



Crowe Chat

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Accounting and Audit

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Accounting for COVID-19 – Related Rent Concessions

1. Introduction

In business, not all companies own the properties that they operate from. Some will rent or lease from property owners. The lessees will then need to account for their obligations (lease liabilities) in accordance with the latest accounting standard, Malaysian Financial Reporting Standards 16 (MFRS 16) – ‘Leases’.

Due to the COVID-19 pandemic, landlords may provide rent concessions to their lessees. These rent concessions include rent holidays or rent reductions for a period of time, perhaps followed by increased rent payments in future periods. These changes in lease payments which may take the form of rent concessions, may have MFRS implications.



2. Existing Accounting Treatment for COVID-19 – Related Rent Concessions

MFRS 16 contains specific accounting requirements for rent concessions mentioned above:-

2.1 Lease modification

A rent concession not envisaged in the original lease contract will often be a lease modification. In such event, at the date of modification:-

- a. the lessee is required to do the following:



identify a revised discount rate



update and re-measure lease assets and lease liabilities using the revised discount rate; and

- b. the lessor is required to revise its operating income for the remaining lease term, but

2.2 Contemplated rent adjustment

Any rent adjustment that is contemplated in the original lease contract is not a lease modification. Instead, the change is to be accounted for as a variable lease payment, thus resulting in an adjustment to lease income or lease expense in the period in which it occurs.

2. Existing Accounting Treatment for COVID-19 Related Rent Concessions (con't)

2.3 Illustration – Lease modification

A retail company in Malaysia is required to close its retail store for some time during the 2020 Movement Control Order period. The retail company received a 3-month lease abatement from its landlord, expiring on 30 June 2020. The original incremental borrowing rate of the lease contract was 5% which was increased to 6% at 1 April 2020 because the credit rating of the lessee has fallen. The monthly rental is RM1,000, payable in arrears. The lease contract contains no rent concessions and is expiring on 30 June 2021.

The lease abatement will be calculated as shown to the right:

Month	Original Payment Profile Discount Rate = 5%	New Payment Profile Revised Discount Rate = 6%
Apr-20	1,000	-
May-20	1,000	-
Jun-20	1,000	-
Jul-20	1,000	1,000
Aug-20	1,000	1,000
Sep-20	1,000	1,000
Oct-20	1,000	1,000
Nov-20	1,000	1,000
Dec-20	1,000	1,000
Jan-21	1,000	1,000
Feb-21	1,000	1,000
Mar-21	1,000	1,000
Apr-21	1,000	1,000
May-21	1,000	1,000
Jun-21	1,000	1,000
	<u>15,000</u>	<u>12,000</u>
PV of cash flows	14,512	11,446
Change +/-	<u>(3,066)</u>	

The journal entry to record the lease abatement

DR Lease liability	3,066	
CR Right-of-use asset		3,066

Lease liability at 1 April 2020 (date of modification) is revised to RM11,446

The assessment of COVID-19-related rent concessions can be complex and tedious, particularly for large portfolios of leases with various features and different types of concessions. Moreover, this can be burdensome if the lease contracts contain no clear parts about the grant of rent concessions.

3. Amended MFRS 16 - Practical Expedient

3.1 Practical Expedient of Amended MFRS 16

Due to the extra complications involved which do not commensurate with the benefits that are derived, the MASB has amended MFRS 16 in June 2020 by allowing lessees (but not lessors) to elect not to perform an assessment to determine whether a COVID-19-related rent concession is a lease modification or not.

This exemption option applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all the following conditions under Paragraph 46B of MFRS 16 are met:-

- | | | |
|---|--|---|
| <p>a) the change in lease payments results in a revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;</p> | <p>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</p> | <p>c) there is no substantive change to the other terms and conditions of the lease.</p> |
|---|--|---|

3. Amended MFRS 16 - Practical Expedient (con't)

3.2 Illustration – Practical Expedient of Amended MFRS 16

We will use the same facts as stated in the previous page. If the retail company elects not to evaluate whether the lease abatement is a lease modification as permitted by the amended MFRS 16, the retail company is not required to assess the changes in lease payments per Paragraphs 44 - 46 of MFRS 16 (accounting requirements of lease modifications).

The analysis below sets out the accounting treatment for the lease liability under 3 scenarios:-

Scenario 1: Original Lease Contract No change in lease payments					Scenario 2: Unconditional Lease Abatement for 3 Months No lease payments for April – June 2020					Scenario 3: Deferred Lease Payments No lease payments for April – June 2020 followed by an increase of RM1,000 for July – September 2020				
	Cash	Lease Liability	Lease Interest, 5%	Other Income		Cash	Lease Liability	Lease Interest, 5%	Other Income		Cash	Lease Liability	Lease Interest, 5%	Other Income
Balance at 1 April 2020		14,512			Balance at 1 April 2020		14,512			Balance at 1 April 2020		14,512		
Apr-20	(1,000)	(940)	60		Apr-20	(2,928)		48	2,976	Apr-20		23		23
May-20	(1,000)	(944)	56		May-20		48	48		May-20		60		60
Jun-20	(1,000)	(948)	52		Jun-20		48	48		Jun-20		60		60
Jul-20	(1,000)	(951)	49		Jul-20	(1,000)	(951)	49		Jul-20	(2,000)	(1,938)		62
Aug-20	(1,000)	(955)	45		Aug-20	(1,000)	(955)	45		Aug-20	(2,000)	(1,947)		53
Sep-20	(1,000)	(959)	41		Sep-20	(1,000)	(959)	41		Sep-20	(2,000)	(1,955)		45
Oct-20	(1,000)	(963)	37		Oct-20	(1,000)	(963)	37		Oct-20	(1,000)	(963)		37
Nov-20	(1,000)	(967)	33		Nov-20	(1,000)	(967)	33		Nov-20	(1,000)	(967)		33
Dec-20	(1,000)	(971)	29		Dec-20	(1,000)	(971)	29		Dec-20	(1,000)	(971)		29
Balance at 31 December 2020		<u>5,914</u>			Balance at 31 December 2020		<u>5,914</u>			Balance at 31 December 2020		<u>5,914</u>		

4. Effective Date

The amendments are mandatory for annual reporting periods beginning on or after 1 June 2020. Earlier application of the amended standard is permitted, including those financial statements not authorised for issue at 28 May 2020.





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