CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Financial Reporting Alert

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

NOVEMBER 2020

In December 2021, Section 3065, *Leases* was amended in the *CPA Canada Handbook – Accounting (Handbook)*. The amendment is effective for fiscal years ending on or after December 31, 2021, with earlier application permitted.

In response to the ongoing effects of the COVID-19 health pandemic, the Accounting Standards Board is extending the optional relief period for both lessees and lessors on accounting for rent concessions received or granted as a result of COVID-19. The amendment extends the relief period by one year to lease payments originally due on or before December 31, 2022.

Accounting for Lease Modifications as a Result of the COVID-19 Pandemic

In November 2020, the Accounting Standards Board (AcSB) issued amendments to Section 3065, *Leases*, in Part II of the *CPA Canada Handbook – Accounting* (*Handbook*).

This CPA Canada Financial Reporting Alert (*Alert*) highlights key changes resulting from the amendments and considers some possible assurance implications.

What is the main objective of the amendments?

The main objective of the amendments is to simplify the accounting by lessees and lessors for certain lease concessions resulting directly from the COVID-19 pandemic. The economic consequences of COVID-19 have given rise to lease concessions, such as lease payment deferrals, reductions and waivers.

Section 3065 provides some guidance on accounting for changes to the provisions of an existing lease, including the requirement that any such lease modifications be considered as a new lease. This requirement could be onerous for private enterprises, particularly those with numerous lease agreements. As a result, the AcSB decided to provide relief from the lease modification accounting requirements, specifically for lease concessions resulting directly from the COVID-19 pandemic.

Who applies the amendments?

The amendments apply to private enterprises that apply Part II of the *Handbook* and to not-for-profit organizations (NFPOs) in the private sector that apply Part III of the *Handbook*. The amendments apply to both lessors and lessees.

When are the amendments effective?

The amendments are effective for annual financial statements relating to fiscal years ending on or after December 31, 2020. Earlier application is permitted, including in financial statements not yet authorized for issue, so that the practical expedient is available for COVID-19-related rent concessions granted or received in 2020.

An enterprise applies the amendments retrospectively, as defined in paragraph 1506.05(d) of Section 1506, *Accounting Changes*. Retrospective application allows for similar COVID-19-related rent concessions to be accounted for consistently, including those that may already have been accounted for as new leases in accordance with Section 3065 before the proposed relief was available.

What are the key changes?

Section 3065 requires changes in the provisions of an existing lease, such as a reduction in a periodic rent payment, to be considered as a new lease. The amendments provide both lessors and lessees with a choice to adopt simpler accounting for certain rent concessions that occur as a direct result of the COVID-19 pandemic. Entities are not required to use the simpler accounting. For example, some entities may prefer to apply the same accounting for rent concessions used in previous years as this provides consistent reporting.

The choice may be made on a lease-by-lease basis. For example, an entity may decide to adopt the simpler accounting for its capital leases but not its operating leases because accounting for capital leases as new leases is more complex, or adopt the simpler accounting for specific leases that are more material.

This *Alert* addresses the key changes as a result of the amendments in three sections:

A. Which rent concessions qualify?

B. Lessees

C. Lessors

A. Which rent concessions qualify?

The simpler accounting provided by the amendments can only be applied to a rent concession that meets *all* of the following conditions:

1. The rent concession occurred as a direct consequence of the COVID-19 pandemic.
2. The total payments resulting from the rent concession are the same or less than the total payments required by the original lease contract. A rent concession that increases the total payments required for the lease contract solely to reflect the time value of money is still considered to meet this condition, while any larger increase will not.
3. Any reduction in lease payments affects only those payments originally due on or before December 31, 2021. For example, a rent concession may provide for the deferral of lease payments of $1,000 per month for 18 months from July 2020 through December 2021 (a total of $18,000), with the deferred amount being paid over 12 months at $1,500 per month, beginning in January 2022 (in addition to the normal rent payments for those months). The rent concession will meet this condition because it results in reduced lease payments on or before December 31, 2021, even though the deferred lease payments will still be paid after December 31, 2021.

Key Concept: This is a limited scope amendment that is intended to apply only to rent concessions driven by the COVID-19 pandemic.

Changes to leases that do not meet the above criteria include:

- Changes resulting from factors other than the COVID-19 pandemic (for example, changes under discussion before the start of the COVID-19 pandemic)
- Changes that increase total rental payments by more than an amount equal to the time value of money and
- Changes affecting lease payments due after December 31, 2021.

