

CA. KAMAL GARG

Comments on Exposure Draft on Covid-19-Related Rent Concessions (Proposed amendment to IFRS 16, Leases)

1. The ED is not capturing the situation where the enforceable terms of the lease contract contemplate the concession to be provided to the lessee and there are no other changes to the contract that were not contemplated in the existing lease. For example, entities may determine that a concession is contemplated in a contract if it includes a *force majeure* provision that requires the lessor to defer or forgive certain lease payments in the case of a natural disaster or pandemic, such as Covid-19.

2. Sometimes, the enforceable rights to a concession need not to be explicitly stated in the lease contract for an enforceable right to exist. For example, the rights of parties to a lease contract, including the right to a concession, can be enforceable by the laws governing the applicable jurisdiction of the lease contract. See the Order issued by Maharashtra Govt. directing the landlords and house owners to consider deferring the recovery of rent payment by three months¹.

3. Moreover, Lessees will remeasure the lease liability using a discount rate (i.e., their incremental borrowing rate when the rate implicit in the lease is not readily determinable) determined at the effective date of the modification. For lessees using the incremental borrowing rate, determining a revised rate at the effective date of the modification may be challenging due to the number of contracts that may be modified. In addition, determining the incremental borrowing rate will require judgment considering recent overall market volatility, the decline in interest rates set by central banks and changes to an entity's credit risk as a result of the Covid-19 pandemic.

4. Further, such a proposed change in lease accounting for the reason of unusual one-time Covid19 like event is not in consonance with the long term vision with which the Standards are set.

5. Attention is invited to IAS 8/ Ind AS 8 which states that: *"A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the **assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities**. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors."*

Para 32 of IAS 8/ Ind AS 8 states that as result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information. For example, estimates may be required of:

- (a)
- (b)
- (c) the fair value of financial assets or financial liabilities;
- (d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
- (e)

¹ Source: <https://www.livemint.com/news/india/covid-19-maharashtra-orders-landlords-to-delay-rent-recovery-by-three-months-11587126724964.html>

Para 33 and 34 further state that the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

Para 35 states that a change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Para 36 states that the effect of change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:

- (a) the period of the change, if the change affects that period only; or
- (b) the period of the change and future periods, if the change affects both.

Before proceeding further, it is important to mention that Para 7 of IAS 8/ Ind AS 8 also states that when an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.

6. There could arise difficulties in identification of whether the changes in lease payments are due to Covid 19 or not. Not only this, the changes in rent payments could be having far reaching impact rather than just being confined to the year ending on 31.3.2020.

7. In addition to above, the changes proposed for leases on account of rent concessions is not enough for the reason being there are many other items of financial statements which will be having an impact due to Covid 19 and corresponding reliefs or waivers from the Govt. as well as parties to the contract. Such items may include recently announced RBI's Relief Package, Revenue Recognition w.r.t. variable consideration, changes in discounting rates, changes in actuarial assumptions corresponding to work from home culture being breeding in and so on.

Conclusion:

In my view, instead of having item specific change viz. 'Rent Concession' as proposed by the ED, the changes should be made in IAS 8/ Ind AS 8 so that the real issues could be addressed at macro level. For instance, a new Para (XYZ) on "Accounting Policies and Estimates for Natural Disasters and Force Majeure Events" may be introduced in the Standard IAS 8/ Ind AS 8.