



Financial Reporting Council

FRS 102 Factsheet 11

Lease accounting for lessees

November 2024

This factsheet has been prepared by FRC staff to aid preparers in applying the lessee requirements of Section 20 *Leases* of FRS 102. It should not be relied upon as a definitive statement on the application of the standard nor is it a substitute for reading the detailed requirements of FRS 102.

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

This document contains copyright material of the IFRS® Foundation (Foundation) in respect of which all rights are reserved.

No rights are granted to third parties other than as permitted by the Terms of Use (www.frc.org.uk/FRStermsfuse) without the prior written permission of the FRC and the Foundation.

Material issued in respect of the application of Financial Reporting Standards in the UK and the Republic of Ireland has not been prepared or endorsed by the International Accounting Standards Board.

© The Financial Reporting Council Limited 2024

The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368. Registered Office:
8th Floor, 125 London Wall, London EC2Y 5AS

Contents

	Page
1. Introduction	3
2. Recognition exemptions	5
3. Identifying a lease	7
4. Lease term	11
5. Measurement	13

1. Introduction

Section 20 *Leases* was completely rewritten as part of the Periodic Review 2024, with the changes effective from 1 January 2026.

The changes, based on the principles of IFRS 16 *Leases*, remove the distinction between operating leases and finance leases for lessees, with the result that more leases will now require the recognition of a right-of-use asset and a lease liability on the balance sheet. This method of accounting is very similar to previous finance lease accounting.

The operating lease and finance lease distinction remains in place for lessors. Whilst the lessor requirements have been rewritten, in many cases the accounting under the new requirements will not differ significantly from that under the previous requirements¹.

This factsheet has been prepared to provide an overview of key aspects of the new lease accounting requirements from the perspective of lessees.

The recognition, measurement and presentation requirements of the revised Section 20 are applicable to all entities applying FRS 102, including those that are in scope of Section 1A *Small Entities*.

Scoping

Section 20 applies to arrangements that meet the definition of a lease – ‘A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration’.

There are some situations where a contract that is, or contains, a lease will not be in scope of Section 20, as set out in paragraph 20.1.

There may also be contracts which do not have the legal form of a lease, but which do in substance meet the definition of a lease, and would therefore be in scope of Section 20. For example, a contract could in substance convey the right to control the use of an identified asset, even if the contract doesn't have the legal form of a lease and the asset is not explicitly specified. Preparers will wish to satisfy themselves that they have identified all relevant contracts.

¹ One change for intermediate lessors to be aware of is in respect of classifying a sublease as a finance or an operating lease, as set out in paragraph 20.92. All else being equal, classifying a sublease by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset, is more likely to result in classification as a finance lease.

Presentation and disclosure

This factsheet does not provide guidance on the presentation or disclosure requirements of Section 20. Presentation requirements are set out in paragraphs 20.74 and 20.75 (for lessees) and 20.113 (for lessors); entities will also need to consider the relevant requirements of company law. Disclosure requirements are set out in paragraphs 20.76 to 20.85 (for lessees) and 20.114 to 20.121 (for lessors); other general disclosure requirements of FRS 102 may also be relevant in some circumstances.

2. Recognition exemptions

	Key FRS 102 references
<p>Generally, the revised Section 20 requires a lessee to recognise all leases on-balance sheet. However, one of the key elements of the revised Section 20 is the existence of recognition exemptions for short-term leases and leases for which the underlying asset is of low value. These are only exemptions from the requirement to recognise a lease on the balance sheet – other requirements of Section 20, such as the disclosure requirements, still apply.</p>	20.5
<p>These exemptions permit lessees to leave eligible leases off the balance sheet and recognise them in a similar manner to operating leases in the previous version of Section 20 (i.e. recognise the expense on a straight-line basis or another systematic basis that is more representative of the pattern of the lessee's benefit).</p>	20.6
<p>Application of these recognition exemptions is voluntary – if a lessee wishes to, it may recognise all its leases on-balance sheet.</p>	
<h3>Short-term leases</h3>	
<p>A short-term lease is one that, at the commencement date, has a lease term (as defined) of 12 months or less, and does not contain a purchase option. This recognition exemption must be applied by class of underlying asset.</p>	Glossary
<p>The assessment of the lease term is discussed in section 4 of this factsheet. It includes whether the lessee is reasonably certain to exercise an extension option, or reasonably certain not to exercise a termination option.</p>	20.38
<h3>Leases for which the underlying asset is of low value</h3>	
<p>The value of an underlying asset is considered in absolute terms, independent of an entity's materiality or the value of the lease payments. There is no limit to the number of individual assets that can be considered as low-value for the purpose of this recognition exemption.</p>	20.9
<p>Section 20 does not specify a particular value threshold. Instead, it provides a list of examples of asset types that are not of low value, including real estate and motor vehicles. It is not exhaustive, and preparers need to consider whether a leased asset is of similar value to those on this list. The purpose is to ensure that leases of significant assets are recognised on a lessee's balance sheet, whilst allowing leases of other, lower-value, assets to be left off-balance sheet.</p>	20.11

