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# FASB Proposes Amendments to New Leasing Standard

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The FASB recently issued the following two proposed Accounting Standards Updates (ASUs) that would amend certain aspects of the Board's new leasing standard, [ASU 2016-02](#):<sup>1</sup>

- [Land Easement Practical Expedient for Transition to Topic 842](#) — Would amend the new standard's transition requirements for land easements. **Comments on this proposal are due by October 25, 2017 (a 30-day comment period).**
- [Technical Corrections and Improvements to Recently Issued Standards: . . . II. Accounting Standards Update No. 2016-02, Leases \(Topic 842\)](#) — Would make 16 technical corrections and improvements to the new standard. **Comments on this proposal are due by November 13, 2017 (a 45-day comment period).**

## Land Easements

The objectives of the land easement amendments, which are being proposed in response to feedback received by the FASB regarding implementation of the new leasing standard, are to:

1. Clarify that land easements entered into (or existing land easements modified) on or after the effective date of the new leasing standard must be assessed under ASC 842.<sup>2</sup>

<sup>1</sup> FASB Accounting Standards Update No. 2016-02, *Leases*.

<sup>2</sup> For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

2. Provide a transition practical expedient for existing or expired land easements that were not previously assessed in accordance with ASC 840. The practical expedient would allow entities to elect *not* to assess whether those land easements are, or contain, leases in accordance with ASC 842 when transitioning to the new leasing standard.

The amendments in the proposed ASU do not, and are not intended to:

1. Provide illustrative or application guidance on whether land easements are, or contain, leases in accordance with the new definition of a lease<sup>3</sup> in ASC 842.
2. Help entities identify the appropriate accounting framework for situations in which a land easement is *not* determined to be a lease under ASC 842.

The questions for respondents from the proposed ASU on land easements are in [Appendix B](#) for reference.

## Background

Generally, an easement is a right to access, cross, or otherwise use someone else's land for a specified purpose. Most easements provide limited rights to the easement holder, such as the right to cross over land or the right to construct and maintain specified equipment on the land. For example, an electric utility will typically obtain a series of contiguous easements so that it can construct and maintain its electric transmission system on land owned by third parties. Easements can be perpetual or term-based, be paid in advance or over time, and provide the customer with exclusive or shared use.

Historically, some companies have considered easements to be intangible assets under ASC 350. In fact, ASC 350 contains an illustrative example of easements acquired to support the development of a natural gas pipeline. In contrast, some companies may have considered easements to be leases or executory contracts. When preparing their financial statements, many companies have presented prepaid amounts related to easements in the PP&E section of their balance sheets because easements are closely associated with the PP&E they support. We understand that reporting requirements of the Federal Energy Regulatory Commission may have also influenced the balance sheet geography for companies regulated by that agency.

Easements generally convey to the customer some rights associated with the use of land (i.e., PP&E). Therefore, questions have arisen about whether easements are within the scope of the new leasing standard and, if so, whether the benefit to financial statement users of entities assessing those arrangements in accordance with the new definition of a lease would outweigh the cost to the entities of doing so (both upon transition and on an ongoing basis).

## Scope

The proposed ASU only addresses *land* easements. Although the FASB does not define this term, ASC 842-10-65-1(gg) and paragraph BC3 of the proposal describe both a land easement and a right of way as a "right to use, access, or cross another entity's land for a specified purpose."

Further, the proposed ASU effectively breaks land easements into two populations on the basis of the effective date of the new leasing standard: (1) land easements entered into (or existing easements modified) on or after the effective date (collectively, "new land easements") and (2) land easements that existed as of, or expired before, the effective date (collectively, "existing land easements").

<sup>3</sup> See ASC 842-10-15-2 through 15-27.



### Connecting the Dots

We think that the FASB's use of the term "land easements" is intentional. Therefore, we do not believe that an entity should analogize to the proposal's favorable transition practical expedient for existing land easements when considering other types of arrangements. The transition practical expedient for existing land easements is further discussed in the [Transition](#) section below.

