

CHEAT SHEET

COVID-19 RELATED LEASE PAYMENT CHANGES (NZ IFRS 16)

BACKGROUND

For 2020 reporting dates, the long-awaited new accounting standard on leases (NZ IFRS 16 Leases) comes into effect for *for-profit* entities who apply NZ IFRS.

As we have covered in previous *Cheat Sheets*, NZ IFRS 16 results in a fundamental change in the way that lessees will need to account for most of their lease agreements.

NZ IFRS reporters will also be aware that in May 2020, NZ IFRS 16 was amended to provide an alternative (simplified) approach to addressing changes to lease payments as a result of COVID-19.

This alternative (simplified) approach departs from the "normal" way these changes would have otherwise had to have been treated in certain instances.

Accordingly, entities will need to revisit their existing lease accounting treatment program (whether this is being managed in (i) spreadsheets, or (ii) on dedicated lease software (such as BDO's very own product, [BDO LEAD](#))) and ensure it can, and does, incorporate this change in treatment.

BDO has issued a number of detailed publications on the COVID-19 related lease payment changes, such as:

- ▶ [IFR Bulletin](#) (including background, and six worked examples)
- ▶ [Accounting Alert Article](#) (June 2020)
- ▶ [Accounting Alert Article](#) (July 2020)

This *Cheat Sheet* has been produced as a high-level summary of the above publications, to provide a general overview of why the amendment was required, when it can be applied, and how it is to be applied.

NEED ASSISTANCE WITH YOUR ADOPTION OF NZ IFRS 16?

BDO [IFRS Advisory](#) is a dedicated service line available to assist entities in adopting NZ IFRS 16.

Further details and contact information are provided on the following page for your information.



WHAT IS COVERED IN THE CHEAT SHEET?

In order to navigate through these areas of accounting, this *Cheat Sheet* is broken down into the following sections:

1. **What has the impact of COVID-19 been in terms of lease arrangements?**
2. **Why was the amendment required?**
3. **So, what does the amendment do?**
4. **So, what are the criteria to meet in order for the COVID-19 amendment to NZ IFRS 16 to apply?**
5. **What needs to be done?**
6. **Practical examples to assist entities**

1. What has the impact of COVID-19 been in terms of lease arrangements?

One of the impacts of COVID-19 around the world is that lessee's have been "shut out" of their premises and/or had their day-to-day operations significantly impacted (i.e. as a result of government imposed "lockdowns" and operating restrictions, as well as a consequence of the general economic downturn).

As a result, the ability for many lessees to make lease payments, and maintain their businesses as viable going concerns, has been compromised.

With a severe reduction in the general "pool" of alternative lessees that could step in to replace a struggling tenant, it is often not in a lessor's ongoing best interest to simply remove these tenants. Rather, many tenants have "crunched the numbers" and realised that it is instead more economically beneficial to keep existing tenants in-place, and to renegotiate the lease payments to be paid during the short-term.

These renegotiations may be made:

- (i) In the presence of "No access in emergency" clauses in the existing lease agreement (which will be the case for many new lease agreements that were entered into in New Zealand subsequent to the Christchurch Earthquakes in 2011/12), or
- (ii) On a goodwill basis by the landlord (i.e. where there is no such "No access in emergency" clause that requires the parties to renegotiate the lease payments in such circumstances).

2. Why was the amendment required?

Where COVID-19 related lease payment changes have been made in the presence of an enforceable "No access in emergency" clause (as per (i) above), these payment changes are considered to be *variable lease payments* contemplated under the originally agreed terms and conditions of the lease arrangement.

Accordingly, any changes to lease payments in this case are made by (i) revising the lease payment stream, (ii) remeasuring the lease liability, and (iii) taking the other side of the adjusting entry (i.e. the "credit") to profit or loss (i.e. as a "[negative] variable lease payment gain").

However, where COVID-19 related lease payment changes have been made in the **absence** of an enforceable "No access in emergency" clause, then NZ IFRS 16 would have viewed these as **modifications** to the originally agreed terms and conditions of the lease arrangement.

