



**Lease modifications – ten
comprehensive examples**

Foreword



IFRS 16 *Leases* was issued in January 2016 and it is effective for accounting periods beginning on or after 1 January 2019.

While not a large standard in terms of pages when compared to other more recent standards, it is a standard that is raising many practical and interpretational issues. Modifications is a particular area which has raised issues and the devil is in the detail.

This very practical publication runs through some of the accounting for these modifications with a series of ten scenarios that build on the various permutations of lease modifications in a logical manner, explaining the principles and concepts while providing easy to follow numeric examples.

A practical and hopefully very useful guide.

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Introduction

Lease modifications: Numbers and journal entries

IFRS 16 *Leases* contains detailed guidance on how to account for lease modifications. A lease modification is defined as 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. A lease modification includes adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term.

IFRS 16's lease modification guidance can be summarised into the diagram overleaf.

Broadly speaking, a lease modification is accounted for in one of two ways:

1. It is treated as a separate lease (IFRS 16.44); or
2. It is not treated as a separate lease (IFRS 16.45-46).

As can be seen from the diagram, a modification will only be treated as a separate lease if it involves the addition of one or more underlying assets at a price that is commensurate with the standalone price of the increase in scope.¹ All other modifications are not treated as a separate lease.

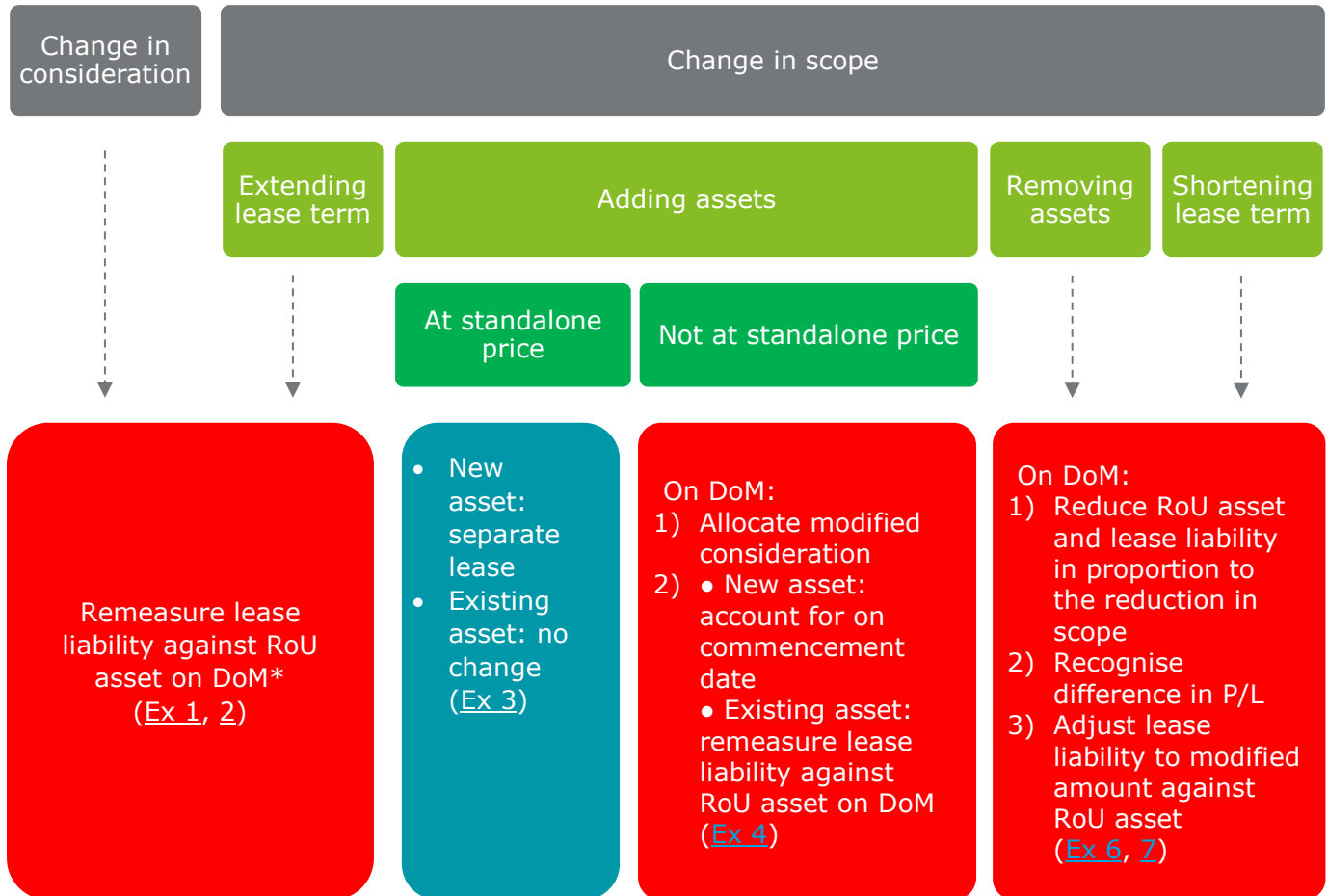
If a modification is a separate lease, a lessee applies the requirements of IFRS 16 to the newly added asset independently of the original lease. The accounting for the original lease continues unchanged. See [example 3](#).

In contrast, if a modification is not a separate lease, the accounting reflects that there is a linkage between the original lease and the modified lease. The existing lease liability is remeasured with a corresponding adjustment to the RoU asset on the effective date of the modification. See examples [1](#) and [2](#). If the modification involves the addition of an underlying asset at off-market rates, we believe the newly added asset should be recognised only when that asset is made available for use by the lessee – see [example 4](#). In the case of a reduction in the scope of the lease, this will result in a modification gain or loss in profit or loss. See examples [6](#) and [7](#).

A further point to note is the need to disaggregate an existing single lease liability and RoU asset into separate lease components if only some of the lease components are modified or if they are modified to a different extent. See examples [7](#), [8](#) and [9](#).

¹ For an addition of a RoU asset to be accounted for as a separate lease, the increase in consideration must be 'commensurate with the standalone price for the increase in scope and any appropriate adjustments to that standalone price to reflect the circumstances of the particular contract' (IFRS 16.44(b)). For ease of reference, that notion has been shortened to an increase in consideration that is 'at market rates' throughout this publication. See appendix I for further elaboration.

Changes that are not part of the original terms of the lease



* DoM: Effective date of the modification

Appendix I to this document reproduces the relevant IFRS 16 definitions and guidance on lease modifications together with explanations on some of those concepts.

Appendix II contains links to further Deloitte guidance on modifications.

The focus of this publication

In our earlier publication [Lease modifications – extending the lease term](#) issued in May 2019, we discussed (1) what constitutes a lease modification, (2) when a lease modification should be accounted for, and (3) what the impact of a lease modification is on the lease term.

In this publication, we build on that foundation and discuss other types of lease modifications. Specifically, we have created ten comprehensive numerical examples to illustrate how to account for different types and permutations of lease modifications. These permutations are summarised in the matrix below:

Space leased	Unchanged	Increase	Decrease
Lease term			
Unchanged	NA	Ex 3 & Ex 4	Example 7
Longer	Example 2	Example 5	Example 9
Shorter	Example 6	Example 10	Example 8
Change in consideration: Example 1			

Abbreviations

DoM	Effective date of the modification
IBR	Lessee's incremental borrowing rate
p.a.	Per annum
P/L	Profit or loss (income statement)
RoU asset	Right-of-use asset

See Appendix I for relevant definitions and explanations.

Comprehensive examples

Pre-modification fact pattern for all ten examples

Lessee leases office space from Lessor with original terms as follows:

- Size of office space leased: 5,000m²
- Lease term: 5 years from 1 January 20x1 to 31 December 20x5 with no extension or termination options
- Lease payments: CHF100,000 payable annually in arrears
- IBR²: 5% p.a.

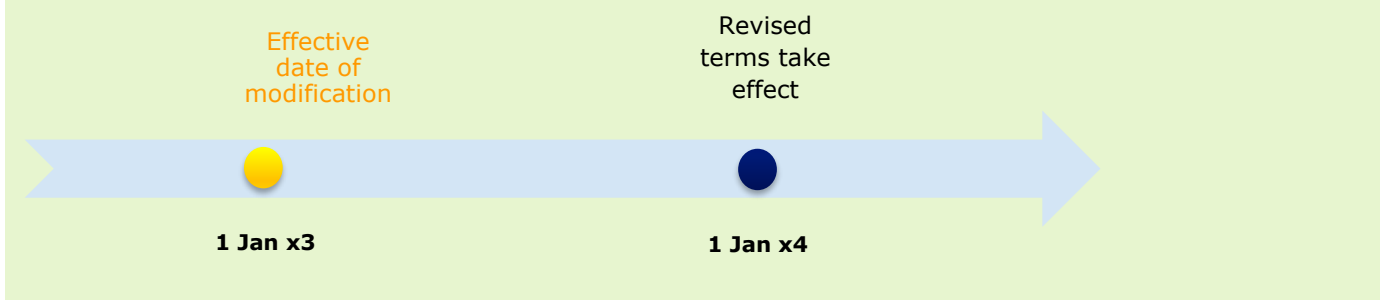
Lessee has a December year-end.

In each of the examples below, Lessee and Lessor agree to amend the original lease³ on 1 January 20x3. All lease payments are paid annually in arrears.

Observation

In practice, there is usually a time gap between when the negotiation is finalised (i.e. the effective date of the modification) and when the revised terms take effect (e.g. when the extended term starts or when a new asset is made available for use by the lessee). This has an impact on the recognition and measurement of the lease liability and the RoU asset.

We have incorporated this into the examples below by setting the date when the revised terms take effect after the effective date of the modification.



² Assume the implicit rate in the lease cannot be readily determined.

