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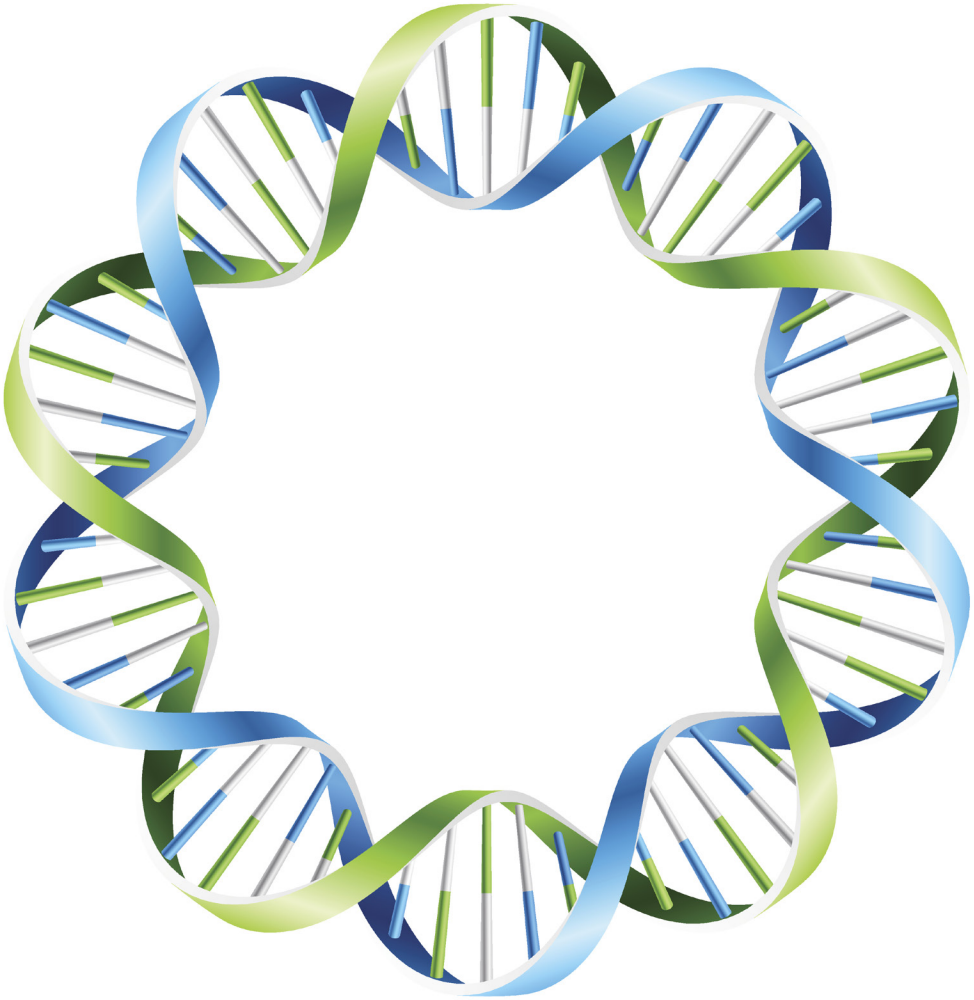

Life Sciences

Accounting and Financial Reporting Update — Interpretive Guidance on Leases

March 2019

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Preface

March 2019

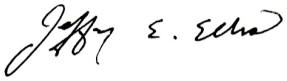
To our clients, colleagues, and other friends:

The life sciences industry represents entities that discover, develop, and manufacture health care products. Such entities include pharmaceutical manufacturers; biotechnology companies; medical device, diagnostic, and medical equipment manufacturers; and service companies such as drug distributors, contract research organizations (CROs), contract manufacturing organizations (CMOs), and health technology companies.

Finance and accounting professionals in the industry face complex issues and must exercise significant judgment in applying existing rules related to research and development (R&D) costs, acquisitions and divestitures, consolidation, contingencies, revenue recognition, income taxes, financial instruments, and financial statement presentation and disclosure. The full life sciences accounting and financial reporting update, our 10th edition, addresses these and other topics affecting the industry in 2019. It includes updated interpretive guidance as well as new sections that discuss initial public offerings (IPOs), accounting considerations for health technology companies, and the latest developments in standard setting. In addition, it discusses the outlook for the life sciences industry in 2019.

Appendix A lists the titles of standards and other literature we cited, and Appendix B defines the abbreviations we used.

