

IFRS 16: Lease Modifications: Lessee

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- **IFRS 16** requirements
 - Modifications accounted for as a separate new lease
 - Other modifications
- **Implementation questions**
 - Effective date of lease modifications
 - Original vs modified discount rates
- **Lease modifications – key takeaways**

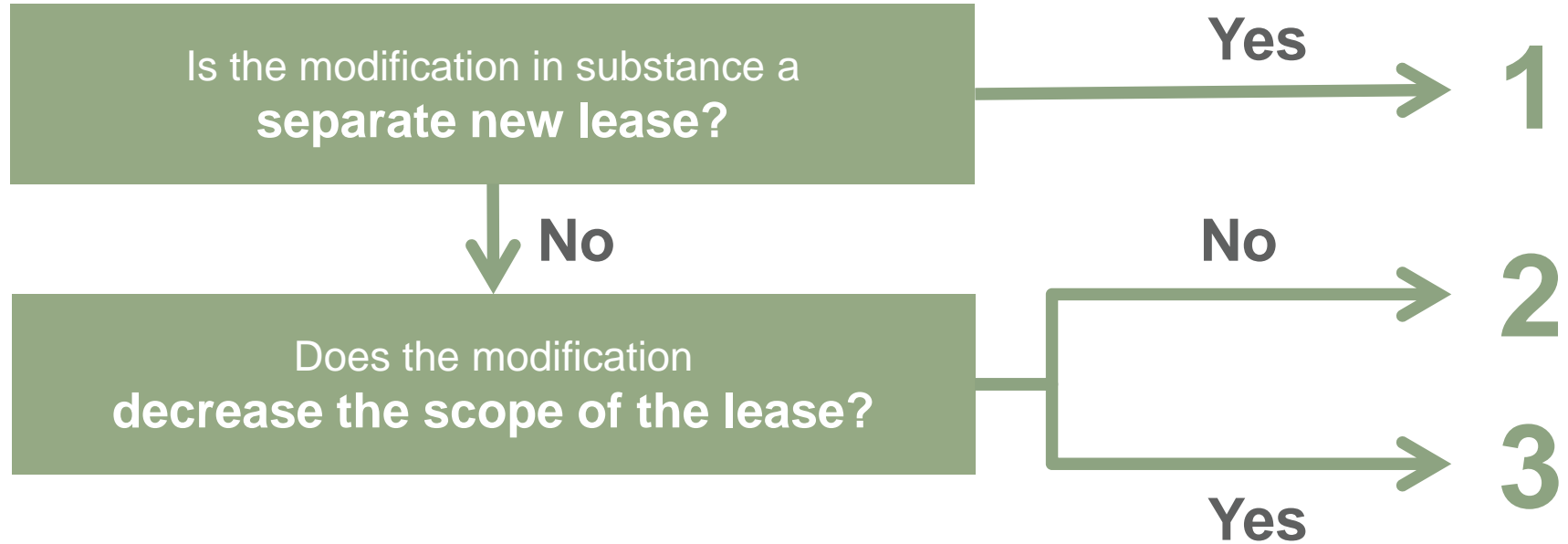


IFRS 16 Requirements

Lease Modifications: Lessee

Overview: Lease modifications

There are **three** possible accounting treatments:



1: Separate new lease

A modification is accounted for as a separate new lease **IF**:

- It increases the scope of the lease by adding the right to use one or more underlying assets; **AND**
- Consideration increases by an amount commensurate with the stand-alone price for the increase in scope

In this case, account for the separate new lease

like any other new lease

2&3: NOT a separate new lease

In all cases, need to calculate the **modified lease liability**:

- a) allocate consideration;
- b) determine lease term;
- c) remeasure lease liability by discounting the revised lease payments using a revised discount rate

Then work out the **accounting entries**:

- These depend upon whether the modification **decreases the scope of the lease**

2: No decrease in scope

Eg: change in consideration or an increase in scope *without* a commensurate increase in consideration



- **Adjust lease liability** to reflect the remeasurement
- Make a **corresponding adjustment to the ROU asset**