³ The accounting would be the same if the lessee and the lessor had incorporated the terms of the modification in a new agreement as opposed to amending the original lease. See the Deloitte publication [Lease modifications – extending the lease term](#) issued in May 2019 for details.

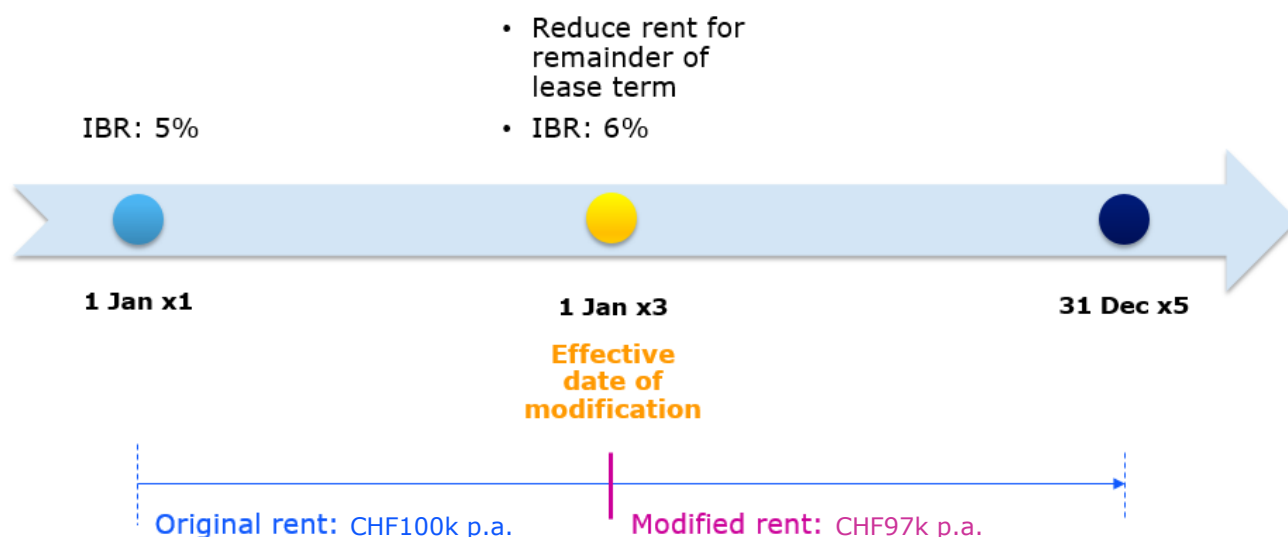
The *pre*-modification RoU asset and lease liability on the effective date of the modification, 1 January 20x3, are as follows:

		CHF
RoU asset		
Balance 1 Jan 20x1	Present value of five payments of CHF100,000 discounted at 5%	432,948
Accumulated depreciation	(432,948/5*2)	(173,179)
Balance 1 Jan 20x3		259,769
Lease liability	Present value of three payments of CHF100,000 discounted at 5%	272,325

Example 1 – changing the consideration

Modification: Lessee and Lessor agree on 1 January 20x3 to reduce the annual lease payments to CHF97,000 for the remaining three years.

The IBR on 1 January 20x3 is 6% p.a.



Analysis

The change in consideration is accounted for on 1 January 20x3 being the effective date of the modification (IFRS 16.45). Lessee remeasures the lease liability to reflect three modified lease payments of CHF97,000 discounted at a revised IBR determined on 1 January 20x3 of 6%, which amounts to CHF259,282.

The difference of CHF13,043 between the original lease liability (CHF272,325) and the modified lease liability (CHF259,282) on 1 January 20x3 is adjusted against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	Lease liability	13,043	
Cr	RoU asset		13,043

The RoU asset and lease liability in relation to the modified lease are as follows:

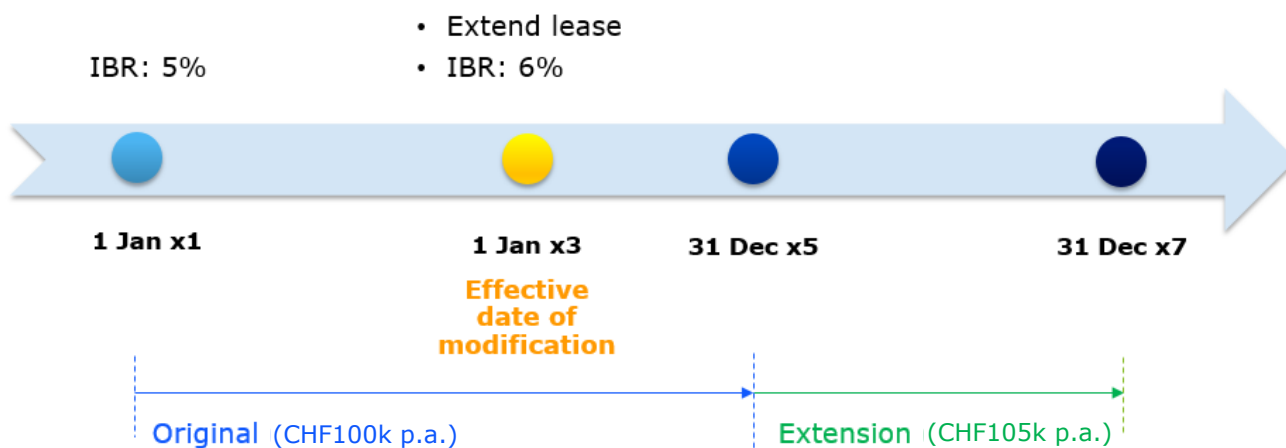
Year	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3							
<i>Pre-m*</i>	272,325				259,769		
<i>Adj*</i>	(13,043)	(JE 1 above)			(13,043)	(JE 1 above)	
<i>Post-m*</i>	259,282	15,557	(97,000)	177,839	246,726	(82,242)	164,484
20x4	177,839	10,670	(97,000)	91,509	164,484	(82,242)	82,242
20x5	91,509	5,491	(97,000)	-	82,242	(82,242)	-

- * Pre-m = pre-modification
- Adj = adjustment
- Post-m = post-modification

Example 2 – extending the lease term

Modification: Lessee and Lessor agree on 1 January 20x3 to extend the lease upon expiry from 1 January 20x6 for two years at an annual lease payment of CHF105,000.

The IBR on 1 January 20x3 is 6% p.a.



Analysis

As the modification does not add the right to use one or more underlying assets, it is not accounted for as a separate lease. Instead, it is accounted for at the effective date of the lease modification, which is 1 January 20x3. Accordingly, Lessee remeasures the existing lease liability on 1 January 20x3 based on the modified lease payments using the IBR on that date (IFRS 16.45). A corresponding adjustment is made to the RoU asset (IFRS 16.46(b)).

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	RoU asset	156,608	
Cr	Lease liability		156,608

To remeasure the lease liability to reflect the modification. This represents the difference between the original lease liability (CHF272,325) and the modified lease liability (CHF428,933) on 1 January 20x3.

The modified lease liability of CHF428,933 is calculated as the present value of three payments of CHF100,000 from 20x3 to 20x5 and two lease payments of CHF105,000 from 20x6 to 20x7, all discounted at 6%.

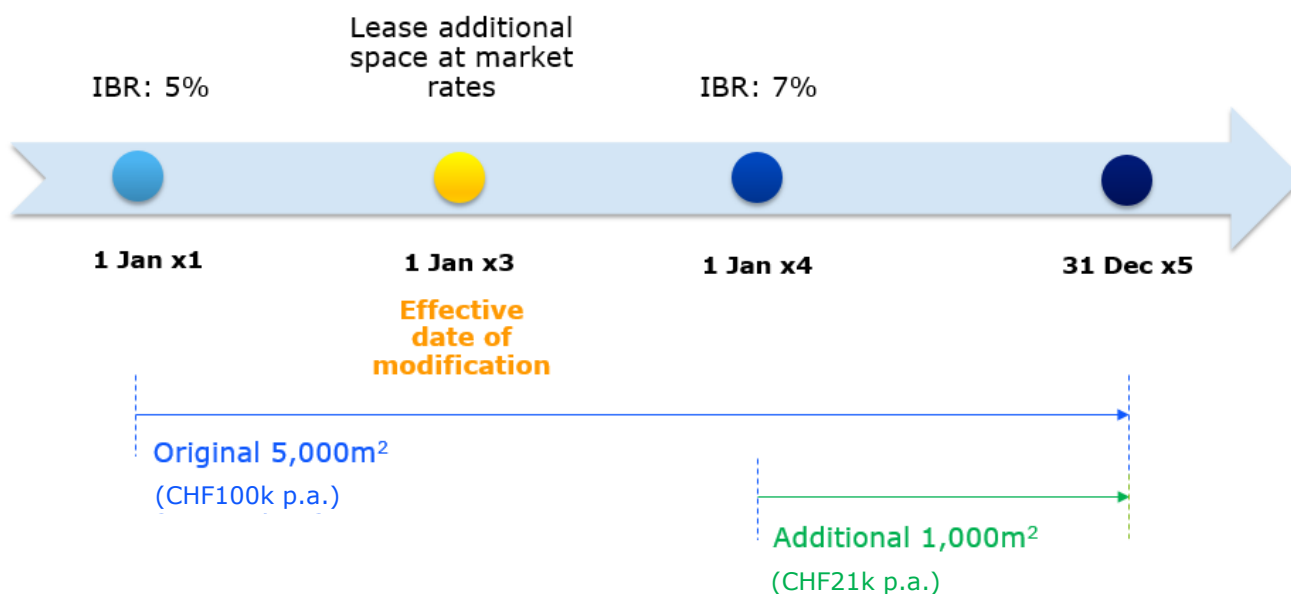
The RoU asset and lease liability in relation to the modified lease are as follows:

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	272,325				259,769		
<i>Adj</i>	156,608	<i>(JE 1 above)</i>			156,608	<i>(JE 1 above)</i>	
<i>Post-m</i>	428,933	25,736	(100,000)	354,669	416,377	(83,275)	333,102
20x4	354,669	21,280	(100,000)	275,949	333,102	(83,275)	249,826
20x5	275,949	16,557	(100,000)	192,506	249,826	(83,275)	166,551
20x6	192,506	11,550	(105,000)	99,057	166,551	(83,275)	83,275
20x7	99,057	5,943	(105,000)	-	83,275	(83,275)	-

Example 3 – leasing additional space at market rates

Modification: Lessee and Lessor agree on 1 January 20x3 to lease an additional 1,000m² of office space from 1 January 20x4 for two years at an annual lease payment of CHF21,000, which is considered to be at market rates. The terms of the lease relating to the original 5,000m² remain unchanged.