For new land easements, the proposal would amend the illustrative example (Example 10) in ASC 350-30-55-30 as follows to clarify that ASC 350 may only be applied after a new land easement is determined not to be a lease in accordance with the definition of a lease in the new leasing standard:

Entity A is a distributor of natural gas. Entity A has two self-constructed pipelines, the Northern pipeline and the Southern pipeline. Each pipeline was constructed on land for which Entity A owns perpetual easements that Entity A evaluated under Topic 842 and determined do not meet the definition of a lease under that Topic. The Northern pipeline was constructed on 50 easements acquired in 50 separate transactions. The Southern pipeline was constructed on 100 separate easements that were acquired in a business combination and were recorded as a single asset. Although each pipeline functions independently of the other, they are contained in the same reporting unit. Operation of each pipeline is directed by a different manager. There are discrete, identifiable cash flows for each pipeline; thus, each pipeline and its related easements represent a separate asset group under the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10. While Entity A has no current plans to sell or otherwise dispose of any of its easements, Entity A believes that if either pipeline was sold, it would most likely convey all rights under the easements with the related pipeline.

In addition, paragraph BC8 of the proposed ASU states, in part:

The Board noted that a land easement conveys (in various forms) a right to use land and that a right to use land needs to be evaluated to determine whether it is within the scope of Topic 842. Accordingly, **the amendments in this proposed Update provide clarity that an entity would apply Topic 842 to a land easement to determine whether that easement is or contains a lease.** [Emphasis added]



### Connecting the Dots

The FASB makes its objective for new land easements very clear in paragraph BC8, and the proposed amendment to ASC 350-30-55-30 helps reinforce the scope hierarchy in GAAP with respect to such easements. That is, all new land easements must first be assessed under ASC 842 to determine whether the arrangement is, or contains, a lease.

If an arrangement is not a lease, other GAAP may be applicable (e.g., ASC 350, ASC 360). However, in paragraph BC8 of the proposed ASU, the Board explains that it intentionally did not address the appropriate accounting guidance to apply in these situations:

While there may be diversity about which guidance an entity should apply when a land easement is not a lease, that diversity is outside the scope of the amendments in this proposed Update.

Existing land easements are addressed in detail in the [Transition](#) section below.

## Identifying a Lease

The proposed ASU is not intended to provide illustrative or application guidance about whether new land easements meet the definition of a lease in the new leasing standard. Therefore, stakeholders and respondents may continue to raise questions about the application of the definition of a lease to new land easement arrangements, and it is possible that the FASB, IASB, and SEC staffs will want to share their perspectives as those questions are raised. Companies involved in land easement arrangements should consult with their accounting advisers and monitor developments on the topic.

The required accounting once the new leasing standard is effective will ultimately depend on the facts and circumstances of each arrangement. However, to determine whether a new land easement contract is, or contains, a lease in accordance with ASC 842-10-15-2 through 15-27, entities may find it helpful to group the contracts into one of two categories, further discussed below: (1) perpetual easements and (2) term-based easements. In addition, we recommend that high-volume users of easements begin their analysis by (1) segregating term-based arrangements on the basis of similar contractual provisions and (2) investigating the rights retained by the landowner in those arrangements. This may streamline the process since many easements will have similar or identical provisions and therefore would be expected to result in similar accounting.

### ***Perpetual Easements***

ASC 842-10-15-3 states, in part, “A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) **for a period of time** in exchange for consideration” (emphasis added). When a land easement is perpetual, we would not expect the arrangement to meet the definition of a lease given the lack of a stated term. In accordance with ASC 842-10-15-3, rights conveyed in a land easement into perpetuity (i.e., for an unlimited time) are not conveyed “for a period of time.”

Arrangements with stated terms are not considered perpetual even if the terms are very long (e.g., 100 years). On the other hand, a use condition contained in a perpetual easement (e.g., when an easement conveys rights to the customer into perpetuity, as long as those rights are used only to run fiber-optic cable) would not affect the conclusion that a land easement is perpetual.

