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FASB Tentatively Decides to Relieve Entities From Implementing Certain Aspects of the New Leasing Standard

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Introduction

At its November 29, 2017, Board meeting, the FASB tentatively decided to amend certain aspects of its new leasing standard, [ASU 2016-02](#),¹ in an attempt to provide relief from the costs of implementing the standard. Specifically, the FASB tentatively decided to amend the guidance in ASC 842² as follows:

- Entities may elect not to restate their comparative periods in the period of adoption when transitioning to the new standard.
- Lessors may elect not to separate lease and nonlease components when certain conditions are met.

In addition, the Board discussed stakeholder feedback on its [proposed ASU](#)³ related to the land easement practical expedient associated with transition to ASC 842 and voted to move forward with drafting a final ASU.

¹ FASB Accounting Standards Update No. 2016-02, *Leases*.

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

³ FASB Proposed Accounting Standards Update, *Land Easement Practical Expedient for Transition to Topic 842*. See Deloitte's October 3, 2017, [Heads Up](#) for a detailed discussion of this proposal.

Transition Relief

ASC 842 currently requires entities to use a “modified retrospective” transition approach that is intended to maximize comparability and be less complex than a full retrospective approach.

Under the modified retrospective approach, ASC 842 is effectively implemented as of the beginning of the earliest comparative period presented in an entity's financial statements. That is, a public business entity for which the standard becomes effective on January 1, 2019, would first apply ASC 842 and recognize an adjustment for the effects of the transition as of January 1, 2017 (i.e., the date of initial application).

However, at its November 29 meeting, the FASB tentatively decided to amend ASU 2016-02 so that entities may elect *not* to restate their comparative periods in transition. Effectively, the amendment would allow entities to change their date of initial application to the beginning of the period of adoption.

Therefore, an entity such as the one described above could elect to change its date of initial application to January 1, 2019. In doing so, the entity would:

- Apply ASC 840 in the comparative periods.
- Provide the disclosures required by ASC 840 for the comparative periods.
- Recognize the effects of applying ASC 842 as a cumulative-effect adjustment to retained earnings as of January 1, 2019.

The entity would not:

- Restate 2017 and 2018 for the effects of applying ASC 842.
- Provide the disclosures required by ASC 842 for 2017 and 2018.



Connecting the Dots

The FASB received feedback from preparers that were experiencing additional and unexpected costs related to the current transition requirements in ASU 2016-02. Those stakeholders indicated that they currently lack the IT solutions and systems providers to handle the comparative-period reporting requirements of the modified retrospective transition approach, thereby increasing the cost and complexity to those stakeholders of restating comparative periods under ASC 842.

The Board was sympathetic to this feedback and, accordingly, voted to amend the standard. In doing so, several Board members noted that the tentative decisions effectively delay lessees' recognition of lease assets and lease liabilities by one year (i.e., public business entities only need to present two years of comparative balance sheet information). Those Board members noted that, in this instance, the benefits to preparers of delaying balance sheet recognition by one year exceeded the costs of requiring them to provide comparative balance sheet information. Further, they indicated that given ASC 842's dual approach to lessee accounting, the new standard does not significantly affect the income statement. Therefore, comparability will not be significantly affected if entities do not restate two years of comparative income statement information.

The Board expects that the new transition election will relieve entities from the cost burdens — described above — that are associated with providing comparative information under the modified retrospective transition approach. However, many entities will still need to enhance their lease-related IT systems as a result of the new standard's data requirements. In addition, the new standard's requirements related to judgments and estimations have not changed, and new processes and internal controls will still need to be instituted accordingly. Therefore, we do not think that the Board's decision suggests that entities should slow their implementation efforts.

Lessor's Separation of Lease and Nonlease Components

ASC 842 currently requires lessors to separate lease and nonlease components in all circumstances. Lessors look to the guidance in step 4 of the new revenue model in ASC 606 to allocate the consideration in the contract to the separated components. ASC 842 (including the presentation and disclosure guidance) applies to the lease component, and ASC 606 (including the presentation and disclosure guidance) applies to the nonlease component.

Further, such separation is required regardless of whether the pattern of transfer to the customer would be different (i.e., a different pattern of revenue recognition) when the lease and nonlease components are separated. Accordingly, under the current guidance in ASC 842, if the patterns of revenue recognition are the same, separation and allocation may only affect presentation and disclosure. For example, this often may be the case when real estate lessors enter into operating leases of real estate and provide common-area maintenance services to the customer.