The original 5,000m² and the additional 1,000m² of space constitute separate lease components. The IBR on 1 January 20x4 is 7% p.a.



Analysis

The additional 1,000m² is accounted for as a separate lease because it increases the scope of the lease by adding the right to use an underlying asset (extra space) at market rates (IFRS 16.44). Furthermore, because the two sets of spaces constitute separate lease components, the lease of the original 5,000m² and the additional 1,000m² are accounted for independently of each other.

As a result, the RoU asset and lease liability relating to:

- the original 5,000m² is not affected as there has been no change to its terms, and
- the additional 1,000m² is recognised on the new lease's commencement date, i.e. on 1 January 20x4.

Lessee records the following journal entry on 1 January 20x4:

JE 1		CHF	CHF
Dr	RoU asset	37,968	
Cr	Lease liability		37,968

To recognise the lease of the additional 1,000m² on commencement date of that lease component at the present value of two payments of CHF21,000 discounted at 7%.

The RoU asset and lease liability in relation to the modified lease are as follows:

Lease of existing 5,000m²

Year	Lease liability				RoU asset		
	Beginning balance	5% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3 ⁽¹⁾	272,325	13,616	(100,000)	185,941	259,769	(86,590)	173,179
20x4	185,941	9,297	(100,000)	95,238	173,179	(86,590)	86,590
20x5	95,238	4,762	(100,000)	-	86,590	(86,590)	-

⁽¹⁾ The pre- and post-modification amount of the lease liability and RoU asset on 1 January 20x3 is the same as the modification does not affect the existing lease component.

Lease of additional 1,000m²

Year	Lease liability				RoU asset		
	Beginning balance	7% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3	NA				NA		
20x4							
<i>Pre-IR*</i>	NA				NA		
<i>IR*</i>	37,968	<i>(JE 1 above)</i>			37,968	<i>(JE 1 above)</i>	
<i>Post-IR*</i>	37,968	2,658	(21,000)	19,626	37,968	(18,984)	18,984
20x5	19,626	1,374	(21,000)	-	18,984	(18,984)	-

* Pre-IR = pre-initial recognition
 IR = initial recognition
 Post-IR = post-initial recognition

The amounts reflected in the financial statements are the sum of the above two lease components.

Observation

In [example 3](#), the original 5,000m² and the additional 1,000m² are accounted for as two unrelated, separate leases because the 1,000m² represents an additional underlying asset that has been added to the original lease at market rates.

There has been no change to the lease of the original 5,000m² hence the accounting for this lease component continues as if nothing happened. The lease payments for this component continue to be discounted at the original IBR of 5%, determined at 1 January 20x1 being the commencement date of this lease component.

In contrast, the lease payments for the additional 1,000m² are discounted at 7%, which is the IBR determined at 1 January 20x4 being the commencement date of that lease component.

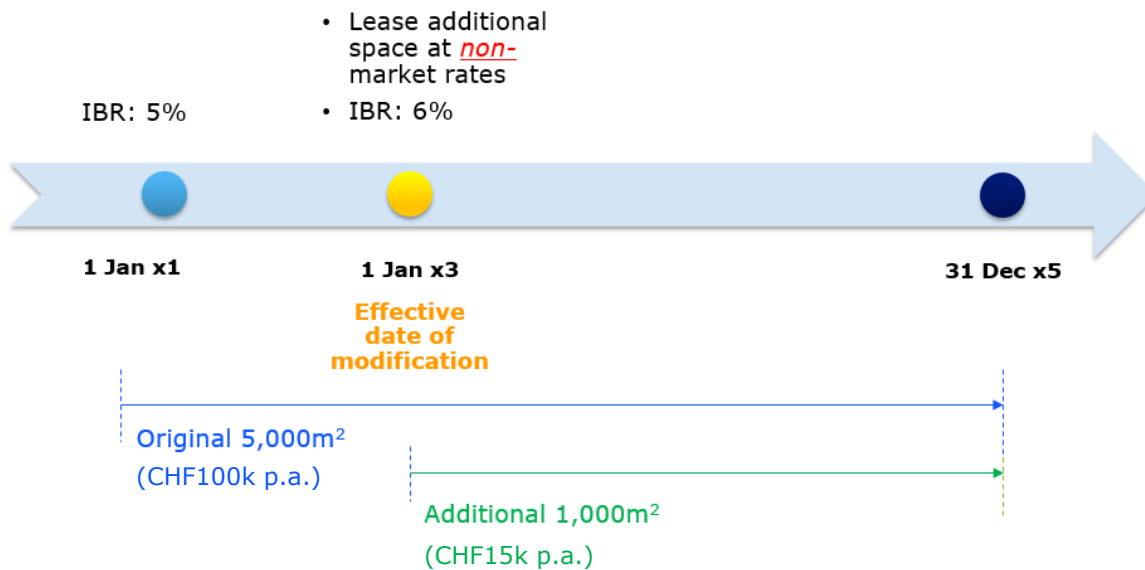
Another point to note is that even though the effective date of the modification is 1 January 20x3, the additional 1,000m² is only recognised on 1 January 20x4 when that space is made available for use by Lessee.

If the additional 1,000m² was *not* priced at market rates, the lease of the original 5,000m² would be modified due to a reallocation of the modified consideration. See [example 4](#).

Example 4 – leasing additional space at off-market rates

Modification: Lessee and Lessor agree on 1 January 20x3 to lease an additional 1,000m² of office space immediately for three years at an annual lease payment of CHF15,000, which is not considered to be at market rates. The terms of the lease relating to the original 5,000m² remain unchanged.

The original 5,000m² and the additional 1,000m² of space constitute separate lease components. The IBR on 1 January 20x3 is 6%.



Analysis

Since the increase in consideration for the increase in scope (the additional 1,000m²) is not at market rates, Lessee applies IFRS 16.45 to account for the modification. Consequently, on 1 January 20x3 which is the effective date of the modification, Lessee:

- 1) allocates the consideration in the modified contract to the two lease components (i.e. the original 5,000m² and the additional 1,000m² of space) on the basis of their relative standalone prices on that date;
- 2) determines the lease term of the modified lease; and
- 3) remeasures the lease liability using the IBR at that date.

(IFRS 16.45)

The two lease components should theoretically be accounted for *separately* following the three steps above (IFRS 16.12):

- Original 5,000m²: allocating the modified consideration to this lease component changes the consideration for this component. Accordingly, this part of the modification is accounted for similarly as [example 1](#) – on 1 January 20x3 being the effective date of the modification, the revised consideration is discounted at the IBR on that date of 6% for three years.
- Additional 1,000m²: this lease component is recognised on the date it is made available for use by Lessee, which coincides with the effective date of the modification of 1 January 20x3. The consideration allocated to this component is discounted at the IBR on the commencement date of this lease component (1 January 20x3) of 6% for three years.

As can be seen above, both lease components are recognised and/or (re)measured on 1 January 20x3 using a discount rate of 6% for three years. As such, there is practically no need for Lessee to allocate the consideration of the modified contract between the two components because however

the lease payments are allocated, they will be discounted at the same rate (6%) over the same time (20x3 to 20x5).

In this analysis, we have taken a shortcut to account for the two lease components on a combined basis post-modification.

Remeasure the lease liability: combined 6,000m²

The post-modification lease liability on 1 January 20x3 for the combined 6,000m² is CHF307,396, calculated as the present value of three lease payments of CHF115,000 discounted at 6%.

The difference of CHF35,071 between the original lease liability (CHF272,325) and the modified lease liability (CHF307,396) on 1 January 20x3 is adjusted against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	RoU asset	35,071	
Cr	Lease liability		35,071

The RoU asset and lease liability in relation to the modified lease are as follows:

Combined 6,000m²

Year	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3							
<i>Pre-m</i>	272,325				259,769		
<i>Adj</i>	35,071	<i>(JE 1 above)</i>			35,071	<i>(JE 1 above)</i>	
<i>Post-m</i>	307,396	18,444	(115,000)	210,840	294,840	(98,280)	196,560
20x4	210,840	12,650	(115,000)	108,491	196,560	(98,280)	98,280
20x5	108,491	6,509	(115,000)	-	98,280	(98,280)	-

Observation

If the additional 1,000m² was made available for use by the lessee at a date later than the effective date of the modification, we believe that the RoU asset and the lease liability for this lease component should be recognised only when the underlying asset is made available for use by the lessee, i.e. on the commencement date of this lease component, and not on the effective date of the modification.

In that case, a lessee cannot take the shortcut to account for both lease components on a combined basis because the inputs used for them are different:

- The modified lease payments allocated to the original 5,000m² are discounted at an IBR of 6% for three years in accordance with [example 4](#); whereas
- The modified lease payments allocated to the additional 1,000m² are discounted at the IBR on the commencement date of that lease component (say 1 January 20x4) which could differ from 6%, over the lease term of this lease component which could also differ from the remaining lease term of the 5,000m².

[Example 10](#) illustrates the accounting for the two components separately.