### ***Term-Based Easements***

For term-based easements, the analysis will most likely be more extensive and involve a consideration of the right to control the use of the underlying land. That is, in accordance with ASC 842-10-15-4, entities will need to assess whether the customer in the arrangement has the right to (1) obtain substantially all of the economic benefits from using the land throughout the period of use and (2) direct the use of the land throughout the period of use. Accordingly, many easement arrangements may not convey the right to control the use of the land to the customer given that the supplier continues to enjoy economic benefits derived from the use of the land and that the rights to direct the use of the land that are conveyed to the customer are limited (i.e., generally only for a specified purpose).

For example, in an arrangement in which a utility (as the easement holder) is allowed to run electric transmission assets through a farmer’s fields (i.e., transmission lines that run over or under the farmer’s fields), it will be important to understand whether the farmer can still use the acreage subject to the easement (i.e., the acreage over or under which the lines run). If so, the utility may conclude that it does not have the right to control the use of the land because the farmer retains (1) rights to direct the use of the land (e.g., rights to farm the land), (2) economic benefits associated with the land that are not insignificant (e.g., the crops yielded from farming), or (3) both (1) and (2). On the other hand, there may be easement arrangements that effectively convey the right to control the use of the land to the easement holder through the rights conveyed or through use restrictions imposed on the landowner.

In addition, to appropriately identify the unit of account, an entity sometimes may need to more carefully consider the identified asset in an easement arrangement, as illustrated in the common scenarios below.

### Example 1

A customer enters into a land easement arrangement with a farmer for the right to pass a natural gas pipeline under the farmer's land. At issue is whether the identified asset includes the entire plot of land or whether the land should be broken down into surface and subsurface rights, the latter of which the parties would evaluate to determine whether the customer has the right to control the use of the land.

If the identified asset is the entire plot of land, the parties are less likely to conclude that the customer has the right to obtain substantially all the economic benefits from use of the land because the farmer retains the surface rights (e.g., to farm the land). However, if the identified asset is only the subsurface rights, the customer might have the right to obtain substantially all the economic benefits from using the area below the surface of the land. Further, subsurface rights for the same plot of land may also be stacked in such a way that one customer has an easement for the depth of 5 to 10 feet below the surface while another customer has an easement for the depth of 10 to 20 feet below the surface.

### Example 2

A customer enters into a land easement arrangement with a farmer for the right to construct and maintain 25 wind turbines on the farmer's 500-acre plot of land. Each wind turbine will be constructed on 25 individual square-acre plots. At issue is whether the identified asset is the entire 500-acre plot of land or whether there are 25 identified assets, each one square acre of land.

As in the previous example, if the identified asset is the entire 500-acre plot of land, the parties are less likely to conclude that the customer has the right to obtain substantially all the economic benefits from use of the land because the farmer retains all of the rights to the economic benefits of the remaining 475 acres. However, if the identified assets are 25 individual square-acre plots of land, the customer may have the right to obtain substantially all the economic benefits from using each square-acre plot.

When the FASB decided to issue the proposed ASU at its August 3, 2017, meeting, one board member noted that an entity must use judgment in determining the unit of account in a land easement and that it is therefore reasonable for there to be diversity in practice in such situations. A careful evaluation of the legally enforceable rights and obligations may be helpful in these situations (e.g., if, under the relevant legal framework that governs the easement arrangement, land is typically interpreted as a single plot or as comprising surface and subsurface rights).

## Effective Date

The effective date of the proposed ASU on land easements would be aligned with that of the new leasing standard.

The new leasing standard is effective for public business entities for annual periods beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), and interim periods therein. For all other entities, the new leasing standard is effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods thereafter. Early adoption is permitted for all entities.

## Transition

The FASB received a significant amount of feedback from stakeholders in several industries who were concerned about the cost and complexity of evaluating all existing land easements under the new definition of a lease at transition. Entities in these industries have potentially tens of thousands of existing land easements, many of which were executed decades ago, and the same complexities described in the [Identifying a Lease](#) section above would be relevant for these arrangements.

