Lease concessions and COVID-19: What to know - by Ane Ohm

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Since the outbreak of the COVID-19 pandemic in March, CPA firms are seeing a large increase in the number of clients asking about lease concessions.

No one, including Financial Accounting Standards Board (FASB), could have foreseen a global pandemic causing this much uncertainty around lease accounting. Between the move to working from home and the major economic disruption, many businesses' needs have shifted dramatically, particularly as it relates to real estate.

Many businesses are negotiating short- or long-term lease concessions to preserve cash flow and strengthen their financials. However, there's a big difference between what qualifies as a lease concession and what requires a lease modification. Combine that with the fact that many public companies are still adjusting to the new lease accounting standard, and it's created a lot of confusion for clients.

Businesses will be navigating many months–if not years–of lease concessions and lease modifications resulting from the COVID-19 pandemic. Here's the latest on what you need to know to help.

Lease concessions versus lease modifications

A lease concession occurs when the lessee enacts an enforceable right or obligation in an existing contract. For example, a lease may contain a reduced lease escalation clause capping the amount of escalated rent, or prevent rent escalation until a certain amount of time.

A lease modification is a change in the scope of the original contract. For example, the scope of the lease could expand to include more assets. The new lease standard differentiates between creating a new lease separate from the original lease, or simply changing the scope of the original lease. Entities must now account for these modifications in a specific way.

FASB offers guidance on lease concessions

On April 10, FASB staff issued a Staff Q&A on Topic 842 (and Topic 840) regarding lease concessions related to the pandemic.

FASB staff acknowledged the problem the pandemic brought: "It may be exceedingly challenging for entities to determine whether existing contracts provide enforceable rights and obligations for lease concessions and, if so, whether those concessions are consistent with the terms of the contract or are modifications to a contract."

As a result, FASB deemed it acceptable for entities to treat any lease changes made as a result of the COVID-19 pandemic as a lease concession rather than a lease modification. Even if the enforceable rights and obligations were not in the original lease, entities don't have to go through the extra work required to treat it as a lease modification.

Firms can treat these lease concessions as they would any other lease concession according to Topic 842 or Topic 840, depending on whether you have implemented the new lease standard yet. Entities may decide to accrue deferred payments (with lessors continuing to recognize income and lessees recognizing expenses) or to account for deferred payments as variable lease payments.

Making an election to account for lease concessions

Making this election saves the time of pouring over leases to determine whether the provision is included or requires a lease modification.

There are two requirements to be able to make an election to an account for a lease concession rather than a lease modification:

• The lessee must be affected by the economic disruptions of COVID-19.

• The lease concessions cannot result in a substantial increase in the lessor's rights or lessee's obligations. There must be a reasonable expectation that the total payments of a modified lease contract will be the same or less than the original.

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