Observation

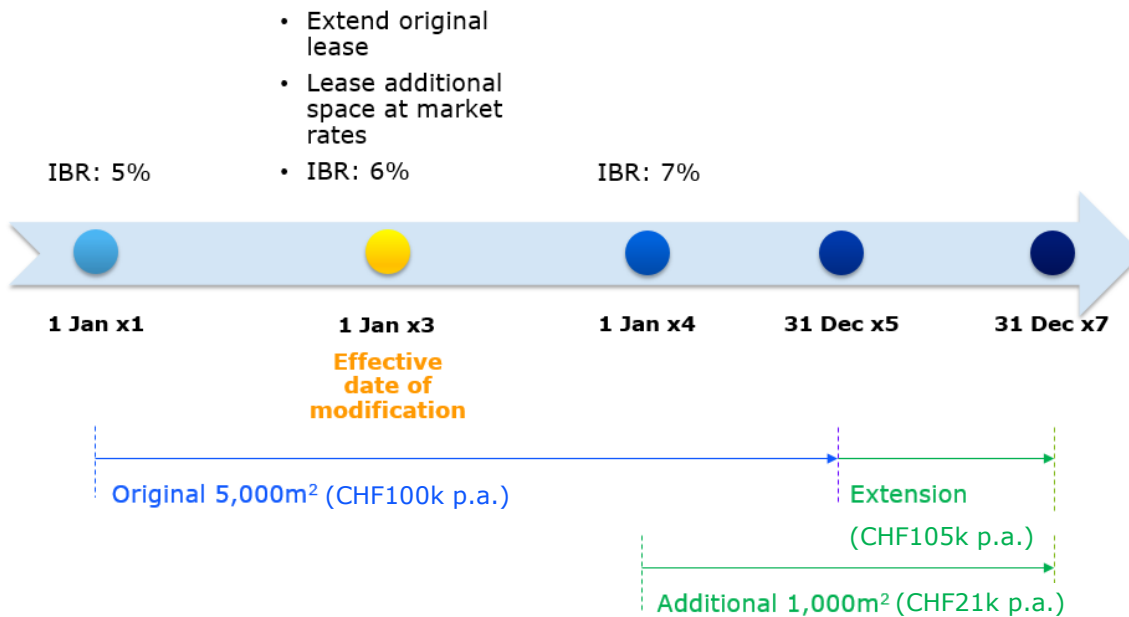
A lessee may want to account for the two lease components separately or keep track of the combined RoU asset and lease liability in a way that will allow for disaggregation in the future if one of the components, e.g. the original 1,000m², were to be subleased or if the two components belong to different cash-generating units for impairment purposes.

In the case of a sublease, the lessee needs to know how much of the combined RoU asset is subject to the sublease in order to assess whether the sublease is an operating or a finance lease, how much RoU asset should be derecognised in the case of a finance lease, as well as to comply with disclosure requirements.

Example 5 – extension plus leasing additional space at market rates

Modification: Lessee and Lessor agree on 1 January 20x3 to extend the lease upon expiry from 1 January 20x6 for two years at an annual lease payment of CHF105,000, as well as to lease an additional 1,000m² of office space from 1 January 20x4 for four years at an annual lease payment of CHF21,000 which is considered to be at market rates.

The original 5,000m² and the additional 1,000m² of space constitute separate lease components. The IBR on 1 January 20x3 and 1 January 20x4 is 6% and 7% p.a. respectively.



Analysis

The additional 1,000m² is accounted for as a separate lease because it increases the scope of the lease by adding the right to use an underlying asset (extra space) at market rates (IFRS 16.44). Furthermore, because the two sets of spaces constitute separate lease components, the lease of the original 5,000m² and the additional 1,000m² are accounted for independently of each other.

A. Extending the lease of the existing 5,000m²

As the lease extension does not add the right to use one or more underlying assets, it is not accounted for as a separate lease. Instead, it is accounted for at the effective date of the lease modification which is 1 January 20x3. Accordingly, Lessee remeasures the existing lease liability on 1 January 20x3 based on the modified lease payments using the IBR on that date (IFRS 16.45). A corresponding adjustment is made to the RoU asset (IFRS 16.46(b)). This is consistent with the base case in [example 2](#).

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	RoU asset	156,608	
Cr	Lease liability		156,608

To remeasure the lease liability to reflect the modification. This represents the difference between the original lease liability (CHF272,325) and the modified lease liability (CHF428,933) on 1 January 20x3.

The modified lease liability of CHF428,933 is calculated as the present value of three payments of CHF100,000 from 20x3 to 20x5 and two lease payments of CHF105,000 from 20x6 to 20x7, all discounted at 6%.

B. Lease of the additional 1,000m²

The additional 1,000m² is accounted for as a separate lease and its related RoU asset and lease liability are recognised at the commencement date of this lease component, i.e. on 1 January 20x4. This is consistent with the base case in [example 3](#).

Lessee records the following journal entry on 1 January 20x4:

JE 2		CHF	CHF
Dr	RoU asset	71,131	
Cr	Lease liability		71,131

To recognise the lease of the additional 1,000m² on commencement date of that lease component at the present value of four payments of CHF21,000 discounted at 7%.

The RoU asset and lease liability in relation to the modified lease are as follows:

Lease of existing 5,000m²

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	272,325				259,769		
<i>Adj</i>	156,608	<i>(JE 1 above)</i>			156,608	<i>(JE 1 above)</i>	
<i>Post-m</i>	428,933	25,736	(100,000)	354,669	416,377	(83,275)	333,102
20x4	354,669	21,280	(100,000)	275,949	333,102	(83,275)	249,826
20x5	275,949	16,557	(100,000)	192,506	249,826	(83,275)	166,551
20x6	192,506	11,550	(105,000)	99,057	166,551	(83,275)	83,275
20x7	99,057	5,943	(105,000)	-	83,275	(83,275)	-

Lease of additional 1,000m²

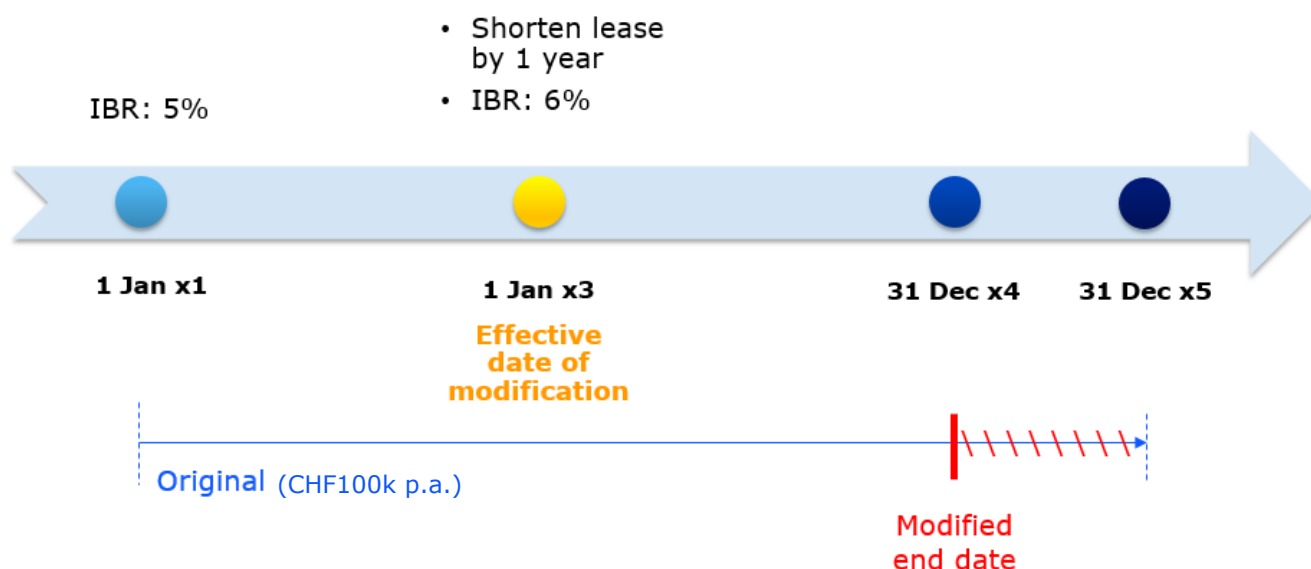
	Lease liability				RoU asset		
	Beginning balance	7% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
20x4							
<i>Pre-IR</i>	NA				NA		
<i>IR</i>	71,131	<i>(JE 2 above)</i>			71,131	<i>(JE 2 above)</i>	
<i>Post-IR</i>	71,131	4,979	(21,000)	55,111	71,131	(17,783)	53,349
20x5	55,111	3,858	(21,000)	37,968	53,349	(17,783)	35,566
20x6	37,968	2,658	(21,000)	19,626	35,566	(17,783)	17,783
20x7	19,626	1,374	(21,000)	-	17,783	(17,783)	-

The amounts reflected in the financial statements are the sum of the above two lease components.

Example 6 – shortening the lease term

Modification: Lessee and Lessor agree on 1 January 20x3 to shorten the lease term by one year to end on 31 December 20x4. The annual lease payment remains at CHF100,000 for the remainder of the lease term.

The IBR on 1 January 20x3 is 6% p.a.



Analysis

As shortening the lease term is a reduction in the scope of the lease, the modification is accounted for on the effective date of the modification, i.e. on 1 January 20x3 (IFRS 16.45).

The reduction in scope is accounted for in two steps:

- I. Reduce the RoU asset and lease liability in proportion to the reduction in lease term, and recognise the difference in profit/loss.
- II. Adjust the lease liability resulting from step I to its modified carrying amount with a corresponding charge to the RoU asset.

(IFRS 16.46)

I. Reduce the RoU asset and lease liability proportionately

The pre-modification carrying amounts of the lease liability and the RoU asset are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payment for 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only two years left after the modification).