The Board observed that the costs of requiring an entity to evaluate all existing land easements under the new definition of a lease outweighed the benefits to financial statement users. Accordingly, the FASB decided to provide transition relief in the form of a proposed practical expedient in ASC 842-10-65-1(gg):

An entity also may elect a practical expedient to not assess whether existing or expired land easements that were not previously assessed under Topic 840 on leases are or contain a lease under this Topic. For purposes of (gg), a land easement (also commonly referred to as a right of way) refers to a right to use, access, or cross another entity's land for a specified purpose. This practical expedient shall be applied consistently by an entity to all its existing and expired land easements that were not previously assessed under Topic 840. This practical expedient may be elected separately or in conjunction with either one or both of the practical expedients in (f) and (g). An entity that elects this practical expedient for existing or expired land easements shall apply the pending content that links to this paragraph to land easements entered into (or modified) on or after the date that the entity first applies the pending content that links to this paragraph as described in (a) and (b). An entity that previously assessed existing or expired land easements under Topic 840 shall not be eligible for this practical expedient for those land easements.

In short, an entity that elects the expedient is relieved from applying the new leasing standard to evaluate all existing land easements that were not previously assessed in accordance with ASC 840. The FASB explains in paragraph BC12 of the proposed ASU that the historical accounting treatment for existing land easements — when the expedient is elected — would be “run off” unless or until the arrangement is modified on or after the date the entity adopts the new leasing standard.

The transition practical expedient for existing land easements may be elected alone or with any of the other transition practical expedients.<sup>4</sup> In a manner consistent with the other transition practical expedients, entities must disclose whether they are electing the transition practical expedient for land easements.



### Connecting the Dots

We think that the FASB's scoping of the transition practical expedient for existing land easements is intentional. That is, the practical expedient is not available to entities that had, and applied, a historical accounting policy indicating that existing land easements are subject to evaluation in accordance with the scoping guidance in ASC 840 before considering other GAAP. For entities with such an accounting policy, the package of practical expedients in ASC 842-10-65-1(f) is available to appropriately cover land easements in transition.

However, because of the diversity in historical practice (e.g., whether under ASC 840, ASC 350, ASC 360), the FASB wanted to provide transition relief to entities with reasonable accounting policies that did not look to ASC 840 first for existing land easements. The proposed ASU is intended to cover those entities in transition.

We note that the practical expedient, as proposed, may create a new challenge for a certain population of entities that (1) applied a historical accounting policy stipulating that existing land easements are subject to evaluation under ASC 840 and (2) would otherwise *not* elect the package of practical expedients in ASC 842-10-65-1(f) (e.g., would want to reassess their contracts — such as certain supply or offtake arrangements — determined to be leases under ASC 840 with the expectation that those contracts do not convey to the customer the right to control the use and thus would not be leases under ASC 842). As a result of the proposed ASU, those entities may instead consider electing the package of practical expedients in ASC 842-10-65-1(f) so that they may avoid reassessing their existing land easements.

<sup>4</sup> See ASC 842-10-65-1(f) and (g).

Any change in historical accounting policy to take advantage of the favorable transition practical expedient in the proposed ASU would be subject to the guidance in ASC 250, including the requirement that the change be preferable. The FASB expressly noted this in paragraph BC15 of the proposed ASU.

## Technical Corrections and Improvements

On June 21, 2017, the FASB met to discuss 16 proposed technical corrections and improvements to its new leases standard in response to feedback received from several sources on the need to clarify certain aspects of, rather than change, the new leases standard. As a result of those decisions, the FASB issued a proposed ASU on September 27, 2017.

See [Appendix A](#) below for a table summarizing the technical corrections. The questions for respondents from the proposed technical-corrections ASU are included in [Appendix C](#) for reference.

## Effective Date

The effective date of the technical-corrections proposed ASU would be aligned with that of the new leasing standard.

The new leasing standard is effective for public business entities for annual periods beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), and interim periods therein. For all other entities, the new leasing standard is effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods thereafter. Early adoption is permitted for all entities.