Accordingly, any changes to lease payments in this case would have required recalculation of the *lease liability* by discounting the new lease payment stream using an **updated** discount rate, and then adjusting the *lease liability* and *right-of-use asset (RoU asset)* accordingly.

Accordingly, it was these onerous practical requirements, for each and every lease:

- (i) Get new updated discount rates, and then
- (ii) Re-calculating the *lease liability*,

... where calls were made by entities "to find a simpler way".

This ultimately resulted in the amendment to NZ IFRS 16 being made.

3. So, what does the amendment do?

Provided that the criteria to use the amendment have been met (refer to 4. below) the amendment would allow those entities who do not have an enforceable "No access in emergency" clause to effectively treat their COVID-19 related lease payment changes as if they did.

Therefore, an entity who can, and chooses to, use the amendment:

- ▶ Would not need to get updated discount rates, and undertake re-calculations of their lease liabilities, and
- ▶ Simply take the impact of remeasuring the *lease liability* through profit and loss (in the lease payment periods the remeasurement relates to).

4. So, what are the criteria to meet in order for the COVID-19 amendment to NZ IFRS 16 to apply?

This is discussed in detail (with a flow chart) in BDO's [IFR Bulletin](#) and June 2020 [Accounting Alert Article](#), but in summary, **ALL** of the following must be present:

- (i) The change in lease payment terms is a direct result of COVID-19, **and**
- (ii) The change in lease payments results in total lease payments that are substantially the same (or less than) the total pre-COVID lease payments, **and**
- (iii) The lease payments are only changed as far out as **30 June 2021**, **and**
- (iv) There are no substantive changes to other terms and conditions of the lease.

5. What needs to be done?

For entities that have COVID-19 related lease payment changes in their 2020 reporting year:

STEP 1: Identify which leases have enforceable "No access in emergency" clauses.

STEP 2a: For those that do, treat the lease payment changes as *variable lease payments*.

STEP 2b: For those that do not, determine whether the amendment criteria are met for each Individual lease.

STEP 3a: If met, treat the lease payment changes as *variable lease payments*.

STEP 3b: If not met, re-calculate the *lease liability* by discounting the new lease payment stream using an **updated** discount rate.

Record an adjustment against the *lease liability*, and *RoU asset*.

Accordingly, entities will need to revisit their existing lease accounting treatment program (whether this is being managed in (i) spreadsheets, or (ii) on dedicated lease software, and ensure it can, and does, incorporate this change in treatment (with respect to *variable lease payments*).

Current and potential users of BDO's very own lease software product, [BDO LEAD](#), can rest assured that the software has recently been updated to incorporate functionality to address COVID-19 related lease payment changes.

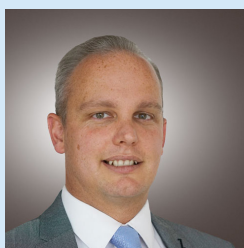
6. Practical examples to assist entities

BDO's [IFR Bulletin](#) and [July 2020 Accounting Alert Article](#) include a number of practical examples to assist entities which how to apply the amendment to different types of COVID-19 lease payment changes, including where the payment relief takes the form of:

1. A deferral of lease payments.
2. A deferral of lease payments with proportionate increase at end of lease term.
3. An unconditional forgiveness of rent.
4. A conditional forgiveness of rent.
5. A conversion of fixed lease payments to variable lease payments.
6. A forgiveness of accrued and unpaid rent.

BDO IFRS ADVISORY

Members of BDO's *IFRS Advisory* department come ready with real life experience in applying IFRS and are therefore well placed to provide entities with the expertise and assistance they require.



For more information as to how BDO Accounting Advisory Services might assist with your entity in navigating this and other areas of IFRS application, please contact James Lindsay at BDO Accounting Advisory Services (james.lindsay@bdo.co.nz ☎ +64 9 366 8041), and visit our webpage below.

<https://www.bdo.nz/en-nz/ifrs-advisory>

Also, visit our dedicated "Adopting NZ IFRS 16 webpage" for more information and resources on NZ IFRS 16.

<https://www.bdo.nz/en-nz/nz-ifrs-16>

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