However, the FASB received feedback from stakeholders indicating that the costs of complying with ASC 842's current separation and allocation requirements for such arrangements outweigh the benefits (i.e., when the separation and allocation guidance only affects presentation and disclosure). As a result, at its November 29 meeting, the FASB tentatively decided to amend ASC 842 to provide lessors with an optional practical expedient that may be elected by class of underlying asset.

A lessor that elects the practical expedient would not be required to separate lease and nonlease components, provided that both of the following conditions are met:

- The patterns of revenue recognition for the components are the same.
- The combined, single unit of account would be classified as an operating lease.

Further, the lessor would be required to disclose (1) that it has elected the expedient and (2) the nature of the items that are being combined.



Connecting the Dots

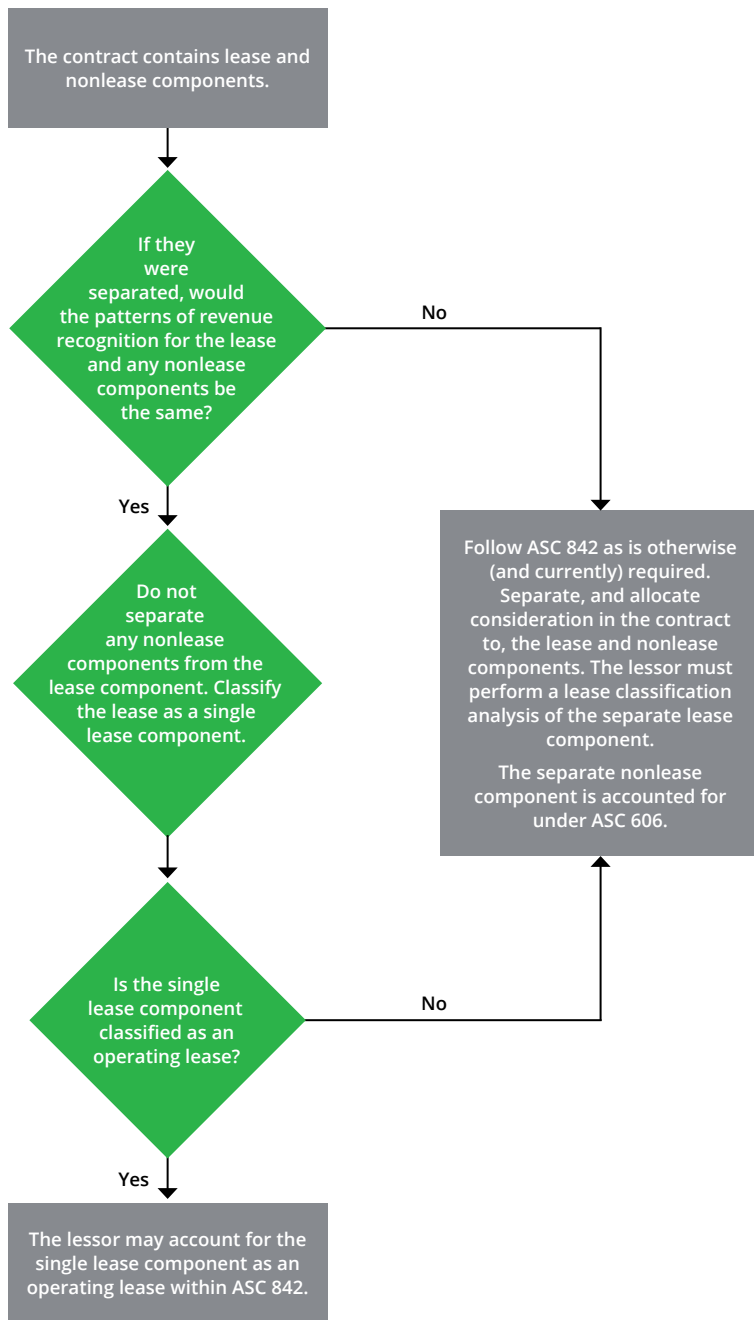
The practical expedient would most likely provide significant relief to real estate lessors that are implementing the new leasing standard. When discussing the expedient, several Board members pointed out that it would allow such lessors to apply the new leasing standard in a manner consistent with how entities are permitted to apply ASC 606 when distinct goods or services are delivered concurrently and have the same pattern of transfer to the customer. Paragraph BC116 of ASU 2014-09⁴ clarifies that, in such cases, entities are not precluded from accounting for, and recognizing revenue from, the goods and services as if they were a single performance obligation. The practical expedient would therefore allow lessors to account for such contracts that provide a lease and related common-area maintenance services as a single deliverable, as would be permitted for any other revenue-generating activity. This is consistent with how the Board describes the leasing activities of lessors (i.e., as revenue-generating activities) in paragraphs BC92 and BC153 of ASU 2016-02.