	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	272,325	259,769
• Reduction	(86,384)	(86,590)
• Post-modification	185,941 ⁽¹⁾	173,179 ⁽²⁾

(1) Present value of two payments of CHF100,000 discounted at the original IBR of 5%

(2) CHF259,769 / 3 years * 2 years

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	Lease liability	86,384	
Dr	Loss on lease modification (P/L)	206	
Cr	RoU asset		86,590

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with the difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 is CHF183,339, being the present value of two lease payments of CHF100,000 discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF2,602 between the lease liability resulting from step I above (CHF185,941) and its modified carrying amount (CHF183,339) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 2		CHF	CHF
Dr	Lease liability	2,602	
Cr	RoU asset		2,602

The RoU asset and lease liability in relation to the modified lease are as follows:

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	272,325				259,769		
<i>Adj</i>	(86,384)	(JE 1 above)			(86,590)	(JE 1 above)	
	(2,602)	(JE 2 above)			(2,602)	(JE 2 above)	
<i>Post-m</i>	183,339	11,000	(100,000)	94,340	170,577	(85,289)	85,289
20x4	94,340	5,660	(100,000)	-	85,289	(85,289)	-

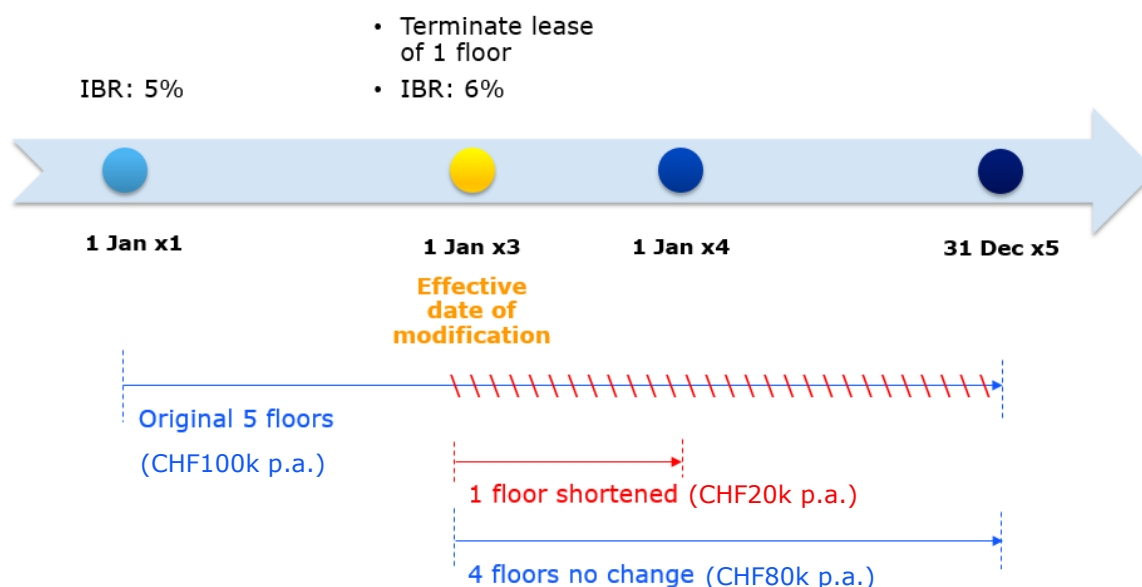
Example 7 – reducing the leased space

The original 5,000m² represents five floors of space of equal size. Each floor constitutes a separate lease component.

Modification: Lessee and Lessor agree on 1 January 20x3 to terminate the lease of one floor starting from 1 January 20x4. The annual lease payment remains at CHF100,000 for 20x3 for all five floors and is proportionately reduced to CHF80,000 for 20x4 and 20x5 for the remaining four floors.

The IBR on 1 January 20x3 is 6% p.a.

The standalone price on a per square meter basis is the same for each floor throughout the five years.



Analysis

Terminating the right to use a floor is a reduction in the scope of the lease. Since the floor that will be relinquished and the remaining four floors constitute separate lease components, they are accounted for separately (IFRS 16.12).⁴ In other words, the four floors that will continue to be leased are not affected by the modification because there has been no change to the terms of the lease relating to these floors.

With regard to the floor that will be relinquished on 1 January 20x4, the modification is equivalent to shortening the lease term of this floor from three remaining years (20x3 to 20x5) to one (20x3). The modification is accounted for on the effective date of the modification, i.e. on 1 January 20x3 (IFRS 16.45). The accounting is the same as that shown in the base case of [example 6](#).

The pre-modification carrying amounts of the lease liability and the RoU asset are presented in the table below.

⁴ See note in the observation box at the end of this example.

	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
Total for five floors (A)	272,325	259,769
• Four floors kept (4/5 * A)	217,860	207,815
• One floor to be relinquished (1/5 * A)	54,465	51,954

The reduction in scope with regard to the floor that will be relinquished is accounted for in two steps:

- I. Reduce the RoU asset and lease liability in proportion to the reduction in lease term, and recognise the difference in profit/loss.
- II. Adjust the lease liability resulting from step I to its modified carrying amount with a corresponding charge to the RoU asset.

(IFRS 16.46)

I. Reduce the RoU asset and lease liability proportionately

The pre-modification carrying amounts of the lease liability and the RoU asset relating to the floor that will be relinquished are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payments for 20x4 and 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only one year left after the modification).

One floor to be relinquished	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	54,465	51,954
• Reduction	(35,417)	(34,636)
• Post-modification	19,048 ⁽¹⁾	17,318 ⁽²⁾

⁽¹⁾ Present value of one payment of CHF20,000 discounted at the original IBR of 5%

⁽²⁾ CHF51,954 /3 years *1 year

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	Lease liability	35,417	
Dr	Gain on lease modification (P/L)		781
Cr	RoU asset		34,636

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 relating to the floor that will be relinquished is CHF18,868, being the present value of one lease payment of CHF20,000 discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF180 between the lease liability resulting from step I above (CHF19,048) and its modified carrying amount (CHF18,868) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 2		CHF	CHF
Dr	Lease liability	180	
Cr	RoU asset		180

The RoU asset and lease liability in relation to the modified lease are as follows:

Four floors kept

Year	Lease liability				RoU asset		
	Beginning balance	5% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3	217,860	10,893	(80,000)	148,753	207,815	(69,272)	138,543
20x4	148,753	7,438	(80,000)	76,190	138,543	(69,272)	69,272
20x5	76,190	3,810	(80,000)	-	69,272	(69,272)	-

One floor to be relinquished (equivalent to shortening the lease term)

Year	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
	CHF				CHF		
20x3							
<i>Pre-m</i>	54,465				51,954		
<i>Adj</i>	(35,417)	(<i>JE 1 above</i>)			(34,636)	(<i>JE 1 above</i>)	
	(180)	(<i>JE 2 above</i>)			(180)	(<i>JE 2 above</i>)	
<i>Post-m</i>	18,868	1,132	(20,000)	-	17,138	(17,138)	-

The amounts reflected in the financial statements are the sum of the above lease components.

Observation

Often a lease of assets constituting separate lease components are accounted as one because the inputs used (i.e. lease term, lease payments, discount rates) are the same for each of the lease components. This is illustrated in [example 7](#) where a single lease liability and RoU asset is calculated for all five floors from the lease commencement date instead of calculating a separate lease liability and RoU asset for each of the five floors which would have yielded the same results.

Nevertheless, when it comes to a lease modification, care must be taken to disaggregate the single lease liability and RoU asset into its separate lease components when only some of the components are modified (as seen in this example) or if different components are modified to a different extent. See examples [8](#) and [9](#).

In this example, there has in effect been no change to the four floors kept. As such, they continue to be accounted for using the original inputs as if nothing happened, i.e. the original IBR of 5%, lease payments for the four floors of CHF80,000 and remaining lease term of three years.

Example 8 – reducing the leased space plus shortening the lease term

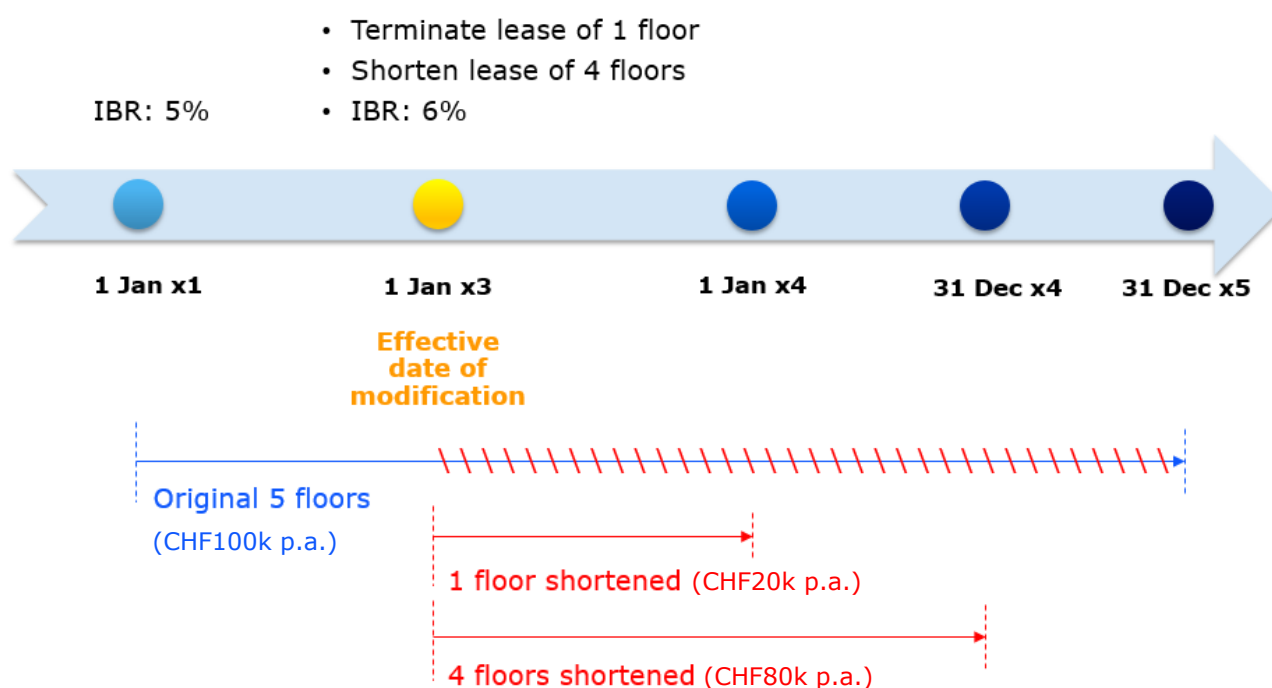
The original 5,000m² represents five floors of space of equal size. Each floor constitutes a separate lease component.

