In depth

A look at current Canadian financial reporting issues

Release Date: January 14, 2021

Accounting implications of Canada Emergency Commercial Rent Assistance (CECRA) under International Financial Reporting Standards (IFRS) for lessors

At a glance

The Government of Canada introduced the Canada Emergency Commercial Rent Assistance (CECRA) program for small businesses in 2020 to provide relief for small businesses experiencing financial hardship due to COVID-19.

The program enables qualifying property owners that negotiate with qualifying small business tenants to reduce rent for the months of April to September. To qualify for CECRA for small businesses, the commercial property owner must enter (or have already entered) into a legally binding rent reduction agreement to reduce the impacted small business tenant's rent by at least 75% for the period to which CECRA applies. The landlord forgives at least 25% of the original rent, while the government funds the remaining 50% of the original rent. Full details are available on the CECRA site.

This "In depth" addresses the accounting implications of the program from the perspective of the lessor.

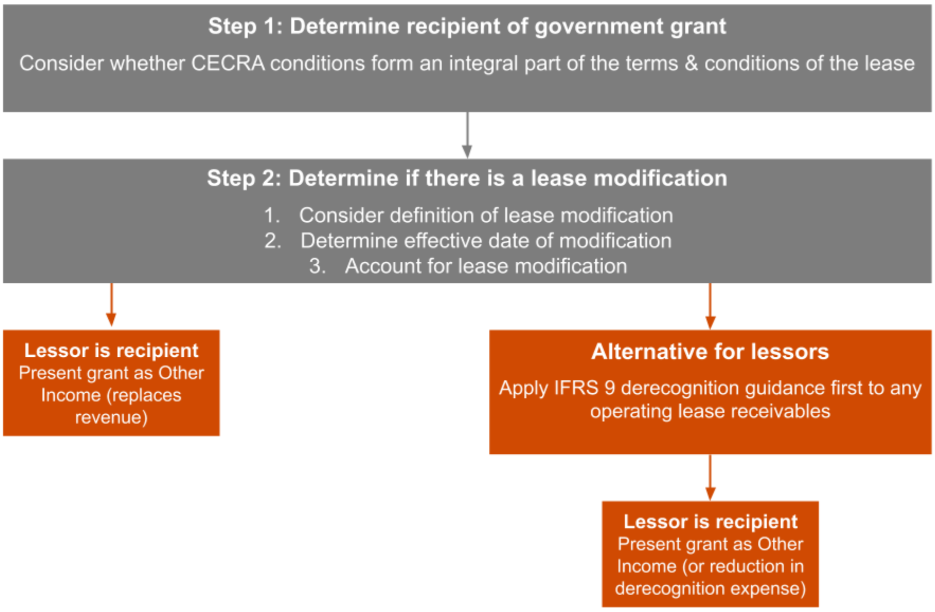
In our view:

- The CECRA assistance is accounted for as a government grant under IAS 20;
- The impact of the government grant is dependent on whether the lessor or the lessee is determined to be the recipient;
- The amount forgiven by the lessor is accounted for either under IFRS 16 as a lease modification or under IFRS 9 as a derecognition of a financial instrument depending on the facts and circumstances of the arrangement.

Changes to the program or new arrangements introduced by governments or lessors may result in a different analysis.

How should entities account for the CECRA assistance?

The following framework may be applied in determining the applicable guidance:



Step 1: Determine the recipient of the government grant

The CECRA assistance is a form of government grant in accordance with IAS 20 *Government grants*. However, ultimately both the lessor and lessee may benefit from this assistance which can lead to significant judgement about the recipient of the grant for accounting purposes. The lessor benefits because a portion of the rent is funded by the government and ultimately this may result in faster collection and less credit risk for the lessor. The lessee benefits because a portion of the rental does not need to be paid.

Ultimately both the landlord and tenant must agree to the terms of the program. The landlord is not obligated to offer the assistance to tenants and could decide that it does not want to bear the 25% reduction of its rental receipts. When the landlord and tenant reach an agreement concerning the program, new terms and conditions are effectively inserted into the modified agreement between the tenant and the landlord which outline the rental reduction for the tenant. CECRA rights and obligations therefore become part of the contractual arrangements, and the 50% CECRA payments are integral to the negotiation of the new lease terms. That is, CECRA would generally be integral to a landlord's decision whether to modify the lease agreement.