⁴ FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.

However, for lessors that enter into other types of lease arrangements, it is sometimes unclear how the practical expedient would be applied or how helpful it would be for relieving the costs of applying the separation and allocation guidance in ASC 842. Consider the following examples:

- In a common vehicle lease arrangement, a lessor may agree to offer the customer, in addition to the lease, roadside assistance services and participation in a loyalty program. It is reasonable to consider that the revenue recognition patterns of the vehicle lease and the roadside assistance services may be the same, but the revenue recognition pattern associated with the loyalty program is unlikely to be. We are uncertain about whether the lessor may apply the practical expedient to combine the lease and the nonlease component for the roadside assistance while separating the nonlease component for the loyalty program and accounting for it in accordance with ASC 606.
- In certain arrangements to provide tenants with accommodations in a health care or retirement community, the nonlease components may represent a significant portion (e.g., 80 percent) of the value of the contract. In addition, the lease and nonlease components may have the same patterns of revenue recognition (e.g., when the lease component is an operating lease and the nonlease components represent stand-ready obligations). If the lease component, when combined with the nonlease components, would be classified as an operating lease, a lessor may apply the practical expedient to combine the components into a single lease component accounted for under ASC 842. However, in this case, the value of the contract is significantly concentrated in the nonlease service components, yet no similar expedient is available for an entity to combine the lease component with the nonlease components and account for the arrangement in accordance with ASC 606. Therefore, we are uncertain about how helpful the practical expedient will be to entities that enter into such arrangements and would prefer to account for the arrangement as a contract with a customer (i.e., under ASC 606).
- The practical expedient will not apply to arrangements in which the patterns of revenue recognition for the lease and nonlease components would not be the same. During the meeting, some Board members highlighted a drilling contract as an example in which a lessor would not meet this condition, but they did not explain the basis for this view. In addition, the Board did not address allocation by lessor entities that may be struggling to determine the appropriate stand-alone selling prices for the lease and nonlease components in such arrangements. Therefore, such entities will need to continue developing processes for estimating stand-alone selling prices in accordance with ASC 606 so that the consideration in the contract can be allocated to lease and nonlease components.

The Board did not discuss any other specifics of when and how the practical expedient may be elected. On the basis of our understanding of the Board's discussion, we think that a lessor would have to perform the analysis in the decision tree below to determine whether the practical expedient applies to a given contract. However, the final wording in the proposed ASU will be key to understanding the analysis required for lessors that wish to apply the practical expedient.



The transition considerations associated with the practical expedient are yet to be determined. Such considerations may significantly affect the cost relief for certain lessors.

Land Easements

Generally, a land easement is a right to access, cross, or otherwise use someone else's land for a specified purpose. The stated objectives of the amendments in the proposed ASU on land easements were to:

- 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.
- 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.

At its November 29 meeting, the Board discussed feedback received during the proposed ASU's comment period. Generally, the Board found that the proposal on land easements achieved the objectives noted above and, accordingly, voted to finalize it.

However, the Board decided that the transition practical expedient in the final ASU should be available for existing or expired land easements that were not previously *accounted for* in accordance with ASC 840 (i.e., as opposed to being *assessed* in accordance with ASC 840). This change would open the practical expedient to a larger population of land easement arrangements, thereby reducing the costs of assessing these arrangements in accordance with ASC 842's lease identification guidance.



Connecting the Dots

The Board indicated that it would not provide additional, formal guidance on determining the unit of account with respect to performing the lease assessment for an easement. However, several Board members pointed out that an entity will need to use judgment in determining the unit of account and that diversity in practice could arise in this area. Board members have publicly expressed this view at previous meetings, including a July 2017 roundtable and an August 2017 meeting. Further, it was noted that the need to use judgment is not limited to scenarios involving subsurface rights (e.g., rights to run gas pipelines underground). Board members specifically discussed easements that convey only surface rights, including rights to construct renewable energy assets (e.g., wind or solar), noting that an entity will also be required to employ judgment in considering these arrangements and that there could be more than one approach to determining the unit of account.

