

Córdoba (SPAIN) May, 5<sup>th</sup> 2020

**Dear members of the International Accounting Standards Board,**

We appreciate the opportunity to comment on Exposure Draft ED/2/2020 *Covid19 Related Rent Concessions - Proposed amendment to IFRS 16*. We are faculty members of the Department of Financial Economics and Accounting at Universidad Loyola Andalucía (Spain). We have been studying IFRS 16 *Leases* for a long time, and we would like to share with you our comments. We hope you find them helpful.

Our main contribution is related to the accounting treatment of “force majeure” clauses as negative variable payments. In our opinion, they are non-avoidable clauses for the lessee, and therefore must be recognised as an adjustment to the cost of the right of use asset and not in Profit or Loss (P&L). This point is discussed in our response to Question 1 as it would resolve the dilemma described in FC9 of the ED/2/2020, and it would reinforce the opportunity of the practical expedient.

Please do not hesitate to contact us for any clarification or further information.

Sincerely,

**PhD Horacio Molina-Sánchez    PhD Marta de Vicente-Lama    Mar Ortiz-Gómez**

**Universidad Loyola Andalucía**

Below is our response to the questions stated in the ED:

**Question 1—Practical expedient (paragraphs 46A and 46B of the [Draft] amendment to IFRS 16)**

**Paragraph 46A of the draft amendment to IFRS 16 proposes, as a practical expedient, that a lessee may elect not to assess whether a covid-19-related rent concession is a lease modification. A lessee that makes this election would account for any change in lease payments resulting from the covid-19-related rent concession the same way it would account for the change applying IFRS 16 if the change were not a lease modification. Paragraph 46B of the draft amendment to IFRS 16 proposes that the practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of the following conditions are met:**

**(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 in 2020; and**

**(c) there is no substantive change to other terms and conditions of the lease. Do you agree that this practical expedient would provide lessees with practical relief while enabling them to continue providing useful information about their leases to users of financial statements? Why or why not? If you disagree with the proposal, please explain what you propose and why.**

**ANSWER:**

We agree with the practical expedient proposed because it is difficult to establish if the parties are negotiating the new terms considering the implicit clauses, regulation or the legal interpretation in a jurisdiction of the contract terms or the agreement is lease modification. Relying on the cost-benefit constraint, we believe that transaction costs compensate for the lack of faithful representation or lack of relevance, and the best solution is to reduce the cost of change. If changes to contract terms represent a lease modification, then the lessee must revise the discount rate, and this is more burdensome than the recalculation of the lease liability.

We agree that the conditions that must be met to assess whether changes to lease contracts are lease modifications should be based on COVID-19 lease payments. Furthermore, we agree with the three conditions proposed. Otherwise, entities could use the practical expedient as a way to avoid lease modification consequences.

Nonetheless, we disagree with the interpretation of the IASB educational materials that consider that, under a revision of the contract rather than a lease modification, the lessee would account for the change in payments as a variable lease payment. The variability would depend on the use of the asset (less “services” than expected due to COVID). Therefore, the IASB educational materials propose to apply paragraph 38 of IFRS 16. In our opinion, we agree with the designation of the change in payments as a “negative” variable payment. However, this variable payment does not depend on the discretion of the lessee as the lessee cannot benefit from this negative variable payment until the event (i.e. the inability to use the underlying asset) takes place. Variable lease

payments linked to the use or future performance of the underlying asset are recognised in P&L as incurred because the lessee can avoid payment. At initial recognition, the lessee does not include variable payments in the measurement of the lease liability for the following reasons: a) those payments can be avoided and they do not meet the definition of liabilities (i.e. the entity has no present obligation); and b) these future payments cannot be measured reliably. We believe that our proposal is principle-based grounded.

In our opinion, “force majeure” clauses are similar to variable lease payments that are not within the lessee’s control, such as the variable payments that depend on an index. Consequently, they are unavoidable, and they cannot be measured reliably. Therefore, the lessee should reassess variable lease payments when uncertainty is solved and make an adjustment to the initial measurement.

We believe that the Educational materials should refer to paragraph 41 of IFRS 16 rather than paragraph 38 when regulating the corresponding adjustment due to implicit regulation of the lease contract (i.e. an implicit “force majeure” clause, lease contracts regulation or legal interpretation by courts in a jurisdiction). **Consequently, the adjustment would reduce the right of use asset rather than recognised in P&L. If our interpretation is right, the practical expedient election or the assessment of whether the change is a lease modification would still result in the change of the discount rate, but it would not affect P&L.**

It is counterintuitive that lessees would recognise gains from changes in lease payments as a consequence of COVID ceases of activities. Lessees are being granted rent holidays or rent reductions for a period of time because they lose the right of use of the underlying asset or their ability to generate future cash flows is partially reduced. These concessions cannot be reflected as impairment losses because the lessee would be able to recover the book value of the right of use asset over its total useful life. Total profitability on the right of use asset over its useful life would compensate for the reduction in its ability to produce cash flows.

***Question 2—Effective date and transition (paragraphs C1A and C20A of the [Draft] amendment to IFRS 16)***

***Paragraphs C1A and C20A of the draft amendment to IFRS 16 propose that a lessee would apply the amendment:***

***(a) for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at the date the amendment is issued; and***

***(b) retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.***

***Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.***

We agree with the proposal because it maintains the optionality that lies behind the IFRS 16 transition requirements.