B. Lessees

For a rent concession that does not change the total rent payable (i.e., a deferral), a lessee records:

1. Lease expense in accordance with the original lease. Thus, for an operating lease, the lease expense is not affected. Similarly for a capital lease, the lessee continues to record interest expense and to amortize the leased asset consistent with the terms of the original lease, as if no rent concession existed.
2. A lease payable for the amount of lease payments deferred.

For a rent concession that reduces the total rent payable (i.e., a waiver), the above accounting also applies. In addition, the lessee will recognize the reduction in lease payments in net income in the period to which the lease payments relate.

Key Concept: The lessee continues to account for the lease as it did before the rent concession was granted. A rent deferral does not affect income and is recognized as a payable. A rent waiver is recognized in the period affected.

Examples of the journal entries are provided in Appendix I to this *Alert*.
A lessee that receives COVID-19-related rent concessions and elects to adopt the simpler accounting for such concessions must provide the following disclosures:

1. The fact that it has adopted the simpler accounting for rent concessions. A lessee that decides to continue treating rent concessions as new leases does not have to disclose this, but may consider doing so.
2. If the simpler accounting has been applied for some but not all rent concessions, that fact and the reasons why.
3. The aggregate amount of lease payables related to the deferral of lease payments.
4. The total amount recognized in net income for the period for rent concessions that result in a reduction in total rent payments.

Key Concept: The extent to which the accounting permitted by the amendments to Section 3065 has been utilized must be disclosed, together with the effect(s) on the financial statements.

C. Lessors

For a rent concession that does not change the total rent receivable (i.e., a deferral), a lessor records:

1. Lease revenue in accordance with the original lease. Thus, for an operating lease, the lease revenue is not affected. For a sales-type or direct financing lease, the lessor continues to record interest income consistent with the terms of the original lease, as if no rent concession existed.
2. A lease receivable for the amount of lease payments deferred.

For a rent concession that reduces the total rent receivable (i.e., a waiver), the above accounting also applies. In addition, the lessor will recognize the reduction in lease amounts received in net income in the period to which the lease amounts received relate.

Key Concept: The lessor continues to account for the lease as it did before the rent concession was granted. A rent deferral does not affect income and is recognized as a receivable. A rent waiver is recognized in the period affected.

Examples of the journal entries are provided in Appendix I to this *Alert*.

A lessor that grants COVID-19-related rent concessions and elects to adopt the simpler accounting for such concessions must provide the following disclosures:

1. The fact that it has adopted the simpler accounting for rent concessions. A lessor that decides to treat rent concessions as new leases does not have to disclose this, but may consider doing so.
2. If the simpler accounting has been applied for some but not all rent concessions, that fact and the reasons why.
3. The aggregate amount of lease receivables related to the deferral of lease payments.
4. The total amount recognized in net income for the period for rent concessions that result in a reduction in total rent payments.

Key Concept: Use of the simpler accounting option will affect comparability with periods when the simpler accounting was not available, and with entities that choose not to use it. The AcSB therefore decided that the extent to which the accounting permitted by the amendments to Section 3065 has been utilized must be disclosed, together with the effect(s) on the financial statements.

Are there any consequential amendments?

There are no consequential amendments.

What are the possible assurance implications?

In planning the audit and relevant audit procedures, the practitioner may need to consider the amendments to Section 3065 discussed in this *Alert* to:

- Identify and assess the risks of material misstatement at the financial statement and assertion levels for lease transactions
- Obtain an understanding of internal controls related to accounting for leases, their design, and whether the controls have been implemented
- Understand the accounting policy chosen and the process for calculating and recording lease modifications in the accounting records
- Design and perform further audit procedures to respond to the assessed risks of material misstatement (e.g., related to lease transactions, obligations, assets, and other disclosures)
- Perform procedures to evaluate whether presentation and disclosures are in accordance with Section 3065.

Other Resources

AcSB

- Leases – Background Information and Basis for Conclusions
- AcSB COVID-19 Resources

CPA Canada

- Assessing Potential COVID-19 Impacts on Financial Statements: Questions and Considerations under ASPE
- Assessing Potential COVID-19 Impacts on Financial Statements: Questions and Considerations under ASNPO
- COVID-19: Financial Reporting Implications and Resources

Comments

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Appendix I

This Appendix provides examples of journal entries (for both the lessee and lessor) for the following:

1. Rent deferral for an operating lease
2. Rent deferral for a capital and sales-type lease
3. Waiver of rent for an operating lease
4. Waiver of rent for a capital and sales-type lease

Each example was replicated from the AcSB's Leases – Background Information and Basis for Conclusions.