Sincerely,



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Chapter 11 — Leases

11.1 New Leases Standard (Codified in ASC 842)

11.1.1 Background

In February 2016, the FASB issued ASU 2016-02 (the "new leases standard"). The primary objective of the new standard was to address the off-balance-sheet financing concerns related to lessees' operating leases. Accordingly, except for those leases that qualify for the short-term lease exemption under ASC 842 (i.e., certain leases with a lease term of less than 12 months), the standard's lessee model requires lessees to adopt a right-of-use (ROU) asset approach that brings substantially all leases onto the balance sheet. Under this approach, a lessee records an ROU asset representing its right to use the underlying asset during the lease term and a corresponding lease liability in a manner similar to the current approach for capital leases.

The FASB also addressed questions such as:

- Whether an arrangement is a service or a lease.
- What amounts should be initially recorded on the lessee's balance sheet for the arrangement.
- How to reflect the effects of leases in the statement of comprehensive income.
- How to apply the resulting accounting in a cost-effective manner.

The standard also aligns certain underlying principles of the new lessor model with those in ASC 606, the FASB's new revenue recognition standard, particularly those related to the evaluation of how collectibility should be considered and the determination of when profit should be recognized.

11.1.2 Scope

The new leases standard applies to leases, including subleases, of all PP&E. It does not apply to leases of or for the following:

- Intangible assets.
- Exploration for or use of nonregenerative resources.
- Biological assets.
- Inventory.
- Assets under construction.

11.1.3 Definition of a Lease

The new leases standard states that a contract is or contains a lease if the contract gives a customer "the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration." Control is considered to exist if the customer has both of the following:

- The "right to obtain substantially all of the economic benefits from use of [an identified] asset."
- The "right to direct the use of that asset."

An entity is required at inception to identify whether a contract is or contains a lease. The entity will reassess whether the contract is or contains a lease only in the event of a modification to the terms and conditions of the contract.

The table below summarizes key concepts related to the definition of a lease.

Concept	Requirement	Observation
Use of an identified asset	An asset is typically considered to be an identified asset if it is explicitly specified in a contract or implicitly specified at the time the asset is made available for use by the customer. However, if the supplier has substantive rights to substitute the asset throughout the period of use **and** would benefit economically from substituting that asset, the asset is not considered "identified," and there is no lease for accounting purposes (see below).	This requirement is similar to the guidance in ASC 840-10-15 (formerly EITF Issue 01-8). An entity does not need to be able to identify the particular asset (e.g., by serial number) but must instead determine whether an identified asset is needed to fulfill the contract. Distinguishing between a lease and a capacity contract requires significant judgment. The standard clarifies that a capacity portion of an asset is an identified asset if it is physically distinct (e.g., a specific floor of a building). On the other hand, a capacity portion of a larger asset that is not physically distinct (e.g., a percentage of a pipeline) is not an identified asset unless that portion represents substantially all of the asset's capacity.
Substantive substitution rights	A supplier's right to substitute an asset is substantive only if both of the following conditions exist: • The supplier has the practical ability to substitute alternative assets throughout the period of use. • The supplier would benefit economically from the exercise of its right to substitute the asset.	The FASB established this requirement because it reasoned that if a supplier has a substantive right to substitute the asset throughout the period of use, the supplier — not the customer — controls the use of the asset.

(Table continued)

Concept	Requirement	Observation
Right to obtain economic benefits from use of the identified asset	To control the use of an identified asset, a customer must have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use.	The economic benefits from use of an asset include the primary output and by-products of the asset as well as other economic benefits from using the asset that could be realized from a commercial transaction with a third party.
Right to direct the use of the identified asset	A customer has the right to direct the use of an identified asset throughout the period of use if either of the following conditions exists: • The customer has the right to direct "how and for what purpose" the asset is used throughout the period of use. • The relevant decisions about how and for what purpose the asset is used are predetermined and (1) the customer has the right to operate (or direct others to operate) the asset throughout the period of use and the supplier does not have the right to change the operating instructions or (2) the customer designed the asset in a way that predetermines how and for what purpose the asset will be used.	The relevant rights to be considered are those that affect the economic benefits derived from the use of the asset. Customers' rights to direct the use of the identified asset include the rights to change: • The type of output produced by the asset. • When the output is produced. • Where the output is produced. On the other hand, rights that are limited to maintaining or operating the asset do not grant a right to direct how and for what purpose the asset is used.