<p>This recognition exemption can be taken on a lease-by-lease basis. However:</p> <ul style="list-style-type: none"> • A lease cannot qualify as a lease of a low-value asset if the lessee subleases, or expects to sublease, the leased asset. • The recognition exemption can only be taken if the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee, and the underlying asset is not highly dependent on, or highly interrelated with, other assets. <p>This means that it is not possible to keep a lease off-balance sheet simply by breaking the leased asset down into low-value components.</p>	<p>20.7</p> <p>20.12</p> <p>20.10</p>
<p>The low-value recognition exemption is intended to be more permissive than the equivalent exemption in IFRS 16 (i.e. the threshold for 'low-value' is higher than in IFRS 16, which does not state a threshold in the standard itself but indicates a figure in the Basis for Conclusions). This is a key element of making the Section 20 changes proportionate for FRS 102 preparers. The Basis for Conclusions to FRS 102 also notes that low-value assets can include 'tablet and personal computers, small items of office furniture and telephones'; this is also not an exhaustive list.</p>	<p>B20.8 to B20.11</p>

3. Identifying a lease

	Key FRS 102 references
<p>A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.</p>	20.15
<p>This assessment is made at the inception date of the contract², and is only re-assessed if the terms and conditions of the contract are changed.</p>	20.15, 20.18
<h4 style="color: #0070C0;">Identified asset</h4>	
<p>For a lease to exist, there must be an identified asset (the underlying asset).</p>	20.15; Glossary
<p><i>Specification of an asset</i></p> <p>An asset may be specified explicitly in a contract:</p> <ul style="list-style-type: none"> - for example, the contract may specify a building by its address or a car by its registration number. 	20.19
<p>However, an asset may also be specified implicitly at the time it is made available for use by the customer:</p> <ul style="list-style-type: none"> - for example, the specific item of railway rolling stock which is delivered to the customer on the commencement date of the contract. 	
<p><i>Substitution rights</i></p> <p>However, even if an asset is specified, there is no identified asset if the supplier has a substantive right to substitute the asset throughout the period of use. If there is no identified asset, there is no lease.</p>	20.20
<p>A supplier's right to substitute the asset is substantive if it:</p> <ol style="list-style-type: none"> a) has the practical ability to substitute alternative assets throughout the period of use; and b) would benefit economically from doing so. 	
<p>Substitution rights are evaluated based on facts and circumstances at the inception date. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that it does not.</p>	20.21

² The inception date is the earlier of the date of the lease agreement, and the date of commitment by the parties to the principal terms and conditions of the lease. This is not the same as the commencement date.