While both landlord and tenant benefit from the CECRA program, from an accounting perspective we believe that one party should be identified as the recipient of a grant within the scope of IAS 20 and the other party should be considered to receive indirect benefits outside the scope of IAS 20. Both the tenant and landlord would have to independently consider whether the direct recipient of the grant is:

- The tenant, whose previous obligation is being settled in part by the CECRA funds, or
- The landlord is being compensated by the CECRA funds for modifying the contract.

The significant judgement should be disclosed in the financial statements, where material, in order to inform users of the accounting that has been applied.

The party who is not considered the recipient does not account for a government grant within the scope of IAS 20.

Implications if the lessor is determined to be the recipient

A lessor recognizes the assistance when they are reasonably assured that CECRA will be applied for and approved, and they intend to comply with the conditions for the forgiveness of the forgivable loan [IAS 20 para 7]. Originally, the CECRA program covered the months of April, May and June 2020. The program was subsequently extended for July to September 2020, with those months being a voluntary "opt-in" for previous applicants, and with new applicants allowed to apply for the full extended period. Depending on the circumstances there may be more than one date when government assistance has become reasonably assured.

If the changes to the lease agreement are treated as a reduction in revenue, the assistance is presented in "other income" or a similar line item in the income statement, since the assistance in substance replaces lost revenue. If the changes to the lease agreement are treated as the derecognition of a receivable, the assistance may be presented either in "other income" or a similar line item, or against the derecognition expense. [IAS 20 para 29]

Whether the changes to the lease agreement are a reduction in revenue or a derecognition expense is discussed in Step 2.

Regardless of which party is determined to be the recipient of the assistance, there has been a change in the terms of the lease. The lessor is considered to receive a grant since contractual payments due from the lessee have been reduced by at least 75% for the applicable months.

The next step is to determine whether the change in the terms of the lease results in a modification for accounting purposes.

If the lessor determines that the lessee is the recipient, the lessor would not account for government assistance and the entire reduction agreed to in rents would be attributable to a lease modification as discussed in Step 2.

Implications if the lessor is not determined to be the recipient

The party who is not considered the recipient does not account for a government grant within the scope of IAS 20. The lessor would consider the implications of the arrangement as a lease modification (see Step 2).

Step 2: Accounting for the lease modification

A lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. [IFRS 16 App A]

Generally, amendments to incorporate the CECRA terms and conditions into the lease agreement meet the definition of a lease modification, regardless of whether the lessee or the lessor is considered to be the recipient of the government assistance.

The requirements of IFRS 16 *Leases* are considered to determine how to account for the lease modification:

1. ***Determine effective date of modification***

   The effective date of the modification is the date on which the parties agree to the modification of the lease [IFRS 16 App A]. Management of lessors and lessees may have to apply judgement in determining when the revised terms have been agreed upon by both parties, as this may vary from entity to entity depending on how landlords have managed the CECRA application process and communications with their tenants.

   Originally, the CECRA program covered the months of April, May and June 2020. The program was subsequently extended for July to September 2020, with those months being a voluntary "opt-in" for previous applicants, and with new applicants allowed to apply for the full extended period. Therefore, there may be more than one modification and more than one effective date, depending on the timing of the application(s) and rent reduction agreements with tenants.

2. ***Account for lease modification***

   The lessor accounts for a modification of an operating lease as a new lease. Any prepaid or accrued lease payments relating to the original lease are considered as payments for the new lease, and they are spread over the new term of the modified lease. [IFRS 16 para 87]

Example 1 - Modification for lessor

Tenant A is a CECRA eligible tenant, paying $1,000 gross rent a month to Landlord X. (For simplicity this example assumes that cash rents equal straight-line rental revenue recognized by the landlord.)The lease expires May 31, 2022. Tenant A paid rent for April and May 2020. On June 1, Landlord X and Tenant A signed the necessary rent reduction agreement and Landlord X applied to CECRA for the period April 1 to June 30, 2020. Landlord X considers itself the recipient of the government assistance.

The effective date of the modification is considered to be June 1, 2020. The lease payments from the lessee have been reduced by $2,250 (75% of the gross monthly payments of $1,000 x three months). The impact of applying IFRS 16 lease modification guidance would be to reduce the rental revenue recognized each month for the remainder of the term (24 months) from $1,000 per month to $906 per month. That is, the impact of the change to the lease payments is recognized evenly over the remaining term of the lease.

If Landlord X considered that the lessee was recipient of the government assistance, the modification would account for a reduction of lease payments for 25% of the gross monthly payments only, as the remaining 50% of lease payments are rental revenues paid by the government on behalf of the tenant. However, the same principles would apply.