## Appendix A — Key Provisions of the Technical Corrections Proposed ASU

The following table, reprinted from the technical-corrections proposed ASU, summarizes the amendments the proposal would make to the new leasing standard:

Area for Correction or Improvement	Summary of Proposed Amendments
<b>Issue 1: Residual Value Guarantees</b>  Stakeholders noted that paragraph 460-10-60-32 incorrectly refers readers to the guidance in Topic 842 about sale-leaseback-sublease transactions, when, in fact, it should refer readers to the guidance about guarantees by a seller-lessee of the underlying asset's residual value in a sale and leaseback transaction.	The proposed amendment would correct the cross reference in paragraph 460-10-60-32.
<b>Issue 2: Rate Implicit in the Lease</b>  Stakeholders raised questions about the treatment of certain sales-type leases with significant variable payments under Topic 842 and whether the application of Topic 842 could result in a negative rate implicit in the lease, rather than a loss at the commencement date of the lease.	The proposed amendment would clarify that the rate implicit in the lease cannot be less than zero.
<b>Issue 3: Lessee Reassessment of Lease Classification</b>  Topic 842 makes it clear that when a lease is modified and that modification is not accounted for as a separate contract, an entity (that is, a lessee or a lessor) should reassess, at the effective date of the modification, lease classification on the basis of the modified terms and conditions and the facts and circumstances existing as of that date. Although Topic 842 also requires a lessee to reassess lease classification if there is a change in the lease term or the assessment of a lessee option to purchase the underlying asset, stakeholders expressed that it is not clear whether the lessee should reassess lease classification on the basis of the facts and circumstances existing as of the date the reassessment is required.	The proposed amendment would consolidate the requirements about lease classification reassessments into one paragraph and better articulate how an entity should perform the lease classification reassessment, that is, on the basis of the facts and circumstances, and the modified terms and conditions if applicable, as of the date the reassessment is required.
<b>Issue 4: Lessor Reassessment of Lease Term and Purchase Option</b>  Topic 842 requires a lessor to not reassess the lease term or a lessee purchase option unless the lease is modified and that modification is not accounted for as a separate contract. Topic 842 also requires a lessor to account for the exercise of a lessee option to extend or terminate the lease, or to purchase the underlying asset, in the same manner as a lease modification. Stakeholders questioned why a lessor should account for a lessee exercise of such options in a manner similar to a lease modification when the exercise of those options is consistent with the assumptions that the lessor made in accounting for the lease at the commencement date of the lease (or the most recent effective date of a modification that is not accounted for as a separate contract).	The proposed amendment would clarify that a lessor should account for the exercise by a lessee of an option to extend or terminate the lease or to purchase the underlying asset as a lease modification unless the exercise of that option by the lessee is consistent with the assumptions that the lessor made in accounting for the lease at the commencement date of the lease (or the most recent effective date of a modification that is not accounted for as a separate contract).

(Table continued)