<p><i>Portions of an asset</i></p> <p>A portion of an underlying asset can be an identified asset if it is physically distinct: for example, a floor of a building. However, a portion of an underlying asset that is not physically distinct (e.g. a percentage of the capacity of a fibre optic cable) is not an identified asset unless the portion is substantially all of the overall capacity of the underlying asset.</p>	20.22
<p>Right to control the use</p> <p>For a lease to exist, the customer must, throughout the period of use, have both:</p> <ul style="list-style-type: none"> • the right to direct the use of the identified asset; and • the right to obtain substantially all the economic benefits from that use. 	20.16
<p><i>Right to direct the use</i></p> <p>For the customer to have the right to direct the use of the identified asset, either:</p> <ul style="list-style-type: none"> • the customer must have the right to direct how and for what purpose the asset is used, throughout the period of use, in a manner that affects the economic benefits derived from its use; or • the relevant decisions about how and for what purpose the asset is used must be predetermined, and either: <ul style="list-style-type: none"> • the customer has the right to operate the asset (or direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those instructions; or • the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose it will be used throughout the period of use. 	20.25
<p><i>Right to obtain economic benefits from use</i></p> <p>A customer can obtain economic benefits from the use of an asset directly or indirectly many ways, such as by using, holding or subleasing the asset.</p>	20.23
<p>The economic benefits from use of an asset include, but are not limited to, its primary output and its by-products (or potential cash flows derived from them).</p>	
<p>An entity considers the economic benefits that result from use of the asset within the defined scope of a customer’s right to use the asset.</p>	20.24
<p>Economic benefits resulting from use of the asset outside the defined scope of the customer’s right to use the asset do not necessitate that there is no lease.</p>	

Separating components of a contract

A contract may contain multiple components, of which some may relate to the lease of an asset and others may relate to non-lease elements such as services (e.g. maintenance of the leased asset). 20.27

The consideration in the contract is allocated to each lease component on the basis of the relative stand-alone price of each lease component and the aggregate stand-alone price of the non-lease components. 20.31

Separating lease components from other lease components

In identifying separate lease components, the right to use an underlying asset is a separate lease component if the lessee can benefit from the use of the underlying asset on its own or together with other readily available resources, and the underlying asset is neither highly dependent on nor highly interrelated with other underlying assets in the contract. 20.29

Otherwise, the right to use multiple underlying assets may represent a single combined lease component.

Separating lease components from non-lease components

Lease and non-lease components are accounted for separately unless the lessee applies the practical expedient in paragraph 20.33. 20.28

The practical expedient allows a lessee to elect, by class of underlying asset, not to separate lease components from non-lease components, and instead account for each lease component and any associated non-lease components as a single lease component. 20.33

Non-exchange components

The standard provides guidance when a lease provides a lessee with incoming resources arising from a government grant or, for a public benefit entity, a non-exchange transaction. 20.35

Example 1

An entity enters into a contract to lease two identical lorries, with accompanying maintenance services and insurance coverage, for total consideration of CU32,000. The standalone price of leasing a lorry is CU14,000; the standalone selling price of the maintenance services (per lorry) is CU4,000 and of insurance (per lorry) is CU2,000. The lessee determines that the lease components meet the separability criteria in paragraph 20.29.

The following table sets out the proportion of the total standalone price that relates to each component, which is applied to the total contract consideration of CU32,000 to determine the consideration for each component.

	Standalone price	% of total standalone price	Amount allocated to each component
	CU		CU
Lorry 1	14,000	35%	11,200
Lorry 2	14,000	35%	11,200
Non-lease	12,000	30%	9,600
	40,000		32,000

If the lessee chose instead to apply the practical expedient in paragraph 20.33, it would instead identify two lease components each with CU16,000 consideration allocated.

Intra-group arrangements

In intra-group situations it may be unclear whether or not a lease within the scope of Section 20 exists. It is important to remember that the definition of a lease requires a contract to exist: an agreement that creates enforceable rights and obligations. Arrangements between group companies may or may not create enforceable rights and obligations. This depends on the substance of those arrangements, rather than their form.

This may have implications, for example, when multiple group companies occupy different parts of a headquarters building for which one group company is the head lessee. If an arrangement between the group companies does not create enforceable rights and obligations between the head lessee and the other group companies occupying the building, those occupiers may not be party to a lease and hence may not be required to recognise a lease liability or right-of-use asset.

Other considerations

A practical expedient allows an entity to apply Section 20 to a portfolio of leases with similar characteristics, rather than separately to each individual lease. 20.13

In certain circumstances, an entity is required to combine two or more contracts and accounts for them as a single contract. 20.14

