**Question:**

What is a lease component and why do I have to identify them when accounting for a lease?

**Answer:**

Lease components are elements of an arrangement that provide the customer with the right to use an identified asset. It is important to identify lease components when accounting for a lease because only the components that are integral to the right to use an underlying asset are considered lease components. This is crucial because lease contracts may also contain nonlease components that should be accounted for using other accounting models, such as common area maintenance or services like security.

To determine if an element is a lease component, an entity should consider whether the right to use an underlying asset is a separate lease component based on two conditions. First, the lessee should be able to benefit from the right to use the asset either on its own or together with other readily available resources. Second, the right to use the asset should not be highly dependent on, or highly interrelated with, other rights to use assets in the contract.

For example, if a customer leases a bulldozer, a truck, and an excavator from a lessor for land development purposes, each of these underlying machines may be considered a separate lease component for accounting purposes. This conclusion is based on the fact that the customer can benefit from each lease individually or together with other resources, and the leases are not highly dependent on each other.

Identifying lease components is essential for allocating the contractual consideration between components of the arrangement. This ensures that assets and liabilities associated with nonlease components are not inappropriately recorded. Both lessors and lessees follow different allocation methods among the components, with lessees needing to consider whether the arrangement contains one lease component or more than one.

In summary, identifying lease components is crucial for accurately accounting for leases and ensuring that the right to use underlying assets is appropriately recognized and measured in accordance with ASC 842 guidance.

References:

* KPMG Leases Handbook, section 4.1, page 151
* PWC Leases Guide, section 2.4, page 2-28
* EY Financial Reporting Developments Lease Accounting, section 1.4, page 27
* ASC 842: 842-10-15-28 to 15-37, 842-10-15-38 to 15-42C

**Question:**

how do I account for a lease modification as a lessor?

**Response:**

To account for a lease modification as a lessor, you need to follow specific steps and considerations. First, determine if the modified contract is a lease or contains a lease. If it does, assess whether the modification results in a separate contract. If it does, you will account for two separate contracts: the unmodified original contract and a separate contract treated as a new lease.

If the modification does not result in a separate contract, you will need to reassess and reallocate the remaining consideration in the contract. Additionally, you must reassess the lease classification at the effective date of the modification. It is crucial to account for any initial direct costs, lease incentives, and other payments made to or by the lessor in connection with the modification.

The change in lease classification, if any, and the nature of the modification will determine the appropriate accounting treatment. For example, if the modified lease is classified as an operating lease, you should consider any prepaid or accrued lease rentals from the original lease as part of the lease payments for the modified lease. If the modified lease is classified as a direct financing lease or a sales-type lease, adjustments to deferred rent liability, accrued rent asset, and selling profit or loss may be necessary.

Ultimately, the key is to carefully assess the terms of the modified lease, reassess the lease classification, and account for the modification in accordance with ASC 842 guidelines. By following these steps and considering the specific circumstances of the lease modification, you can ensure accurate and compliant accounting practices as a lessor.

References:

* EY - Financial Reporting Developments: Lease Accounting, section 5.6, page 281
* PWC - Leases Guide, section 5.6, page 5-45
* KPMG - Leases Handbook, section 7.6, page 706
* ASC: 842-10-25-8 to 25-18, 842-10-35-3 to 35-6, 842-10-55-190 to 55-209