Area for Correction or Improvement	Summary of Proposed Amendments
<b>Issue 5: Variable Lease Payments That Depend on an Index or a Rate</b>	
<p>Stakeholders noted that the guidance in paragraph 842-10-35-4(b) about remeasurement of the lease payments when a contingency upon which some or all of the variable lease payments are based is resolved might be perceived as applying to any variable lease payments, including those that depend on an index or rate, which would be inconsistent with the Board's decisions on this issue.</p>	<p>The proposed amendment would clarify that a change to a reference index or rate upon which some or all of the variable lease payments in the contract are based does not constitute the resolution of a contingency subject to the guidance in paragraph 842-10-35-4(b).</p> <p>Variable lease payments that depend on an index or a rate should be remeasured, using the index or rate at the remeasurement date, only when the lease payments are remeasured for another reason (that is, when one or more of the events described in paragraph 842-10-35-4(a) or (c) occur or when a contingency unrelated to a change in a reference index or rate under paragraph 842-10-35-4(b) is resolved).</p>
<b>Issue 6: Investment Tax Credits</b>	
<p>Stakeholders indicated that there is an inconsistency in terminology used about the effect that investment tax credits have on the fair value of the underlying asset between the definition of the term <i>rate implicit in the lease</i> and the lease classification guidance in paragraph 842-10-55-8.</p>	<p>The proposed amendment would remove that inconsistency in terminology.</p>
<b>Issue 7: Lease Term and Purchase Option</b>	
<p>Stakeholders indicated that the description in paragraph 842-10-55-24 about lessor-only termination options is not consistent with the description in paragraph 842-10-55-23 about the noncancellable period of a lease.</p>	<p>The proposed amendment would remove that inconsistency by clarifying that a lessor-only option to terminate the lease is an input to the determination of the lease term and does not affect the noncancellable period of the lease.</p>
<b>Issue 8: Transition Guidance for Amounts Previously Recognized in Business Combinations</b>	
<p>Stakeholders indicated that the transition guidance for lessors in paragraph 842-10-65-1(h)(3) is unclear because it relates to leases classified as direct financing leases or sales-type leases under Topic 840, while the lead-in sentence to paragraph 842-10-65-1(h) provides transition guidance for leases classified as operating leases under Topic 840.</p>	<p>The proposed amendment would clarify that paragraph 842-10-65-1(h)(3) applies to lessors for leases classified as direct financing leases or sales-type leases under Topic 842, not Topic 840. In other words, paragraph 842-10-65-1(h)(3) would apply when an entity does not elect the package of practical expedients in paragraph 842-10-65-1(f), and, for a lessor, an operating lease acquired as part of a previous business combination is classified as a direct financing lease or a sales-type lease when applying the lease classification guidance in Topic 842.</p>
<b>Issue 9: Certain Transition Adjustments</b>	
<p>When an entity does not elect the package of practical expedients in Topic 842, paragraph 842-10-65-1(p) requires a lessee to write off, as an adjustment to equity, any unamortized initial direct costs that do not meet the definition of <i>initial direct costs</i> under Topic 842 for leases previously classified as operating leases under Topic 840.</p>	<p>The proposed amendments would clarify whether to recognize a transition adjustment to earnings rather than through equity.</p>
<p>Stakeholders questioned why those nonqualifying costs should be charged to equity when such costs are incurred after the beginning of the earliest period presented in the financial statements in which an entity adopts Topic 842. Similar issues also were noted elsewhere in the transition guidance.</p>	

(Table continued)

Area for Correction or Improvement	Summary of Proposed Amendments
<p><b>Issue 10: Transition Guidance for Leases Previously Classified as Capital Leases under Topic 840</b></p> <p>Paragraph 842-10-65-1(r) provides guidance to lessees for leases previously classified as capital leases under Topic 840 and classified as finance leases under Topic 842.</p> <p>Paragraph 842-10-65-1(r)(4) provides subsequent measurement guidance before the effective date, but it refers readers to the subsequent measurement guidance in Topic 840 about operating leases. It should refer them to the subsequent measurement guidance applicable to capital leases.</p>	<p>The proposed amendment would correct that reference.</p>
<p><b>Issue 11: Transition Guidance for Modifications to Leases Previously Classified as Direct Financing or Sales-Type Leases under Topic 840</b></p> <p>Paragraph 842-10-65-1(x) provides transition guidance applicable to lessors for leases previously classified as direct financing leases or sales-type leases under Topic 840 and classified as direct financing leases or sales-type leases under Topic 842. For modifications to those leases beginning after the effective date, paragraph 842-10-65-1(x)(4) refers readers to other applicable guidance in Topic 842 to account for the modification, specifically paragraphs 842-10-25-16 through 25-17, depending on how the lease is classified after the modification.</p> <p>Stakeholders noted that it should refer to how the lease is classified <i>before</i> the modification to be consistent with the guidance provided in paragraphs 842-10-25-16 through 25-17.</p>	<p>The proposed amendment would correct that inconsistency.</p>
<p><b>Issue 12: Transition Guidance for Sale and Leaseback Transactions</b></p> <p>Stakeholders noted that the heading above the transition guidance on sale and leaseback transactions appears to suggest that there is no transition guidance for sale and leaseback transactions that occur after the earliest comparative period presented in the financial statements in which an entity adopts Topic 842 but before the effective date. Some stakeholders also questioned some of the references included in paragraph 842-10-65-1(bb).</p>	<p>The proposed amendments would clarify that the transition guidance on sale and leaseback transactions in paragraph 842-10-65-1(aa) through (ee) applies to all sale and leaseback transactions that occur before the effective date and would correct the referencing issues noted.</p>
<p><b>Issue 13: Impairment of Net Investment in the Lease</b></p> <p>Paragraph 842-30-35-3 provides guidance to lessors for determining the loss allowance of the net investment in the lease and describes the cash flows that should be considered when the lessor determines that loss allowance.</p> <p>Stakeholders questioned whether the guidance, as written, would accelerate and improperly measure the loss allowance because the cash flows associated with the unguaranteed residual asset appear to be excluded from the evaluation.</p>	<p>The proposed amendment would clarify the application of the guidance for determining the loss allowance of the net investment in the lease, including the cash flows to consider in that assessment.</p>