4. Lease term

	Key FRS 102 references
<p>The term of a lease is the aggregate of:</p> <ul style="list-style-type: none"> • the non-cancellable period of the lease; • periods covered by an extension option that the lessee is reasonably certain to exercise; and • periods covered by a termination option that the lessee is reasonably certain not to exercise (or that can only be exercised by the lessor). <p>(As a result, when a lessee is able to choose between a shorter or a longer period, the lease term is the shorter period unless the lessee is reasonably certain to choose the longer period.)</p>	20.38
<p>The lease term begins at the commencement date³ and therefore includes any rent-free period.</p>	20.37
<p><i>Assessing the non-cancellable period</i></p> <p>In assessing the length of the non-cancellable period, an entity determines the period for which the contract is enforceable.</p>	20.39
<p>A lease is no longer enforceable when the lessee and the lessor each have the right to terminate the lease without permission from the other party, with no more than an insignificant penalty.</p>	
<p><i>Assessing reasonable certainty</i></p> <p>Both the lessee and the lessor assess, at the commencement date, whether the lessee is reasonably certain to exercise extension options or reasonably certain not to exercise termination options.</p>	20.40
<p>The standard sets out a non-exhaustive list of factors to consider in this assessment. These include the importance of the underlying asset to the lessee's operations, and the significance of any leasehold improvements. It may also be helpful to consider an entity's past practice in respect of similar assets.</p>	20.41, 20.42
<p><i>Reassessing reasonable certainty</i></p> <p>Having made the assessment at the commencement date, a lessee only reassesses whether it is reasonably certain to exercise its options in certain situations involving</p>	20.43

³ The commencement date is the date on which the lessor makes the underlying asset available for use by the lessee. This is not the same as the inception date.

a significant event or a significant change of circumstances that is within the control of the lessee.

Revising the lease term

An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. Such a change could arise if, for example, the lessee exercises an option not previously included in the determination of the lease term.

20.44

Example 2

An entity enters into a contract to lease office space at a market rent. The initial term is for 10 years and there is an option for the lessee to extend this for a further 5 years on similar terms. The entity expects to spend a significant amount on fitting out the office space to meet its requirements, which is consistent with its approach to previous leased offices. The entity's business is growing and profitable and it has historically elected to extend other office leases.

The lessee concludes that the lease term is 15 years since remaining in the office space confers an economic benefit (not having to fit out another office instead) and it has past practice of extending leases in similar situations.

Rolling leases

Entities may enter into so-called 'rolling leases' where there is no specified term or end date and the lease is terminated when either the lessee or the lessor decides to terminate it. An entity may also be party to a lease which automatically becomes a rolling lease following an initial agreed contractual period.

In these situations, an entity needs to consider carefully for what period the lease is enforceable, and what the non-cancellable period of the lease is (e.g. whether there is a notice period that forms a non-cancellable element; or whether any economic penalty from subsequent cancellation is more than insignificant).

As set out in Section 2 of this factsheet, if there is a lease term of 12 months or less, the lease may be eligible for the recognition exemption for short-term leases.

Landlord and Tenant Act 1954

The *Landlord and Tenant Act 1954* (LTA) grants a statutory right to a new tenancy in some circumstances once the current lease expires; entities will need to consider any implications of this.

In particular, an entity needs to consider carefully whether or not occupation of a property in relation to a lease that has expired and not (yet) been renewed constitutes a lease (e.g. whether an enforceable contract exists), for what period the lease is enforceable, and what the non-cancellable period of the lease is.

5. Measurement

<p>To measure its lease balances, a lessee must first calculate the lease liability, then calculate the right-of-use asset.</p>	Key FRS 102 references
<p>Measurement of the lease liability</p> <p>Calculating the lease liability requires knowledge of:</p> <ul style="list-style-type: none">• Unpaid lease payments at the date of calculation; and• A suitable interest rate with which to discount these cashflows.	
<p>Lease payments</p> <p>The lease payments to be included in the measurement of the liability are:</p> <ul style="list-style-type: none">• fixed payments (including in-substance fixed payments), less any lease incentives receivable;• variable lease payments that depend on an index or rate, initially measured using the index or rate as at the commencement date;• amounts expected to be payable by the lessee under residual value guarantees;• the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and• payments of penalties for terminating the lease, if the lease term reflects the lessee exercising a termination option.	20.51
<p>In-substance fixed lease payments</p> <p>These are payments that may, in form, contain variability, but are in substance unavoidable. For example, a payment that is contingent on the occurrence of an event that has no genuine possibility of not occurring, is in substance a fixed payment. Payments which initially contain variability can become in-substance fixed payments when the variability is resolved.</p>	20.52
<p>Variable lease payments that depend on an index or a rate</p> <p>Examples of such payments include those linked to a consumer price index, to a benchmark interest rate or to reflect changes in market rents.</p>	20.53

Example 3a

A lessee enters into a five-year property lease on 01/01/X1, with annual lease payments of CU10,000 (paid in advance), a six-month rent-free period, and a cash lease incentive of CU3,000 received at the start of the lease (as opposed to receivable in the future). The lease also includes an additional turnover rent, payable in arrears, of 5% of the sales made by the lessee using the leased property.