On the basis of these views, we believe that, in practice, some will conclude that the unit of account is the entire land area defined by the easement contract (e.g., a larger area) while others will decide that a new unit of account should be established and assessed each time the easement holder occupies a portion of the land (e.g., a smaller area, such as the area taken up by a concrete pad used to serve as the foundation for a windmill or a transmission tower). We believe that either of these approaches is acceptable.

For further discussion of the ASC 842 amendments related to land easements, see Deloitte's October 3, 2017, [Heads Up](#).

Lessee Implementation Issues

The FASB also discussed a number of implementation issues associated with the lessee accounting requirements in ASC 842 but ultimately agreed with staff recommendations and decided against amending the new leasing standard in response to these issues.

The following list summarizes these implementation issues:⁵

- “Certain stakeholders assert that the required disclosures in Topic 842 for leases with 100 percent variable payments are burdensome and will not result in incremental information that is decision useful. To address this concern, they requested that the Board remove from the scope of Topic 842 those leases that are determined to have 100 percent variable payments.”
- “Certain stakeholders assert that the costs associated with complying with the disclosure requirements for short-term leases, as defined in Topic 842, do not justify the benefits associated with the incremental information that would be provided to users about these leases. These stakeholders requested that short-term leases be removed from the scope of Topic 842.”
- “Certain stakeholders raised concerns about the challenges that would exist in accounting for leases denominated in foreign currencies because accounting systems often do not retain foreign exchange rate information. Those stakeholders requested that the Board allow reporting entities to disclose leases in foreign currencies in the currency of the lease, rather than the entity’s reporting currency, particularly for the required disclosures of weighted-average lease term and weighted-average discount rate.”
- “Some stakeholders are concerned that, as a result of removing specific guidance for real-estate leases during the development of Topic 842, a portion of their land-only leases may be classified as finance leases. . . . These stakeholders have requested that the Board consider amending Topic 842 to specify that leases of land only would be classified as operating leases unless ownership of the land transfers to the lessee by the end of the lease term or that the lessee has an option to purchase the land that it is reasonably certain to exercise.”
- “Some [stakeholders] have communicated concerns regarding the change in the definition of incremental borrowing rate in Topic 842 from that provided currently in Topic 840. Specifically, Topic 840 currently allows entities to use an unsecured rate in certain circumstances while Topic 842 requires a collateralized rate for purposes of measuring right-of-use assets and lease liabilities. These stakeholders believe that in situations in which their borrowing practices are generally based on unsecured terms, the use of an unsecured borrowing rate as the incremental borrowing rate is preferable.”
- “A private company stakeholder raised concerns about the costs and effort required to comply with the weighted-average lease term and weighted-average discount rate disclosure requirements. This stakeholder also asserted that the required disclosure of future lease payments would provide sufficient information for private company users. Therefore, this private company stakeholder requested that the weighted-average lease term and weighted-average discount rate disclosure requirement be optional for private companies.”

⁵ Excerpted from the FASB’s November 29, 2017, [Board meeting handout](#).



Connecting the Dots

Although the FASB chose not to address stakeholder concerns related to the mandatory use of a collateralized rate for lease classification and measurement purposes, some Board members offered their observations about the Board's intent with respect to this issue. On the basis of those observations and other inquiries we have received on this topic in recent months, we expect that this issue will continue to evolve as additional perspectives are considered, including those of the SEC staff. Specifically, questions have arisen regarding the (1) appropriate base rate to be used (i.e., secured vs. unsecured); (2) form of collateral to be assumed (i.e., underlying asset vs. other forms); and (3) extent of the collateral to be assumed (i.e., 100 percent vs. a lower percentage, which may be more comparable to a collateral requirement in a loan to acquire a similar asset). Interested parties should monitor developments in this area and discuss the matter with their auditors or accounting advisers.

Next Steps

The FASB plans to issue a (1) final ASU on land easements and (2) proposed ASU that addresses the Board's decisions on transition relief and the lessor's separation of lease and nonlease components. The FASB staff indicated that the proposed ASU on transition relief and the lessor's separation of lease and nonlease components is expected to be issued in January 2018 for a 30-day comment period. The staff did not specify when the final ASU on land easements would be issued.

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