3. *Alternative accounting policy choices for lessors*

Due to the mechanics and timing of the CECRA application process, lessors may be able to apply an alternative approach for certain lessees.

In Canada, it is common for landlords to have offered rent deferrals for April, May and June (and beyond), even prior to the decision to apply for CECRA. Rent deferral agreements that do not change the total consideration under the lease and do not change the lease term would not typically be considered modifications for the lessor. If the lessee did not make any lease payments in April through June, and the lease is modified at the end of June or later, the lessor has a receivable on the balance sheet for those rents. Lease receivables are in scope of IFRS 9 *Financial instruments* for impairment and derecognition purposes as well as IFRS 16 *Leases* for lease modifications as they relate to consideration paid under the lease.

In our view, there is a policy choice with regards to which standard is applied first when assessing changes to the lease contract. This choice is applied consistently. Some changes to lease contracts may impact both existing receivables for past rent and amounts payable by the lessee for the remaining term of the lease. In these cases, both standards may need to be applied.

Example 2 - Alternative for lessors

Tenant A is a CECRA eligible tenant, paying $1,000 gross rent a month to Landlord X. For simplicity this example assumes that cash rents equal straight-line rental revenue recognized by the landlord. The lease expires May 31, 2022. Tenant A did not pay any rent for April or May. On June 1, Landlord X and Tenant A signed the necessary rent reduction agreement with the tenant agreeing to pay 25% of the previous contractual rents and Landlord X applied to CECRA for the period April 1 to June 30, 2020. Landlord X considers itself the recipient of the government assistance.

The effective date of the modification is considered to be June 1, 2020. Under the revised terms total payments from the lessee will be $23,750. Landlord X applies IFRS 9 to its $2,000 lease receivables first prior to assessing the modification under IFRS 16. Under the IFRS 9 assessment, Landlord X determines that there is a substantial modification to the receivables and the new carrying amount of the receivables is $500 under the revised rent reduction agreement (25% of the previous rent for April and May that is payable by tenant A). Landlord X recognizes a derecognition expense of $1,500 in net income. Landlord X then applies IFRS 16 guidance as if the operating lease is a new lease. The $500 of payments are considered to be in respect of the existing receivables, so the lease consideration for the remaining term is $23,250, being $250 for June and $1,000 for the remaining months of the lease. This revenue is recognized on a straight-line basis over the remainder of the term (24 months) resulting in $969 of revenue each month.

Alternatively, if Landlord X applies IFRS 16 first, then of the total payments from the lessee $2,000 are considered to effectively settle the existing receivable, with the remaining $21,250 recognized on a straight-line basis over the remainder of the term (24 months) resulting in $885 of revenue each month.

Other considerations

Many real estate leases in Canada consist of a lease of a specified space (the lease component) and the provision of certain related services, such as common area maintenance, utilities and so on (non-lease components). For lessors these components are separate and non-lease components are accounting for under IFRS 15, *Revenue from contracts with customers*. CECRA requires that the rent reduction agreement applies to gross rent, that is, it includes amounts for services whether they are separately charged (under a triple net lease) or charged through a fixed rate in a gross lease.

For lessors, as well as a modification to a lease, there is also a modification to a revenue contract that is accounted for under IFRS 15. Changes in consideration may have to be applied to both the lease consideration accounted for under IFRS 16 and the service consideration accounted for under IFRS 15. The impact of accounting for modifications under IFRS 15 depends on the nature of the goods and services promised and how these were analyzed by the entity upon adoption of IFRS 15.

The grant amounts are allocated between lease and non-lease components on a pro rata basis if the lessor considers themselves to be the recipient of the government grant.

Is additional disclosure about the assistance required?

Disclosure requirements relating to government assistance include the accounting policy adopted for government grants and the nature and extent of government grants. [IAS 20 para 39]

The broad disclosure objective of IFRS 16 requires lessors and lessees to disclose information that gives users of financial statements a basis to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. [IFRS 16 para 51, 89]

Lessees that have applied the practical expedient in IFRS 16 are required to disclose that fact and the relevant amounts recognized. [IFRS 16 para 60A]

Where do I get more details?

For more information on Canada Emergency Commercial Rent Assistance, refer to Canada's COVID-19 Economic Response Plan and Canada Mortgage and Housing Corporation's CECRA site.

For more information on accounting for leases and other accounting impacts of the pandemic refer to PwC In depth INT2020-04: Accounting implications of coronavirus.

Questions?

Entities impacted by the items described above can discuss these with their local PwC contact.

National office contacts

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