The lease payments to be reflected in the calculation of the lease liability are as follows:

Date	Lease payment
	CU
01/07/X1	5,000
01/01/X2	10,000
01/01/X3	10,000
01/01/X4	10,000
01/01/X5	10,000

The turnover rent is a variable lease payment that does not depend on an index or rate, and is therefore not included in the measurement of the lease liability.

The cash lease incentive of CU3,000 is not included in the calculation of the lease liability, but is deducted from the cost of the right-of-use asset. The benefit of the lease incentive is therefore recognised as reduced depreciation of the right-of-use asset.

20.47(b)

Example 3b

A lessee enters into a three-year lease for a lorry, with monthly lease payments of CU1,000 structured as a CU10 fixed payment and a CU990 variable payment that becomes due if the lorry is proven to be capable of being driven at any point during the lease term.

Whilst, in form, this payment is variable, it is judged that it has no genuine possibility of not occurring, and so constitutes an in-substance fixed lease payment, and is included in the measurement of the lease liability.

Example 3c

A lease contract states that the lease payment, which is set initially at a market level, will increase every third year to align to market increases in rent. This is an example of a variable lease payment that depends on an index or rate (paragraph 20.53).

The initial measurement of the lease liability does not include any amount in respect of the future market rent adjustment. The lease liability is measured initially using the index or rate at the commencement date (paragraph 20.51(b)), and so reflects the initial market-based lease payment, but does not reflect, or contain any assumptions about, changes to the index or rate after that date (paragraph 20.54).

Subsequently, the lease liability is remeasured, in line with paragraph 20.68(b), when there is a change in the cash flows resulting from a change in an index or rate. A corresponding adjustment is made to the right-of-use asset, in line with paragraph 20.56(b).

Example 3d

A lessee signs a ten year lease with annual payments of CU10,000 and a break clause at five years, accompanied by a CU5,000 penalty if exercised. It assesses that it is reasonably certain not to exercise the break clause; therefore the lease term is ten years and the total lease payments are CU100,000.

Discount rate

Having determined the lease payments to include in the measurement of the lease liability, the lessee applies a discount rate to measure the lease liability at present value.

In general, the discount rate for a given lease is determined at the commencement date of the lease, and is not re-assessed other than for certain reassessments of the lease liability (see paragraphs 20.66 and 20.69) and certain lease modifications (see paragraph 20.71(c)). Such situations are discussed in the *Subsequent measurement of the lease liability* section of this factsheet.

<p>Interest rate implicit in the lease</p> <p>FRS 102 requires the lessee to discount the lease payments at the interest rate implicit in the lease. This is the rate that results in:</p> <p>the present value of:</p> <ul style="list-style-type: none"> • the lease payments; and • the unguaranteed residual value <p>equalling the sum of:</p> <ul style="list-style-type: none"> • the fair value of the underlying asset; and • any initial direct costs of the lessor. <p>The lessee is required to use this rate if it can be readily determined.⁴</p> <p>However, the standard acknowledges that in some cases the implicit rate may not be readily determinable.</p>	<p>20.49, Glossary</p>
<p>Incremental and obtainable borrowing rates</p> <p>If the interest rate implicit in the lease cannot be readily determined, the lessee has a choice, on a lease-by-lease basis, of using either the lessee’s incremental borrowing rate or the lessee’s obtainable borrowing rate.</p> <p>The lessee’s incremental borrowing rate for any given lease is the rate of interest that the lessee would have to pay in order to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment.</p> <p>The lessee’s obtainable borrowing rate for any given lease is the rate of interest that the lessee would have to pay to borrow, over a similar term, an amount similar to the total undiscounted value of lease payments to be included in the measurement of the lease liability.</p>	<p>20.49, Glossary</p>
<p>Lessees will need to consider, for each lease, what an appropriate interest rate is. They may also be able to apply the portfolio approach, which allows Section 20 to be applied to a portfolio of leases with similar characteristics (e.g. a similar lease term for a similar class of underlying asset in a similar economic environment).</p>	<p>20.13</p>

⁴ Except on initial application of the revised Section 20 following the *Periodic Review 2024 amendments* – refer to [Factsheet 9 – Initial Application of the Periodic Review 2024 amendments](#) .