Modification: Lessee and Lessor agree on 1 January 20x3 to:

- terminate the lease of one floor from 1 January 20x4. The lease payment for this floor remains at CHF20,000 for 20x3; and
- shorten the lease term of the remaining four floors by one year to end on 31 December 20x4. The annual lease payment remains at CHF80,000 for these four floors for the remainder of the lease term.

The IBR on 1 January 20x3 is 6% p.a.

The standalone price on a per square meter basis is the same for each floor throughout the five years.



Analysis

This modification is tantamount to shortening the lease term of different floors for different periods. Since each floor constitutes a separate lease component, the modification for each floor is accounted for separately (IFRS 16.12). The procedure for accounting for the modification is the same for all five floors and it is consistent with the base case shown in [example 6](#).

The pre-modification carrying amounts of the lease liability and the RoU asset are presented in the table below.

	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
Total for five floors (A)	272,325	259,769
• Four floors (4/5 * A) ⁽¹⁾	217,860	207,815
• One floor (1/5 * A)	54,465	51,954

⁽¹⁾ The four floors have been accounted for on a combined basis as they are subject to the same modification – shortening the lease term by one year.

A. Shortening the lease term of four floors

As shortening the lease term is a reduction in the scope of the lease, the modification is accounted for on the effective date of the modification, i.e. on 1 January 20x3 (IFRS 16.45). The reduction in scope is accounted for in two steps:

- I. Reduce the RoU asset and lease liability in proportion to the reduction in lease term, and recognise the difference in profit/loss.
- II. Adjust the lease liability resulting from step I to its modified carrying amount with a corresponding charge to the RoU asset.

(IFRS 16.46)

I. *Reduce the RoU asset and lease liability proportionately*

The pre-modification carrying amounts of the lease liability and the RoU asset relating to the four floors are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payments for 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only two years left after the modification).

Four floors	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	217,860	207,815
• Reduction	(69,107)	(69,272)
• Post-modification	148,753 ⁽¹⁾	138,543 ⁽²⁾

⁽¹⁾ Present value of two payment of CHF80,000 discounted at the original IBR of 5%

⁽²⁾ CHF207,815 / 3 years * 2 years

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	Lease liability	69,107	
Dr	Loss on lease modification (P/L)	165	
Cr	RoU asset		69,272

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 relating to the four floors is CHF146,671, being the present value of two lease payment of CHF80,000 discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF2,082 between the lease liability resulting from step I above (CHF148,753) and its modified carrying amount (CHF146,671) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 2		CHF	CHF
Dr	Lease liability	2,082	
Cr	RoU asset		2,082

B. Shortening the lease term of one floor

This is accounted for in the same way as the four floors above and the impact is identical to that shown in [example 7](#).

I. Reduce the RoU asset and lease liability proportionately

The pre-modification carrying amounts of the lease liability and the RoU asset relating to this floor are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payments for 20x4 and 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only one year left after the modification).

One floor	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	54,465	51,954
• Reduction	(35,417)	(34,636)
• Post-modification	19,048 ⁽¹⁾	17,318 ⁽²⁾

(1) Present value of one payment of CHF20,000 discounted at the original IBR of 5%

(2) CHF51,954 / 3 years * 1 year

Lessee records the following journal entry on 1 January 20x3:

JE 3	CHF	CHF
Dr Lease liability	35,417	
Dr Gain on lease modification (P/L)		781
Cr RoU asset		34,636

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 relating to this floor is CHF18,868, being the present value of one lease payment of CHF20,000 discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF180 between the lease liability resulting from step I above (CHF19,048) and its modified carrying amount (CHF18,868) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 4	CHF	CHF
Dr Lease liability	180	
Cr RoU asset		180

The RoU asset and lease liability in relation to the modified lease are as follows:

Four floors

Year	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	217,860				207,815		
<i>Adj</i>	(69,107)	(JE 1 above)			(69,272)	(JE 1 above)	
	(2,082)	(JE 2 above)			(2,082)	(JE 2 above)	
<i>Post-m</i>	146,671	8,800	(80,000)	75,472*	136,461	(68,231)	68,231*
20x4	75,472	4,528	(80,000)	-	68,231	(68,231)	-

* Rounding difference

One floor

Year	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	54,465				51,954		
<i>Adj</i>	(35,417)	(JE 3 above)			(34,636)	(JE 3 above)	
	(180)	(JE 4 above)			(180)	(JE 4 above)	
<i>Post-m</i>	18,868	1,132	(20,000)	-	17,138	(17,138)	-

The amounts reflected in the financial statements are the sum of the above lease components.

Example 9 – reducing the leased space plus extending the lease term

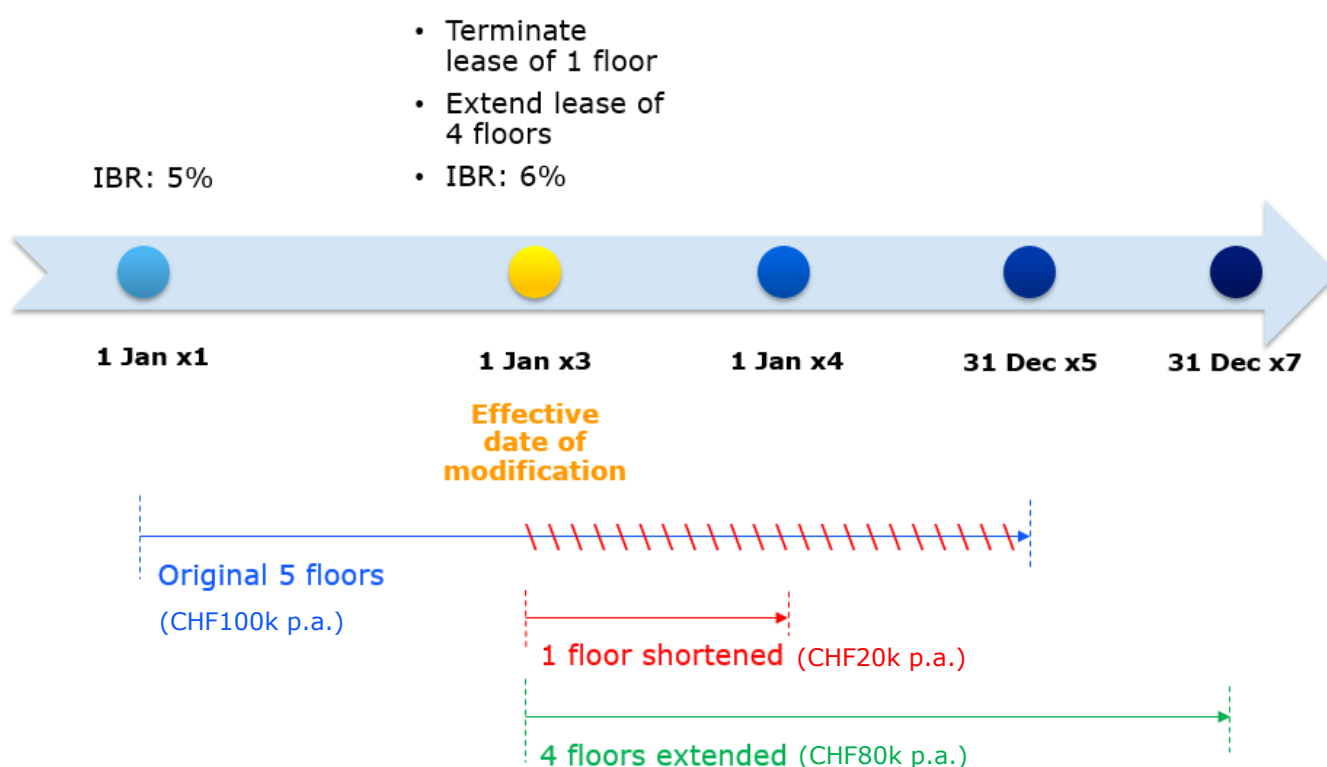
The original 5,000m² represents five floors of space of equal size. Each floor constitutes a separate lease component.

Modification: Lessee and Lessor agree on 1 January 20x3 to:

- terminate the lease of one floor starting from 1 January 20x4. The lease payment for this floor remains at CHF20,000 for 20x3; and
- extend the lease of the remaining four floors from 1 January 20x6 for two years at an annual lease payment of CHF80,000.

The IBR on 1 January 20x3 is 6% p.a.

The standalone price on a per square meter basis is the same for each floor throughout the five years.



Analysis

Since the floor that will be relinquished and the remaining four floors constitute separate lease components, they are accounted for separately (IFRS 16.12). Consequently, the extension of the lease term for the four floors is accounted for in the same way as [example 2](#); whereas the floor that will be relinquished is accounted for in the same way as [example 7](#).

The pre-modification carrying amounts of the lease liability and the RoU asset are presented in the table below.