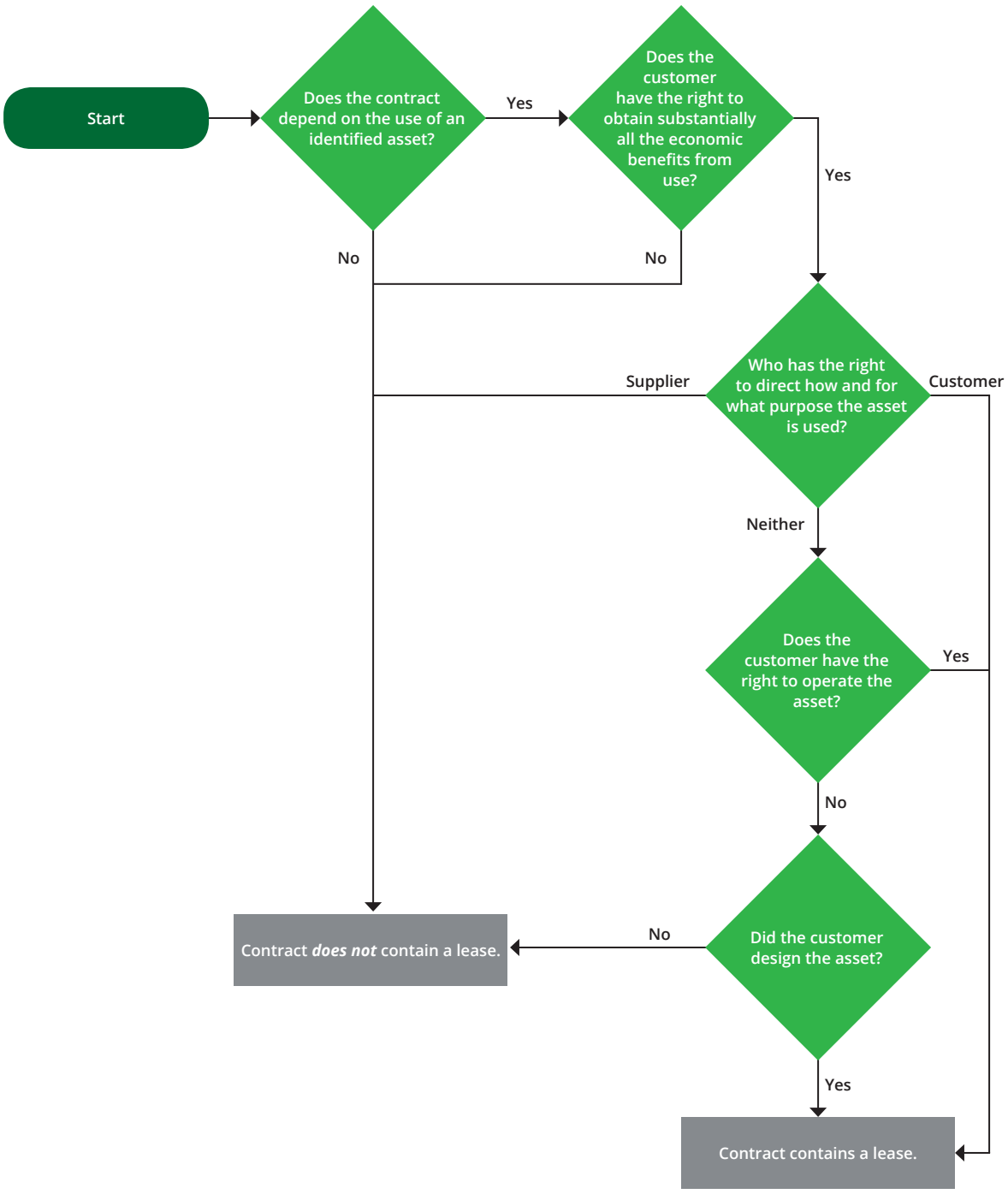
11.1.4 Embedded Leases

Often, the assessment of whether a contract is or contains a lease will be straightforward. However, the evaluation will be more complicated when an arrangement involves both a service component and a leasing component or when both the customer and the supplier make decisions about the use of the underlying asset. An asset typically is identified by being explicitly specified in a contract. However, an asset also can be identified by being implicitly specified at the time the asset is made available for the customer's use.