Example 4

A lessee enters into a five-year property lease on 01/01/X1, with annual lease payments of CU10,000 (paid in arrears).

The lessee concludes that it cannot readily determine the interest rate implicit in the lease. It chooses to determine its obtainable borrowing rate instead, and – taking into account a quote from its bank to borrow CU50,000 over a similar term – concludes that this is 7%.

The table below sets out the undiscounted and discounted cash flows.

Date	Lease payment	Discount factor	Discounted amount
	CU		CU
31/12/X1	10,000	1.070	9,346
31/12/X2	10,000	1.145	8,734
31/12/X3	10,000	1.225	8,163
31/12/X4	10,000	1.311	7,629
31/12/X5	10,000	1.403	7,130
	50,000		41,002

The lessee therefore recognises a lease liability of CU41,002 at the commencement date.

Public benefit entities: Deposit rate

A public benefit entity that is unable readily to determine either the interest rate implicit in the lease, or the lessee's incremental or obtainable borrowing rate for a lease, shall use the rate of interest otherwise obtainable by the public benefit entity on deposits held with financial institutions.

Subsequent measurement of the lease liability

After the commencement date, the lease liability is measured by increasing the carrying amount for the interest expense on the lease liability, reducing the carrying amount for the amount of lease payments made, and remeasuring the carrying amount for the effects of any reassessment, lease modifications, and revised in-substance fixed lease payments.

PBE20.50

20.62, 20.63

Example 5

Based on the fact pattern in example 4, a table can be constructed showing how the lease liability unwinds over the lease term. The interest expense is equal to the interest rate (7%) multiplied by the opening balance for the period.

The table below sets out how the lease liability unwinds over the lease term.

Date	Opening balance	Lease payment	Interest expense	Closing balance
	CU	CU	CU	CU
31/12/X1	41,002	(10,000)	2,870	33,872
31/12/X2	33,872	(10,000)	2,371	26,243
31/12/X3	26,243	(10,000)	1,837	18,080
31/12/X4	18,080	(10,000)	1,266	9,346
31/12/X5	9,346	(10,000)	654	0
		(50,000)	8,998	

In respect of the right-of-use asset, the initial balance would also be CU41,002 (assuming no other adjustments to be made in line with paragraph 20.47), which would typically be depreciated on a straight line basis over the five year lease term.

The total expense recognised in profit or loss is therefore interest of CU8,998 plus depreciation of CU41,002, which equals the total cash flows of CU50,000.

Using spreadsheets for calculations

Discounting can be done in spreadsheets using a line-by-line approach for each period or one of the inbuilt formulae. There are generally three such formulae – PV, NPV and XNPV. It should be noted that PV assumes that the periodic cashflows are identical and at the end of a period, NPV allows differing cashflows but only allows them to be at the end of a period, and XNPV allows full flexibility over cashflow amounts and timing. Care will be needed to ensure that appropriate formulae are applied to appropriate inputs.