	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
Total for five floors (A)	272,325	259,769
• Four floors kept (4/5 * A)	217,860	207,815
• One floor to be relinquished (1/5 * A)	54,465	51,954

A. Extending the lease term of four floors

This is accounted for in the same way as [example 2](#).

As the modification does not add the right to use one or more underlying assets, it is accounted for at the effective date of the lease modification, which is 1 January 20x3. Accordingly, Lessee remeasures the existing lease liability for these four floors on 1 January 20x3 based on the modified lease payments using the IBR on that date (IFRS 16.45). A corresponding adjustment is made to the RoU asset (IFRS 16.46(b)).

Lessee records the following journal entry on 1 January 20x3:

JE 1		CHF	CHF
Dr	RoU asset	119,129	
Cr	Lease liability		119,129

To remeasure the lease liability to reflect the modification. This represents the difference between the original lease liability (CHF217,860) and the modified lease liability (CHF336,989) on 1 January 20x3.

The modified lease liability of CHF336,989 is calculated as the present value of five payments of CHF80,000 discounted at 6%.

B. Relinquishing one floor

The impact of this part of the modification is identical to that in [example 7](#).

This part of the modification is equivalent to shortening the lease term of this floor from three remaining years (20x3 to 20x5) to one (20x3). The modification is accounted for on the effective date of the modification, i.e. on 1 January 20x3 (IFRS 16.45) and is accounted for in two steps:

- I. Reduce the RoU asset and lease liability in proportion to the reduction in lease term, and recognise the difference in profit/loss.
- II. Adjust the lease liability resulting from step I to its modified carrying amount with a corresponding charge to the RoU asset.

(IFRS 16.46)

I. Reduce the RoU asset and lease liability proportionately

The pre-modification carrying amounts of the lease liability and the RoU asset relating to this floor are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payments for 20x4 and 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only one year left after the modification).

One floor to be relinquished	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	54,465	51,954
• Reduction	(35,417)	(34,636)
• Post-modification	19,048 ⁽¹⁾	17,318 ⁽²⁾

(1) Present value of one payment of CHF20,000 discounted at the original IBR of 5%

(2) CHF51,954 /3 years *1 year

Lessee records the following journal entry on 1 January 20x3:

JE 2		CHF	CHF
Dr	Lease liability	35,417	
Dr	Gain on lease modification (P/L)		781
Cr	RoU asset		34,636

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 relating to the floor that will be relinquished is CHF18,868, being the present value of one lease payment of CHF20,000 discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF180 between the lease liability resulting from step I above (CHF19,048) and its modified carrying amount (CHF18,868) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

JE 3		CHF	CHF
Dr	Lease liability	180	
Cr	RoU asset		180

The RoU asset and lease liability in relation to the modified lease are as follows:

Four floors kept with extended lease term

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	217,860				207,815		
<i>Adj</i>	119,129	(JE 1 above)			119,129	(JE 1 above)	
<i>Post-m</i>	336,989	20,219	(80,000)	277,208	326,944	(65,389)	261,555
20x4	277,208	16,633	(80,000)	213,841	261,555	(65,389)	196,166
20x5	213,841	12,830	(80,000)	146,671	196,166	(65,389)	130,778
20x6	146,671	8,800	(80,000)	75,472	130,778	(65,389)	65,389
20x7	75,472	4,528	(80,000)	-	65,389	(65,389)	-

One floor to be relinquished (equivalent to shortening the lease term)

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	54,465				51,954		
<i>Adj</i>	(35,417)	(JE 2 above)			(34,636)	(JE 2 above)	
	(180)	(JE 3 above)			(180)	(JE 3 above)	
<i>Post-m</i>	18,868	1,132	(20,000)	-	17,138	(17,138)	-

The amounts reflected in the financial statements are the sum of the above lease components.

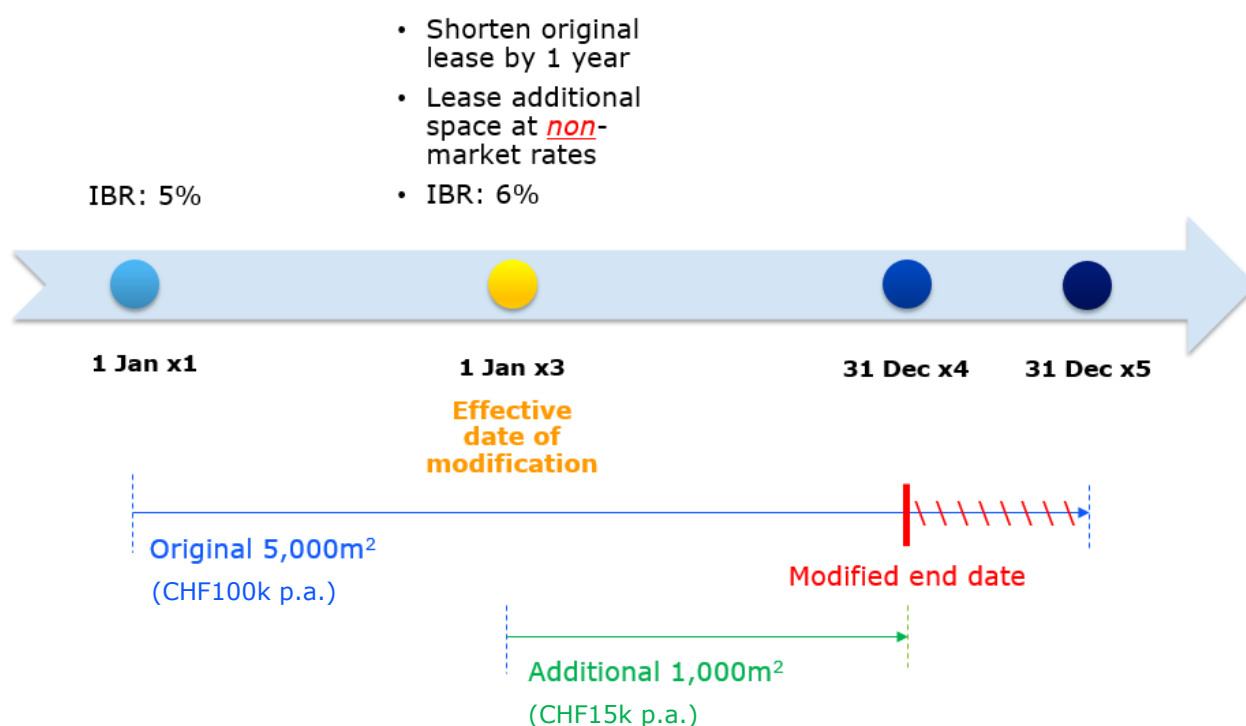
Example 10 – shortening the lease term plus leasing additional space at off-market rates

Modification: Lessee and Lessor agree on 1 January 20x3 to:

- shorten the lease term of the original 5,000m² of office space by one year to end on 31 December 20x4. The annual lease payment remains at CHF100,000 for the remainder of the lease term.
- lease an additional 1,000m² of office space for two years to start immediately at an annual lease payment of CHF15,000, which is considered not to be at market rates.

The original 5,000m² and the additional 1,000m² of space constitute separate lease components. The IBR on 1 January 20x3 is 6%.

The standalone price on a per square meter basis for the existing and the additional space is the same on 1 January 20x3.



Analysis

Since the increase in consideration for the increase in scope (the additional 1,000m²) is not at market rate, Lessee applies IFRS 16.45 to account for the modification. Consequently, on 1 January 20x3 which is the effective date of the modification, Lessee:

- 1) allocates the consideration in the modified contract to the two lease components (i.e. the original 5,000m² and the additional 1,000m² of space) on the basis of their relative standalone prices on that date;
- 2) determines the lease term of the modified lease; and
- 3) remeasures the lease liability using the IBR at that date.

(IFRS 16.45)

1) **Allocate the modified consideration**

Lessee has the use of the original and the additional spaces for two years from 1 January 20x3 for a total lease payment of CHF230,000 (CHF100,000*2 + CHF15,000*2). Since the standalone price on a per square meter basis for the two spaces is the same, an acceptable way to allocate the modified consideration is as follows:

	Total floor area for remainder of lease term	Modified consideration allocated based on relative standalone price	
		For remainder of lease term	Per year
	m²	CHF	CHF
Original 5,000m ²	10,000 ⁽¹⁾	191,667 ⁽³⁾	95,833 ⁽⁵⁾
Additional 1,000m ²	2,000 ⁽²⁾	38,333 ⁽⁴⁾	19,167 ⁽⁶⁾
	12,000	230,000	

(1) 5,000m² * 2 years

(2) 1,000m² * 2 years

(3) 10,000m²/12,000m² * CHF230,000

(4) 2,000m²/12,000m² * CHF230,000

(5) CHF191,667/ 2 years

(6) CHF38,333/ 2 years

The revised annual consideration allocated to the original 5,000m² and the additional 1,000m² is therefore CHF95,833 and CHF19,167 respectively.

2) **Determine the modified lease term**

Following the allocation of the modified consideration to the separate lease components, Lessee accounts for each lease component independently (IFRS 16.12).

Each of the original 5,000m² and the additional 1,000m² lease components has a remaining lease term of two years from 1 January 20x3. In this example, the effective date of the modification coincides with the commencement date of the additional 1,000m² lease component.

3) **Remeasure the lease liability**

A. Lease of the original 5,000m²

There has effectively been a change in consideration (due to the reallocation per step 1 above) coupled with a shortening of lease term for the lease of the original 5,000m². Both the change in consideration and the decrease in lease term are accounted for on the effective date of the modification, i.e. on 1 January 20x3 (IFRS 16.45).

Consistent with [example 6](#), the decrease in lease term is accounted for in two steps:

- I. Reduce the RoU asset and lease liability in proportion to the reduction in lease term, and recognise the difference in profit/loss.
- II. Adjust the lease liability resulting from step I to its modified carrying amount with a corresponding charge to the RoU asset.