Connecting the Dots

As discussed further in Chapter 16 of Deloitte's *A Roadmap to Applying the New Leasing Standard*, entities in transition to ASC 842 may elect a package of transition relief (commonly referred to as "the package of three") that, among other things, permits entities to retain historical assessments of whether contracts are or contain a lease. This means that on the effective date of the standard, for those contracts existing as of the date of adoption, the initial ASC 842 accounting is based on those contracts that meet the definition of a lease under ASC 840. Therefore, if entities elect the transition relief package, they should evaluate embedded leases that may not have been identified under legacy U.S. GAAP in accordance with ASC 840. If entities do not elect the transition relief package, they should evaluate whether contracts are or contain leases under ASC 842.

The following flowchart illustrates how to evaluate whether an arrangement is or contains a lease:



Example 11-1

Contract Manufacturing Arrangement

Entity A, a pharmaceutical company, enters into an arrangement with a contract manufacturer, Entity B, to purchase a particular type, quality, and quantity of active pharmaceutical ingredient (API) needed to manufacture drug compound X. Entity B has only one factory that can meet the requirements of the contract with A, and B is prohibited from supplying A through another factory or third-party suppliers. Entity A has not contracted for substantially all of B's factory's capacity.

The required quantities of API are established in the contract at inception. Entity B makes all of the decisions about the factory's operations, including when to run the factory to satisfy the required quantities and which customer orders to fulfill.

The contract does not contain a lease. The factory is an identified asset because it is implicit that B can fulfill the contract only through the use of the specific factory. However, A does not have the "right to obtain substantially all of the economic benefits from use of [an identified] asset" since the amount of capacity A has contracted for does not represent substantially all of the factory's capacity. In addition, A does not have the "right to direct the use of that asset." While A may specify quantities of product, B has the right to direct the factory's use because it can determine when to run the factory and which customer contracts to fulfill. As a result, A does not meet the new leases standard's criterion of directing "how and for what purpose" the factory is being used, and the arrangement is not a lease.

Q&A 11-1 Determining Whether a Service Arrangement Contains a Lease

Question

Does an entity need to evaluate a service arrangement that involves the use of PP&E to determine whether the arrangement contains a lease?

Answer

Yes. In accordance with ASC 842-10-15-2, an entity is required at contract inception to identify whether a contract contains a lease. Not all contracts that contain accounting leases will be labeled as such, and accounting leases may be embedded in larger service arrangements.

Failure to identify accounting leases, including those embedded in service arrangements, could lead to a financial statement error. On the other hand, if a customer concludes that a contract is a service arrangement and that contract does not contain an embedded lease, the customer is not required to reflect the contract on its balance sheet (unless required to do so by other U.S. GAAP). The outcome of the accounting assessment of the contract may be more material to the financial statements under ASC 842 than under current U.S. GAAP since under ASC 840, the impact of operating leases on the financial statements is often the same as that of service arrangements.

Connecting the Dots

Historically, the accounting for operating leases under ASC 840 has generally not been materially different from the accounting for service contracts. However, under ASC 842, since most leases will be recognized on the balance sheet, the financial statement implications of not identifying a lease in a service contract could be more significant than under ASC 840.

For example, under ASC 840, "placed equipment" by a medical device entity may not have represented an identified asset if it was demonstrated that substitution rights existed, which could result in a conclusion that the placed equipment did not represent a lease. Under ASC 842, however, for a medical device entity to conclude that it has a substantive substitution right, it would have to demonstrate not only that it has the practical ability to substitute the placed equipment but also that it would benefit economically from the exercise of its right to substitute the asset. As a result, it is possible that more arrangements that allow for placed equipment will represent an identified asset under ASC 842.