<p>Changes to lease accounting</p>	
<p>Variable lease payments that were not included in the measurement of the lease liability (e.g. turnover-based rentals) are recognised in profit or loss in the period in which the event or condition that triggers those payments occurs.</p>	20.64
<p>Otherwise, changes to the lease term, lease payments and other conditions of a lease fall into two categories:</p>	
<ul style="list-style-type: none"> • Changes within the existing terms and conditions of a lease – referred to as reassessment of the lease liability; and 	20.65 to 20.69
<ul style="list-style-type: none"> • Changes to the terms and conditions of the lease – referred to as lease modifications. 	20.70 to 20.73
<p>Reassessment of the lease liability</p>	
<p>Changes within the existing terms and conditions of a lease are approached as follows:</p>	
<ul style="list-style-type: none"> • A change in the lease term, or in the assessment of an option to purchase the underlying asset, results in remeasurement of the lease liability using a revised discount rate. 	20.66
<ul style="list-style-type: none"> • A change in the amounts expected to be payable under a residual value guarantee, or a change in future lease payments resulting from a change in an index or a rate used to determine those payments (for example a change to reflect changes in market rentals following a market rent review), results in remeasurement of the lease liability using an unchanged discount rate (unless the change in lease payments results from a change in floating interest rates, in which case a revised discount rate is used). 	20.68
<p>A revised discount rate is used when there is a change in the underlying economics of the lease.</p>	
<p>Remeasurement</p>	
<p>The process for remeasuring a lease liability is the same as that set out in Example 4, and any remeasurement of the lease liability results in an equivalent adjustment to the right-of-use asset, with the condition that the right-of-use asset cannot have a value less than zero (any excess in this case is recognised in profit or loss).</p>	20.65, 20.66, 20.68
<p>For a change in future lease payments resulting from a change in an index or a rate used to determine those payments, remeasurement of the lease liability is triggered only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect).</p>	20.68(b)

Lease modifications	
Lease modifications are approached as follows:	
<ul style="list-style-type: none"> • An increase in the scope of a lease (by adding the right to use one or more underlying assets), accompanied by a commensurate increase in the consideration for the lease, is treated as a separate lease. 	20.70
<ul style="list-style-type: none"> • The lessee may use an unchanged discount rate instead of a revised discount rate to remeasure the lease liability if: <ul style="list-style-type: none"> - the additional consideration is insignificant to the total consideration of the original lease; - the scope of the lease is decreased by removing the right to use one or more underlying assets with a commensurate decrease in consideration; or - the consideration payable is decreased for the remaining term of the lease but the scope of the lease is not decreased by removing the right to use one or more underlying assets. 	20.71, 20.72
<ul style="list-style-type: none"> • For a lease modification not captured by the above criteria, the lessee uses a revised discount rate to remeasure the lease liability. 	20.71
Remeasurement approach	
For lease modifications that are not accounted for as separate leases, at the effective date of the lease modification the lessee shall allocate the consideration in the modified contract (applying paragraphs 20.31 to 20.35) and determine the lease term of the modified lease (applying paragraphs 20.38 to 20.42).	20.71
Recognition of remeasurements	
For lease modifications that decrease the scope of the lease, the lessee shall recognise a proportionate reduction in the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, account for any incoming resources from a government grant or non-exchange transaction in the modified lease, and recognise any resulting gain or loss in profit or loss.	20.73(a)
For all other lease modifications, the lessee shall make a corresponding adjustment to the right-of-use asset, net of any adjustment for incoming resources from a government grant or non-exchange transaction in the modified lease.	20.73(b)

Measurement of the right-of-use asset	
At the commencement date, a lessee shall measure the right-of-use asset at cost.	20.46
The cost of the right-of-use asset is comprised of the initial measurement of the lease liability as discussed above, adjusted for lease payments made prior to commencement less any lease incentives received, and including initial direct costs of the lessee, estimates of dismantling and removing the underlying asset recognised in accordance with Section 21 <i>Provisions and Contingencies</i> , and any amounts recognised in accordance with Section 24 <i>Government Grants</i> or Section 34 <i>Specialised Activities</i> in respect of non-exchange transactions.	20.47
Subsequently, a right-of-use asset is generally measured applying the cost model, except that: <ul style="list-style-type: none"> the fair value model in Section 16 <i>Investment Property</i> is applied to right-of-use assets that meet the definition of investment property, unless applying the exemption for investment property rented to another group entity; and if the lessee applies the revaluation model in Section 17 <i>Property, Plant and Equipment</i> to one or more classes of assets, it may also elect to apply the revaluation model to right-of-use assets relating to the same classes. 	20.55, 20.60, 20.61
Under the cost model, the right-of-use asset is measured at cost less any accumulated depreciation and accumulated impairment losses, and adjusted for any remeasurement of the lease liability in accordance with paragraph 20.62(c).	20.56



Financial Reporting Council

**Financial
Reporting Council**

8th Floor
125 London Wall
London EC2Y 5AS
+44 (0)20 7492 2300

www.frc.org.uk

Follow us on
LinkedIn
or  [@FRCnews](https://twitter.com/FRCnews)