Eg: Dr ROU asset; Cr lease liability

Reflects a **change in cost** of the ROU asset

3: Decrease in scope

Eg: less floor space in a property lease or a shorter lease term



- **Decrease pre-modification ROU asset** (and pre-modification lease liability) to reflect partial or full termination
- **Recognise any gain or loss** in P&L



Eg:
Dr lease liability;
Cr ROU asset;
Dr/Cr loss/gain

For any other elements of the modification (eg a change in consideration for the remaining ROU asset), make a **corresponding adjustment to the ROU asset** as per previous slide



Implementation Questions

Lessee Modifications

Effective date of a lease modification = Date that both parties agree to the modification (ie: date the modified contract is signed)

IFRS 16, 45: Measure the modified lease liability on this date*

Q

When should the modified lease liability be recognised?

Decrease in scope

Increase in scope, other than lease term

Increase in lease term

*Unless the modification is accounted for as a separate lease

Example: Effective date of modification is before a decrease in scope takes effect

- 10 year lease of 2 floors of a building;
- At the end of year 4, modified contract is signed
- **Modification:** in years 6-10, the lease will be for only 1 floor. The 2nd floor will be returned to the lessor at the end of year 5.

Q

- Why does the lessee recognise the modification, including any gain/loss on partial termination, a year before the 2nd floor is returned?
- How does this reconcile with recognition at commencement of a lease?

Example: Effective date of modification is before an increase in scope, other than lease term, takes place

- 10 year lease of 2 floors of a building;
- At the end of year 4, modified contract is signed
- **Modification:** in years 6-10, the lease will be for 3 floors. The lessee will get access to the 3rd floor at the end of year 5. The price for the additional floor is not commensurate with the stand-alone price.

Q

- Does the lessee recognise a right-of-use asset and lease liability with respect to the 3rd floor at the end of year 4 or year 5?

Example: Modification that increases lease term

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- 5 year lease of a property;
- At the end of year 4, modified contract is signed
- **Modification:** lease is extended for a further 5 years (so 10 years in total).

Q

- Should a lessee account for this modification as a separate new lease?
- If not, is it correct that a lessee accounts for the 'new' additional lease liability and right-of-use asset at the end of year 4?

IFRS 16, para 45(c)



Re-measure the lease liability using a **revised discount rate**

Q

The Illustrative Examples on lease modifications use both original and revised discount rates – can you clarify when to use which rate?

Example

(IFRS 16 Illustrative Example 18)

- 10 year lease of 2,000m² of space;
- Lease payments are £100,000pa
- At the end of year 5, modified contract is signed.
- **Modification:** (i) include an additional 1,500m² of space; (ii) reduce lease term to 8 years; and (iii) increase annual lease payments to £150,000

Important to remember that **two** things are happening:

- Decrease in scope (reduced lease term); **AND**
- Increase in scope (more space)

Example

(IFRS 16 Illustrative Example 18)

- Calculate the partial termination of the **original lease** using the **original discount rate** (IFRS 16, para 46(a))
 - Calculate reduction in ROU asset and reduction in lease liability; any difference is gain or loss on partial termination
- Calculate the **modified lease liability** using the **modified discount rate** (IFRS 16, para 45(c));
 - Make corresponding adjustment to ROU asset (IFRS 16; para 46(b))

Lease Modifications: Key takeaways

- Unless there is a separate new lease:
 - **measurement** takes place at the **effective date of the modification**;
 - **recognition** will depend upon when the lessee has access to the modified right-of-use asset.
- If there are **multiple elements** to a modification (eg an increase AND a decrease in scope), think about each element separately.
- Use **modified discount rates** unless calculating the gain or loss on a partial termination/decrease in scope.
- Use the **Illustrative Examples!** IE15-19 in IFRS 16 cover different lease modification scenarios in detail, including double entry.

- Leases website

<http://www.ifrs.org/Current-Projects/IASB-Projects/Leases>

- Leases implementation page

<http://www.ifrs.org/Current-Projects/IASB-Projects/leases-implementation/Pages/IFRS-16-Leases-Implementation.aspx>