Example 11-2

Placement of Medical Device With Sale of Consumables

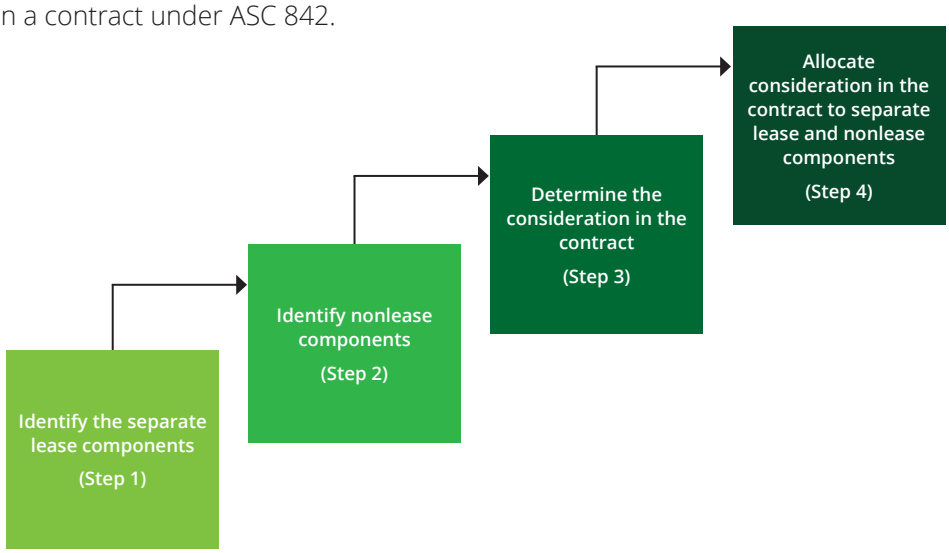
Entity C is a medical device manufacturer that supplies diagnostic kits to customers. The kits can be used only on instruments manufactured by C. Entity C provides its customers with the right to use its instruments at no separate cost to the customer in exchange for a multiyear agreement to purchase annual minimum quantities of diagnostic kits. The term of the agreement generally corresponds with the expected useful life of the instruments. Entity C retains title to the instruments and is permitted to substitute them under the terms of the contract, although historically these instruments have been substituted only when they malfunction given that C does not benefit economically from the exercise of its right to substitute the asset.

The multiyear agreement to purchase diagnostic kits contains an embedded lease for the instrument system. The instrument system is an identified asset because it is implicit that C can fulfill the contract only through the customers' use of the specific instruments. Although C has the right to substitute the instruments, the substitution right is not substantive because of the lack of economic benefit from doing so. In addition, customers have the right to control the instruments' use because they have the right to obtain substantially all of the economic benefits from the use of the instruments during the multiyear term of the contract, which corresponds to the useful life of the instruments. Further, customers can make decisions about how and when the instruments are used when the customers perform diagnostic testing procedures.

11.2 Components of a Contract

A contract can contain both lease and nonlease components. Generally, the nonlease components are services that the supplier is also performing for the customer. For example, in a single contract, the supplier could be leasing a lab facility and related laboratory equipment to a biotechnology customer while also agreeing to provide ongoing maintenance services for the equipment throughout the period of use. Contracts may contain multiple lease components (e.g., leases of land, buildings, and equipment).

The graphic below outlines steps related to considering how to separate, and allocate consideration to, components in a contract under ASC 842.



Identify the separate lease components (Step 1)

Once an entity determines that a contract is, or contains, a lease (i.e., part or all of the contract is a lease), the entity (i.e., both the customer and the supplier) must assess whether the contract contains multiple lease components (i.e., when a contract conveys the rights to use multiple underlying assets). ASC 842-10-15-28(a) and (b) prescribe criteria for identifying whether one lease component is considered separate from other lease components in the contract.