(Table continued)

Area for Correction or Improvement	Summary of Proposed Amendments
<b>Issue 14: Unguaranteed Residual Asset</b>	
<p>Paragraph 842-30-35-4 provides guidance explaining that if a lessor sells the lease receivable associated with a direct financing lease or a sales-type lease and retains an interest in the residual value of the asset, the lessor should not continue to accrete the unguaranteed residual asset to its estimated value over the remaining lease term. Stakeholders questioned whether the Board intended to change the application as compared with current generally accepted accounting principles (GAAP) because the guidance in paragraph 840-30-35-53 (which will be superseded by the amendments in Update 2016-02) requires a lessor to continue to recognize interest resulting from accretion of the unguaranteed residual asset to its estimated value unless the lessor sells <i>substantially all</i> of the minimum rental payments.</p>	<p>The proposed amendment would clarify that a lessor should not continue to accrete the unguaranteed residual asset to its estimated value over the remaining lease term to the extent that the lessor sells substantially all of the lease receivable associated with a direct financing lease or a sales-type lease, consistent with Topic 840.</p>
<b>Issue 15: Effect of Initial Direct Costs on the Rate Implicit in the Lease</b>	
<p>Stakeholders noted that the ordering of the illustration in Case C of Example 1 in paragraphs 842-30-55-31 through 55-39 has raised questions about how initial direct costs factor into the determination of the rate implicit in the lease for lease classification purposes for lessors only.</p>	<p>The proposed amendment would more clearly align the illustration to the guidance in paragraph 842-10-25-4.</p>
<b>Issue 16: Failed Sale and Leaseback Transaction</b>	
<p>In accordance with Subtopic 842-40, Leases—Sale and Leaseback Transactions, when a sale and leaseback transaction does not qualify as a sale, the entity should account for the transaction as a financing arrangement. Paragraph 842-40-30-6(a) further requires a seller-lessee to adjust the interest rate as necessary to prevent negative amortization of the financial liability recognized. Some stakeholders questioned whether the language used in paragraph 842-40-30-6(a) actually meets the objective of preventing negative amortization of the financial liability recognized by a seller-lessee in a failed sale and leaseback transaction.</p>	<p>The proposed amendment would clarify that a seller-lessee in a failed sale and leaseback transaction should adjust the interest rate on its financial liability as necessary to ensure that the interest on the financial liability does not exceed the total payments (rather than the principal payments) on the financial liability.</p>

## Appendix B — Questions for Respondents (Land Easements Proposal)

The questions for respondents from the proposed ASU on land easements are listed below for reference. Stakeholder comments are due by October 25, 2017.

**Question 1:** Would the land easement practical expedient in this proposed Update reduce the cost and complexity to implement Topic 842? If not, please explain why.

**Question 2:** Would the proposed amendments require transition provisions or an effective date that is different from those for Topic 842? If yes, please explain what transition requirements and/or effective date you would recommend and why.

## Appendix C — Questions for Respondents (Technical-Corrections Proposal)

The questions for respondents from the technical-corrections proposed ASU are listed below for reference. Stakeholder comments are due by November 13, 2017.

**Question 1:** Would the amendments in this proposed Update clarify the guidance in Topic 842 or provide a better link between paragraphs within Topic 842 or between the guidance in Topic 842 and other Topics? If not, please explain which proposed amendment(s) you disagree with and why.

**Question 2:** Will any of the proposed amendments result in substantive changes to the application of Topic 842 that would require transition provisions or an effective date for the final amendments other than those noted in the Summary section “When Would the Amendments Be Effective?” If so, please describe.

**Question 3:** Should other changes that are directly or indirectly related to the proposed amendments be made? Please note that the Board will conduct Codification improvements projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvements project.

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