Example 1 – Rent Deferral for an Operating Lease

The following provides an example of the journal entries for an operating lease with a three-month lease payment deferral of $1,000 per month in January – March 2021 that needs to be repaid in October – December 2021. This example is for illustrative purposes only and for simplicity assumes that the $1,000 monthly lease payments have been the same throughout the lease term which equals the straight-line expense amount, and all amounts have been presented on a gross basis.

In each of January – March 2021 (the deferral period):

Lessee records:			*Lessor records:*		
DR Lease expense	1,000		DR Lease receivable (deferral)	1,000	
CR Lease payable (deferral)		1,000	CR Lease revenue		1,000

In each of April – September 2021:

Lessee records:			*Lessor records:*		
DR Lease expense	1,000		DR Cash	1,000	
CR Cash		1,000	CR Lease revenue		1,000

In each of October – December 2021:

Lessee records:			*Lessor records:*		
DR Lease expense	1,000		DR Cash	2,000	
DR Lease payable (deferral)	1,000		CR Lease receivable (deferral)		1,000
CR Cash		2,000	CR Lease revenue		1,000

Example 2 – Rent Deferral for a Capital and Sales-Type Lease

The following provides an example of the journal entries for a capital and sales-type lease with a three-month lease payment deferral of $1,000 per month in January – March 2021 that needs to be repaid in October – December 2021. This example is for illustrative purposes only and for simplicity assumes that the interest expense amount is the same each month, and all amounts have been presented on a gross basis. This example also assumes that no interest is included in the lease receivable or lease payable.

In each of January – March 2021:

Lessee records:

DR Interest expense	250	
DR Obligation for capital lease	750	
CR Lease payable (deferral)		1,000

Lessor records:

DR Lease receivable (deferral)	1,000	
DR Unearned income	250	
CR Finance income		250
CR Lease payments receivable		1,000

In each of April – September 2021:

Lessee records:

DR Interest expense	250	
DR Obligation for capital lease	750	
CR Cash		1,000

Lessor records:

DR Cash	1,000	
DR Unearned income	250	
CR Finance income		250
CR Lease payments receivable		1,000

In each of October – December 2021:

Lessee records:

DR Interest expense	250	
DR Obligation for capital Lease	750	
DR Lease payable (deferral)	1,000	
CR Cash		2,000

Lessor records:

DR Cash	2,000	
DR Unearned income	250	
CR Finance income		250
CR Lease payments receivable		1,000
CR Lease receivable (deferral)		1,000

Example 3 – Waiver of Rent for an Operating Lease

The following provides an example of the journal entries for an operating lease with a three-month lease payment waiver of $1,000 per month in January – March 2021 that does not need to be repaid. This example is for illustrative purposes only and for simplicity assumes that the $1,000 monthly lease payments have been the same throughout the lease term which equals the straight-line expense amount, and all amounts have been presented on a gross basis.

In each of January – March 2021 (the waiver period):

Lessee records:

DR Lease expense	1,000	
CR Gain due to waiver		1,000

Lessor records:

DR Loss due to waiver	1,000	
CR Lease revenue		1,000

In each of April – December 2021:

Lessee records:

DR Lease expense	1,000	
CR Cash		1,000

Lessor records:

DR Cash	1,000	
CR Lease revenue		1,000

Example 4 – Waiver of Rent for a Capital and Sales-Type Lease

The following provides an example of the journal entries for a capital and sales-type lease with a three-month lease payment waiver of $1,000 per month in January – March 2021 that does not need to be repaid. This example is for illustrative purposes only and for simplicity assumes that the interest expense amount is the same each month, and all amounts have been presented on a gross basis. This example also assumes that no interest is included in the lease receivable or lease payable.

In each of January – March 2021:

Lessee records:

DR Interest expense	250	
DR Obligation for capital lease	750	
CR Gain due to waiver		1,000

Lessor records:

DR Loss due to waiver	1,000	
DR Unearned income	250	
CR Finance income		250
CR Lease payments receivable		1,000

In each of April – December 2021:

Lessee records:

DR Interest expense	250	
DR Obligation for capital lease	750	
CR Cash		1,000

Lessor records:

DR Cash	1,000	
DR Unearned income	250	
CR Finance income		250
CR Lease payments receivable		1,000