID-19 pandemic in the 2020 half-yearly financial statements.

For example, ESMA mentions disclosures on financial risks (debt renegotiations, new financing arrangements, breach of covenants, exposure and sensitivity to credit and liquidity risk, and management of these risks) and on the most significant impacts. As regards financial risks, ESMA emphasises the need to provide updated information in accordance with IFRS 7, in light of everything that has occurred since 31 December 2019. ESMA also points out that some of these disclosures are also relevant to the calculation of expected credit losses in accordance with IFRS 9².

ESMA notes that, due to the crisis, many entities will need to make more use of significant judgements and assumptions when preparing their 2020 half-yearly financial statements. These judgements and assumptions should therefore be disclosed in the interim financial statements, along with the significant impacts on the accounts. Examples cited by ESMA

¹ To comply with this regulation, entities must publish information that is specific, non-public, and may significantly affect the price of financial instruments, in a timely fashion.

² We included a feature on ESMA's public statement regarding IFRS 9 expected credit losses in the March 2020 issue of our Beyond the GAAP COVID-19 supplement. ESMA's statement can be downloaded [here](#).



include the accounting treatment of government support measures, impairment of assets, fair value measurement, recognition of deferred tax assets, provisions and onerous contracts.

On the topic of government support, ESMA notes that governments have implemented various different support measures in response to the current crisis. However, an entity's entitlement to a given support measure may depend on whether specific conditions are met. ESMA recommends that issuers should ensure transparency on the application of these measures in terms of eligibility, conditions and consequences for the financial statements, as well as in terms of the underlying judgements they made.

- **Additional information to be presented in the half-yearly management report**

As regards the disclosures to be presented in the half-yearly management report, ESMA recommends that issuers should provide detailed, entity-specific information. It mentions the following topics on which information should be provided:

- a description of the impacts that the epidemic notably has had on strategic orientation, financial performance, cash flows and key sub-totals in the statement of financial position;
- details of measures taken by the entity to mitigate the effects of the crisis (particularly any specific support measures that it has applied for/received);
- the strategic and operational decisions made or expected to be made, and if practicable their expected impacts.

The regulator emphasises the importance of helping users to understand the information provided, by including the assumptions used and providing narrative explanations of the figures presented in the financial statements.

4. Presentation of the impacts of the COVID-19 crisis in the financial statements

In line with the guidance already provided by ESMA in its updated Q&A on Alternative Performance Measures (cf. the new question 18, which relates specifically to the application of ESMA's guidelines in the context of the COVID-19 epidemic; for more details, see the April 2020 issue of our Beyond the GAAP COVID-19 supplement), the European market regulator is recommending caution regarding separate presentation of the impacts of the COVID-19 pandemic in profit or loss, and encourages issuers to instead provide qualitative and quantitative information on the significant impacts recognised, in a separate note to the financial statements.

- **Except in very specific situations, it is not appropriate to separately present the impacts of COVID-19 in profit or loss**

For many companies, the impacts of the epidemic are spread across profit or loss and it is not possible to isolate individual items (either because they are not recognised, as in the case of a fall in turnover, or because they cannot be reliably determined).

- **The impacts of COVID-19 should be brought together in a single note to the financial statements**

ESMA observes that a dedicated note on the impacts of the COVID-19 epidemic is likely to prove useful to investors.

As regards financial reporting in the broader sense, ESMA notes that the use of alternative performance measures within and outside the financial statements is subject to the principles and disclosure requirements set out in ESMA's Q&A document, mentioned above.

5. What approach should be used for going concern issues, impairment testing and leases?

- **Ability to continue as a going concern**

In the current climate, ESMA emphasises the need to re-assess the entity's ability to continue as a going concern, taking into account of all available information.

- **Impairment testing of non-financial assets**

The COVID-19 epidemic is not in itself an indicator of impairment. However, the regulator believes that the large majority of entities will most likely conclude that the effects of the epidemic trigger indicators of impairment (e.g. shutdown or slowdown in activity) and should thus carry out impairment testing of tangible and intangible assets.

Furthermore, ESMA is aware that these tests will be particularly difficult to carry out, largely due to the uncertainty facing some companies.

ESMA states that some entities, particularly those facing a high level of risk and uncertainty, should calculate the value in use based on different weighted scenarios. ESMA emphasises that the weighting of these various scenarios should be calibrated on the basis of reasonable, supportable and realistic estimates and assumptions, to avoid the risk of excessively optimistic or pessimistic biases.

Anticipating market demand, ESMA emphasises that financial statements (and, where relevant, press releases) must clearly communicate the key assumptions used by the management, and explain any significant changes in key assumptions since the previous round of impairment testing. Disclosures on impairment testing should also include updated information on sensitivity analyses.

- **Leases and the amendment to IFRS 16**

ESMA recommends that issuers should keep a close eye on the European endorsement process for the amendment to IFRS 16 *Covid-19-Related Rent Concessions*, which was published by the IASB on 28 May (for more details, see the Closer Look article in this issue).

ESMA's Public Statement is available here: <https://www.esma.europa.eu/press-news/esma-news/esma-calls-transparency-covid-19-effects-in-half-yearly-financial-reports>

Key points to remember

- ESMA reminds issuers of the need for **maximum possible transparency** regarding the impacts of the crisis.
- Entities may delay the publication of their half-yearly financial report, subject to certain conditions (e.g. it must be published within three months of the end of the reporting period).
- Additional information should be presented in interim financial statements. ESMA expects that, in accordance with IAS 34, a **particularly substantial** amount of information will be presented in order to provide an **update** to the latest complete set of annual financial statements.
- ESMA emphasises that **certain information that is usually only required in the annual financial statements should nonetheless be provided** in the half-yearly financial statements. This includes, but is not limited to, disclosures on debt renegotiations and on exposure and sensitivity to credit risk. ESMA additionally points out that some of these disclosures are also relevant to the calculation of expected credit losses in accordance with IFRS 9.
- ESMA states that **significant judgements and assumptions** should therefore be disclosed in the interim financial statements, along with the **significant impacts on the accounts**.
- Additional information should also be presented in the half-yearly management report, including but not limited to the impacts that the epidemic has had on strategic orientations and measures taken to mitigate the effects of the crisis. The information presented in the management report should complement the information in the financial statements.
- Except in very specific situations, **it is not appropriate to separately present the impacts of COVID-19 in profit or loss**, or to present alternative performance measures that do not take account of the impacts of COVID-19. The impacts of COVID-19 may be presented in a **single note to the financial statements**.
- ESMA also specifies the approach to be used for going concern issues, impairment testing of non-financial assets, and leases (amendment to IFRS 16, not yet endorsed by the EU at the time the Public Statement was issued).



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