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Accounting for rent concessions

April 27, 2020

With the economic uncertainty surrounding COVID-19, many lessees are asking for rent concessions, which are being granted by many lessors. A concession may take the form of free or reduced rent for a period, the deferral of rent, or some other type of relief.

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The FASB staff recently issued a Staff Q&A addressing the accounting for lease concessions related to the effects of COVID-19 under ASC 842 and ASC 840. In the Q&A, the staff states that an entity may make an election to treat a lease concession related to COVID-19 as though it results from an enforceable right, and to apply or not to apply the modification guidance, if certain criteria are met, thereby simplifying the accounting for concessions made and received as a result of COVID-19.

Background

A concession may take the form of deferred rent, rent forgiveness, a combination of a deferral of rent with an extension of the lease term, or some other form of relief. The accounting for a concession depends on whether the lessee has an enforceable right to the concession. A lease contract may provide a lessee with an enforceable right to a concession, such as a "force majeure" clause, or the laws in the jurisdiction governing the lease may create an enforceable right when a concession is legally required. Whether or not an enforceable right to a concession exists is ultimately a legal determination.

If the concession is based on an enforceable right, and no other terms of the lease have changed, then the concession is generally not accounted for as a lease modification. If the concession is not based on an enforceable right, or if other changes are made to the terms of the lease, then the concession is generally accounted for as a lease modification.

FASB staff Q&A

In its Q&A, the FASB staff notes that the guidance on accounting for lease modifications was written with routine lease changes in mind, not for the rapidly executed and widespread concessions granted in response to the COVID-19. The staff believes that under both ASC 840 and ASC 842, an entity may elect to treat qualifying lease concessions as if they were based on enforceable rights and obligations, and may choose to apply or not to apply modification accounting to those qualifying concessions. This election allows an entity to forego making a detailed review of each individual lease to determine if the lessee has an enforceable right to each concession.

According to the FASB staff Q&A, qualifying concessions must meet both of the following criteria:

- The concession is related to COVID-19.
- There is not a substantial increase in the lessee's obligations or the lessor's rights under the contract. For example, total payments required by the modified contract are substantially the same as or less than total payments required by the original contract.

Based on our discussion with the SEC staff, we believe that the SEC staff concurs with this view.

The Q&A states that an entity should apply its election consistently to contracts with similar characteristics and should disclose material concessions and the accounting for those concessions.

Concession is not a modification

A lease concession not accounted for as a modification is accounted for according to the terms of the concession.

A common form of lease concession discussed by the staff in the Q&A is a deferral of rent, which changes the timing, but not the amounts, of the rental payments. The staff noted that there could be multiple appropriate methods of accounting for a deferral under both ASC 842 and ASC 840, and described two of those methods in its Q&A:

1. Continue to account for the lease as if no deferral has been provided. A lessee should record a payable and a lessor should record a receivable for rental payments deferred.
2. Account for the deferred payments as variable lease payments.

Lessee rent deferral example

Assume that Lessor defers one period of Lessee's rent, which will be paid in equal installments over the remaining life of the lease. Lessee has adopted ASC 842 and has classified the lease as an operating lease.

Under the method listed in the first bullet, at the end of the period for which rent is deferred, Lessee records its normal leasing journal entry, including straight-line rent expense, and the changes in the lease liability and the right-of-use (ROU) asset. But, instead of crediting cash, Lessee accrues a payable, which is relieved when the deferred rent is paid. Under this method, there is no impact to rent expense, the lease liability, or the ROU asset.

Under the method in the second bullet, Lessee records its normal entry to reduce both the lease liability and the ROU asset, and recognizes straight-line rent expense. But, instead of crediting cash, Lessee records a reduction to rent expense in the period of the deferral. When Lessee later incurs the deferred rent, it recognizes a variable rent expense.

Lessor rent deferral example

Assume that Lessor defers one period of rent, which will be paid in equal installments over the remaining life of the lease. Lessor has adopted ASC 842 and has classified the lease as operating.

Under the first method, at the end of the period for which rent is deferred, Lessor records its normal straight-line rental income. The receivable recorded as part of recognizing the normal straight-line rental income is relieved over time as Lessee pays the deferred rent. The lease remains subject to the collectability guidance in ASC 842 for operating leases. Under this method, there is no impact to rental income.

Under the method outlined in the second bullet, Lessor recognizes its normal straight-line rental income and receivable, but also recognizes a negative variable rental income in the deferral period by crediting the receivable. Lessor recognizes the deferred amount as variable rental income in the period it is earned according to the deferral schedule.

Concession is a modification

Under ASC 842, if a rent concession is a modification, both a lessee and a lessor must first determine if a lease modification should be treated as a new lease or as a continuation of the current lease. An entity accounts for a modification that is not considered a separate contract as a continuation of the existing lease and reassesses lease classification, taking into account all modified terms and conditions and updating all inputs as of the effective date of the modification.

For details on accounting for lessee modifications under ASC 842, see Section 5.8.2 of Grant Thornton's Leases: Navigating the guidance in ASC 842.

For details on accounting for lessor modifications under ASC 842, see Section 6.10 of Grant Thornton's Leases: Navigating the guidance in ASC 842.

Visit Grant Thornton's COVID-19 Resource Center for in-depth coverage of the COVID-19 impact.

Source:
Grant Thornton, On the Horizon April 16, 2020

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