(IFRS 16.46)

I. Reduce the RoU asset and lease liability proportionately

The pre-modification carrying amounts of the lease liability and the RoU asset are presented in the table below. The reduction in the lease liability corresponds to excluding the present value of the lease payment for 20x5 at the original IBR of 5%. The reduction in the ROU asset represents a proportionate decrease in its carrying amount (originally three years left, now only two years left after the modification).

	Lease liability	RoU asset
	CHF	CHF
1 January 20x3		
• Pre-modification	272,325	259,769
• Reduction	(86,384)	(86,590)
• Post-modification	185,941 ⁽¹⁾	173,179 ⁽²⁾

(1) Present value of two payments of CHF100,000 discounted at the original IBR of 5%

(2) CHF259,769 / 3 years * 2 years

Lessee records the following journal entry on 1 January 20x3:

JE 1	CHF	CHF
Dr Lease liability	86,384	
Dr Loss on lease modification (P/L)	206	
Cr RoU asset		86,590

To recognise the proportionate decrease in the RoU asset and lease liability to reflect the reduction in scope of the lease, with the difference recognised in P/L.

II. Remeasure the lease liability to the modified carrying amount

The modified lease liability on 1 January 20x3 is CHF175,700, being the present value of two lease payments of CHF95,833 as allocated in step I above discounted at 6% (the revised IBR at the effective date of the modification). Lessee recognises the difference of CHF10,241 between the lease liability resulting from step 1 above (CHF185,941) and its modified carrying amount (CHF175,700) against the RoU asset.

Lessee records the following journal entry on 1 January 20x3:

		CHF	CHF
Dr	Lease liability	10,241	
Cr	RoU asset		10,241

B. Lease of the additional 1,000m²

The additional 1,000m² is made available for use by the lessee immediately on 1 January 20x3. Lessee therefore recognises its related RoU asset and lease liability on this date.

Lessee records the following journal entry on 1 January 20x3:

		CHF	CHF
Dr	RoU asset	35,140	
Cr	Lease liability		35,140

To recognise the lease of the additional 1,000m² on commencement date of that lease component at the present value of two payments of CHF19,167 discounted at 6%.

The RoU asset and lease liability in relation to the modified lease are as follows:

Lease of existing 5,000m²

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-m</i>	272,325				259,769		
<i>Adj</i>	(86,384)	(JE 1 above)			(86,590)	(JE 1 above)	
	(10,241)	(JE 2 above)			(10,241)	(JE 2 above)	
<i>Post-m</i>	175,700	10,542	(95,833) ⁽¹⁾	90,409	162,938	(81,469)	81,469
20x4	90,409	5,425	(95,833)	-	81,469	(81,469)	-

Lease of additional 1,000m²

	Lease liability				RoU asset		
	Beginning balance	6% interest expense	Lease payments	Ending balance	Beginning balance	Depreciation	Ending balance
Year	CHF				CHF		
20x3							
<i>Pre-IR</i>	NA				NA		
<i>IR</i>	35,140	(JE 3 above)			35,140	(JE 3 above)	
<i>Post-IR</i>	35,140	2,108	(19,167) ⁽¹⁾	18,082	35,140	(17,570)	17,570
20x4	18,082	1,085	(19,167)	-	17,570	(17,570)	-

⁽¹⁾ The sum of the lease payments allocated to the original 5,000m² and the additional 1,000m² is CHF115,000, which equals the actual payment made every year.

The amounts reflected in the financial statements are the sum of the above two lease components.

Observation

In this example, as the additional 1,000m² is made available for use by the lessee on the effective date of the modification and both lease components (the 5,000m² and the 1,000m²) are being discounted at 6% for two years, it is not necessary to allocate the modified consideration to the two lease components. In other words, because both components are recognised and/or (re)measured on the same date using the same inputs, the sum of the lease liability and RoU asset of the two lease components will be the same regardless of how the modified consideration is allocated.

Be that as it may, the proportionate decrease in the RoU asset and the lease liability to reflect the reduction in scope as well as the resulting gain/loss on modification (i.e. JE 1 in this example) will have to be calculated first, separately, using the existing inputs (i.e. original IBR, original lease payments and shortened lease term). Once that has been determined, the remainder of the modification may be accounted for on a combined basis.

Despite the above, entities may want to account for the different lease components separately due to subsequent impairment assessment considerations (e.g. the need to allocate different lease components to different cash-generating units) and/or subleasing potentials. In the latter case, an entity needs to know how much RoU asset is subject to the sublease in order to assess whether the sublease is an operating or a finance lease, how much RoU asset should be derecognised in the case of a finance lease, as well as to comply with disclosure requirements.

See [example 4](#) for an illustration of how to account for the modification on a combined basis.

Observation

If the additional 1,000m² was made available for use by the lessee at a date later than the effective date of the modification, we believe that the RoU asset and the lease liability for this lease component should be recognised only when the underlying asset is made available for use by the lessee, i.e. on the commencement date of this lease component, and not on the effective date of the modification.

In that case, a lessee cannot take the shortcut to account for the lease components on a combined basis because the inputs used for them are different:

- The modified lease payments allocated to the original 5,000m² are discounted at an IBR of 6% for two years in accordance with [example 10](#); whereas
- The modified lease payments allocated to the additional 1,000m² are discounted at the IBR on the commencement date of that lease component (say 1 January 20x4) which could differ from 6%, over the lease term of this lease component which could also differ from the remaining lease term of the 5,000m².

Appendix I – relevant IFRS 16 guidance

Definitions

<i>Commencement date of the lease</i>	The date on which a lessor makes an underlying asset available for use by a lessee.
<i>Effective date of the modification</i>	The date when both parties agree to a lease modification.
<i>Inception date of the lease</i>	The earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.
<i>Lessee's incremental borrowing rate</i>	The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the RoU asset in a similar economic environment.
<i>Lease modification</i>	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 (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Recognition principle

22 At the commencement date, a lessee shall recognise a right-of-use asset and a lease liability.

Inception date v. commencement date – example

A lessee and a lessor agree to the principal terms of a lease on 1 January 20x1. The principal terms include but are not limited to the leased item (a residential unit), lease term, lease payments, payment profile, termination and extension rights etc. The agreement is non-cancellable from this date.

The lease agreement is signed on 1 March 20x1 and the key to the residential unit is handed over to the lessee on 1 June 20x1.

In this case, the inception date of the lease is 1 January 20x1, being the earlier of the date of the lease agreement (1 March 20x1) and the date of commitment by the parties to the principal terms and conditions of the lease (1 January 20x1).

The commencement date is 1 June 20x1 being the date on which the residential unit is made available for use by the lessee.

Correctly identifying the inception date and the commencement date is important because parties to an agreement need to assess whether an agreement is, or contains, a lease at the inception date and a lessee is required to disclose information about committed but not yet commenced leases in certain cases (IFRS 16.59(b)(iv)).

As for the commencement date, its importance is evident in the fact that it is the date of initial recognition of the RoU asset and the lease liability.

Effective date of the modification

It is straightforward to identify the effective date of the modification in most cases.

In situations where this is not clear, it is worth bearing in mind that 'the date when both parties agree to a lease modification' is essentially the date when both parties have a shared understanding of, and are committed to, the modified principal terms and conditions of the lease. It could be viewed as equivalent to the inception date of a lease but on modified terms.

Separating components of a contract

12 For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 15....

B32 The right to use an underlying asset is a separate lease component if both:

- (a) the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
- (b) the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract....

Lease modification

44 A lessee shall account for a lease modification as a separate lease if both:

- (a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- (b) the consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope and any appropriate adjustments to that standalone price to reflect the circumstances of the particular contract.

Observation

As can be seen from para 44(b), pricing is an important consideration when it comes to assessing whether a modification should be accounted for as a separate lease. A lessee has to consider:

- (1) Firstly, whether the pricing is commensurate with the standalone price of the increase in scope; and
- (2) Secondly, whether the pricing incorporates appropriate adjustments to reflect the circumstances of the particular contract.

In most cases, it is straightforward to conclude whether an increase in scope is priced at its standalone price.

In some cases, however, it is difficult to determine what the standalone price is in the first place, never mind the additional assessment of what the appropriate adjustments to the standalone price should be to reflect the circumstances of the particular contract. Significant judgement may be

required in such cases and we recommend entities to consult their auditors and accounting advisors in this regard.

See example 10 in the Deloitte publication [Lease modifications – extending the lease term](#) issued in May 2019 for further detail.

For ease of reference, the para 44(b) notion of increasing the scope of a lease at 'standalone price as adjusted for circumstances particular to the contract' has been shortened to an increase in consideration that is 'at market rates' throughout this publication.

- 45 For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:
- (a) allocate the consideration in the modified contract applying paragraphs 13–16;
 - (b) determine the lease term of the modified lease applying paragraphs 18–19; and
 - (c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate...
- 46 For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
- (a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognise in profit or loss any gain or loss relating to the partial or full termination of the lease.
 - (b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.

Appendix II – relevant Deloitte guidance

The following links are accessible by DART (Deloitte Accounting Research Tool) subscribers only.

[Sign up](#) for a subscription to DART or a 30-day free trial.

[IFRS 16:44>8.7.1-1 Identifying a lease modification](#)

[IFRS 16:44>8.7.2-1 Lease modification when a new lease contract is entered into over different assets – example](#)

[IFRS 16:44>8.7.4-1 Accounting for a lease modification which extends the lease term of an existing asset and adds another asset](#)

[IFRS 16:45>8.7.4-2 Lease modification to add an asset from a future date accounted for as an additional component of the existing lease – example](#)

[IFRS 16:45\(b\)>8.7.3-2 Assessment of lease term upon a lease modification – example](#)

[IFRS 16:46>8.7.3-1 Accounting for a lease modification when the lease liability is denominated in a foreign currency – example](#)

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