

To the Point

FASB staff clarifies accounting for lease concessions and other effects of COVID-19

The FASB staff issued the interpretation in response to questions about how to account for concessions that many lessors are providing.

What you need to know

- ▶ The FASB staff said in a staff question-and-answer document that entities can elect not to evaluate whether certain relief provided by a lessor in response to the COVID-19 pandemic is a lease modification.
- ▶ The FASB staff said an entity that elects not to evaluate whether a concession is a modification can then elect to apply the modification guidance to that relief or account for the concession as if it were contemplated as part of the existing contract.
- ▶ This publication also addresses other questions the FASB staff discussed at a public meeting this week about applying the guidance on loan modifications, hedge accounting and fair value in light of the economic effects of the COVID-19 pandemic.

Overview

The staff of the Financial Accounting Standards Board (FASB) issued a [question-and-answer document](#) that says entities can elect not to evaluate whether a concession provided by a lessor to a lessee in response to the COVID-19 pandemic is a lease modification.

In the document, which was posted on the FASB website, the staff said an entity that makes this election can then elect to apply the lease modification guidance to that relief or account for the concession as if it were contemplated in the existing contract.

The staff issued the interpretative guidance in response to questions it received about how to account for the concessions many lessors are providing or are expected to provide to lessees in response to the operational and financial challenges lessees are facing. The staff said it

believes the guidance on lease modifications in US GAAP did not contemplate concessions being executed so rapidly as a result of what it called “a major financial crisis arising from the COVID-19 pandemic.”

This publication also addresses other questions the FASB staff discussed at a public meeting this week about how to apply the guidance on loan modifications, hedge accounting and fair value measurement in light of the COVID-19 pandemic.

Key considerations

Concessions provided by lessors to lessees

The FASB staff said entities may elect to not evaluate whether lease-related relief that lessors provide to mitigate the economic effects of COVID-19 on lessees is a lease modification under Accounting Standards Codification (ASC) 842¹ or ASC 840.² Instead, the FASB staff said an entity that elects not to evaluate whether a concession is a modification can then elect whether to apply the modification guidance (i.e., assume the relief was always contemplated by the contract or assume the relief was not contemplated by the contract). The FASB staff said both lessees and lessors could make this election.

The election to not evaluate whether a concession is a modification is intended to reduce the operational challenges of evaluating the enforceable rights and obligations of leases at a time when many businesses that have been ordered to close or have seen their revenue drop due to the COVID-19 pandemic are receiving concessions from lessors.

Entities may make these elections for any lessor-provided COVID-19-related relief (e.g., deferral of lease payments, cash payments, reduction of future lease payments) that does not result in a substantial increase in the rights of the lessor or the obligations of the lessee. The FASB staff cited as examples concessions that would result in the total cash flows of the modified lease being substantially the same as or less than the total cash flows of the existing lease. The FASB staff also said the elections should be applied consistently to leases with similar characteristics and in similar circumstances, consistent with the overall objective described in ASC 842-10-10-1.

Evaluating whether to apply the modification guidance and applying it when appropriate can be operationally challenging, particularly for entities with large portfolios of contracts that have various terms and conditions. Under ASC 842, for example, that guidance requires entities to remeasure and reallocate consideration in the contract, reassess the lease term, reassess lease classification and update the discount rate if the modification is not accounted for as a separate contract.

Making these elections would simplify the accounting. For example, a lessee that is not required by the lessor to pay rent in April due to the pandemic and makes the election would not be required to evaluate the contract terms. If it chose not to apply the lease modification guidance, the lessee would account for the reduction in lease payments as if it were part of the enforceable rights and obligations of the existing contract (e.g., reduce its existing lease obligation and recognize negative variable lease expense in the period the concession is granted).

The FASB staff also said entities should consider the disclosure requirements in US GAAP and provide disclosures that enable users to understand the nature and financial effect of material rent relief provided or granted related to the effects of the COVID-19 pandemic.

How we see it

Making these elections could simplify an entity's accounting, but entities will need to carefully evaluate the terms of any concessions to make sure they qualify for the elections.

Loan modifications

The FASB staff discussed a technical inquiry on how a financial institution should account for interest income if it provides a payment holiday during which interest is not accrued for a borrower affected by COVID-19 and the payment holiday is not considered a troubled debt restructuring (TDR). The FASB staff said such a financial institution may either (1) determine a new effective interest rate and recognize interest income on the loan during the payment holiday or (2) not recognize any interest income during the payment holiday and resume recognition of interest income based on the contractual terms of the loan when the payment holiday ends.

Separately, several banking regulators³ issued a revised **statement** on loan modifications that clarifies that a financial institution may account for an eligible loan modification under section 4013 of the **Coronavirus Aid, Relief, and Economic Security (CARES) Act** or in accordance with ASC 310-40⁴ and the interpretive guidance provided in the revised statement. The CARES Act allows financial institutions to elect not to consider whether loan modifications relating to COVID-19 that they make between 1 March 2020 and the earlier of 31 December 2020 or 60 days after the COVID-19 national emergency ends to borrowers that are current (i.e., less than 30 days past due as of 31 December 2019) are TDRs.

Entities need to evaluate whether a loan modification relating to COVID-19 that's not accounted for under the CARES Act or made after the relief period provided by the CARES Act ends is a TDR. The banking regulators have expressed the view, and the FASB staff has confirmed that view, that short-term modifications (e.g., six months) made on a good-faith basis in response to COVID-19 for borrowers who are current (i.e., less than 30 days past due at the time a modification program is implemented) are not TDRs.

Cash flow hedging relationships

The FASB staff discussed a question on discontinued cash flow hedges and whether delays in the timing of forecasted transactions related to COVID-19 may be considered rare cases caused by extenuating circumstances outside the control or influence of the reporting entity under the guidance in ASC 815-30-40-4.

The staff indicated that the exception regarding extenuating circumstances may be applied to COVID-19-related delays in the timing of a forecasted transaction. Consequently, if a forecasted transaction delayed by COVID-19 is probable of occurring more than two months after the originally specified period, the entity may continue to defer amounts previously recorded in accumulated other comprehensive income (AOCI) until the forecasted transaction affects earnings. However, the staff emphasized that the exception only applies to situations in which the forecasted transaction remains probable of occurring. If the entity determines that it is not probable that the forecasted transaction will occur in a future period, the exception would not apply and amounts previously recorded in AOCI would have to be reclassified into earnings immediately and disclosed in the entity's interim and annual financial statements.

The staff said it continues to monitor the situation and will communicate with stakeholders through public statements or question-and-answer documents.

The FASB staff addressed other questions from stakeholders during a public meeting.

Fair value measurement

The FASB staff addressed a question about whether mark-to-market accounting would be suspended by saying that ASC 820⁵ provides guidance on the measurement of fair value when the volume or level of activity for an asset or a liability has significantly decreased and when transactions are not orderly.

Endnotes:

- ¹ ASC 842, *Leases*.
- ² ASC 840, *Leases*.
- ³ The statement was issued by the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau and state banking regulators.
- ⁴ ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors*.
- ⁵ ASC 820, *Fair Value Measurement*.

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