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FASB Offers Guidance on Lease Concessions

On April 8, 2020, the staff of the Financial Accounting Standards Board (“FASB”) responded to a question from constituents on whether the accounting for modifications in Accounting Standards Codification (“ASC”) Topic 842 *Leases* or Topic 840 *Leases* applies to lease concessions (i.e., deferrals or forgiveness of lease payments) provided as a result of the effects of the COVID-19 pandemic. Subsequently, the FASB staff posted a Q&A document to the FASB web site that provides the following guidance:

... the FASB staff believes that it would be acceptable for entities to make an election to account for lease concessions related to the effects of the COVID-19 pandemic consistent with how those concessions would be accounted for under Topic 842 and Topic 840 as though enforceable rights and obligations for those concessions existed (regardless of whether those enforceable rights and obligations for the concessions explicitly exist in the contract).

The effect of the FASB staff guidance is that lessees and lessors will not be required to review their lease agreements to determine whether a concession granted by the lessor is consistent with the original terms of the

lease agreement. Prior to the issuance of the FASB staff guidance, if a concession granted by a lessor was not required by the terms of the lease agreement, both the lessee and the lessor would need to account for the concession as a modification under either Topic 842 or Topic 840.

The FASB staff Q&A identifies two methods that reporting entities could use to account for concessions where certain rental payments are deferred, wherein the lessee will either pay the deferred rents during the existing lease term or during an extension of the lease term corresponding to the number of months for which rental payments were deferred:

... The staff expects that there will be multiple ways to account for those deferrals, none of which the staff believes are more preferable than the others. Two of those methods are:

- a. Account for the concessions as if no changes to the lease contract were made. Under that accounting, a lessor would increase its lease receivable, and a lessee would increase its accounts payable as receivables/ payments accrue. In its income statement, a lessor would continue to recognize income, and a lessee would continue to recognize expense during the deferral period.
- b. Account for the deferred payments as variable lease payments.

As it relates to situations where the lessor forgives rental payments, the two methods included in the FASB staff Q&A should lead to the same result.

If a lessee elects the first method, it will either need to recalculate the interest rate used in accreting the lease liability so that the balances of the right-of-use asset and

lease liability amortize to zero by the end of the lease or recognize a payable for the cash payments applied to reduce the lease liability but that were deferred to a future period; that payable would not bear interest.

If a lessee selects the second method, it will recognize a reduction of the periodic rent expense by the amount of the cash payment not made (in effect, in the periods when rent is deferred, the lessee records negative variable rent).

The FASB staff's guidance is limited to concessions that result in the total payments required by the modified contract being "substantially the same as or less than total payments required by the original contract." In determining whether that is the case for a lease where the payments will increase (i.e., because the lessor will charge interest on deferred payments), the FASB staff encouraged reporting entities to exercise judgment.

Reach out to our Real Estate experts for assistance in understanding the accounting for COVID-19-related lease modifications

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