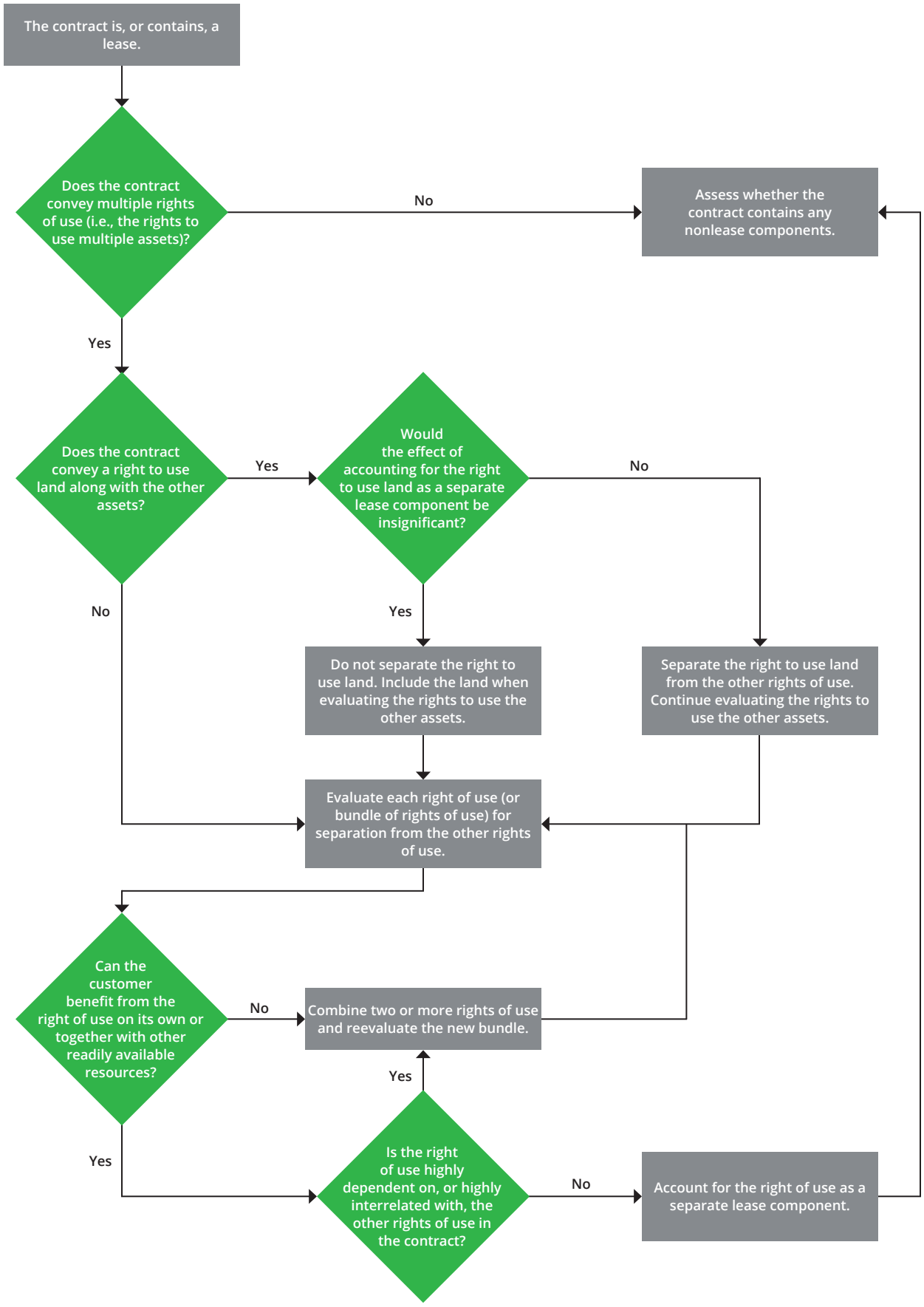
However, land is considered an exception to the guidance in ASC 842-10-15-28. ASC 842-10-15-29 requires that a right to use land be separated from the rights to use other underlying assets (e.g., from the right to use a building that sits on top of the land), unless the effect of separating the land is insignificant to the resulting lease accounting.

Connecting the Dots

The new leases standard indicates that it is important for an entity to identify the appropriate unit of account when applying the lessee or lessor accounting models since the unit of account can affect the allocation of consideration to the components in the contract. Paragraph BC145 of ASU 2016-02 states, in part:

> By way of example, regarding allocation, the Board noted that the standalone price (observable or estimated) for a bundled offering (for example, the lease of a data center) may be substantially different from the sum of the standalone prices for separate leases of the items within a bundled offering (for example, the lease of each asset in the data center). Given the substantially different accounting for lease and nonlease components in Topic 842, the allocation of contract consideration carries additional importance as compared with previous GAAP. Consequently, the Board concluded that including separate lease components guidance in Topic 842 will result in more accurate accounting that also is more consistent among entities.

The decision tree on the following page illustrates how an entity might think about identifying lease and nonlease components for each contract containing a lease.


The contract is, or contains, a lease.
Does the contract convey multiple rights of use (i.e., the rights to use multiple assets)?
No
Assess whether the contract contains any nonlease components.
Yes
Does the contract convey a right to use land along with the other assets?
Yes
Would the effect of accounting for the right to use land as a separate lease component be insignificant?
No
No
Yes
Do not separate the right to use land. Include the land when evaluating the rights to use the other assets.
Separate the right to use land from the other rights of use. Continue evaluating the rights to use the other assets.
Evaluate each right of use (or bundle of rights of use) for separation from the other rights of use.
Can the customer benefit from the right of use on its own or together with other readily available resources?
No
Combine two or more rights of use and reevaluate the new bundle.
Yes
Yes
Is the right of use highly dependent on, or highly interrelated with, the other rights of use in the contract?
No
Account for the right of use as a separate lease component.

Identify nonlease components (Step 2)

Once the separate lease components are identified, entities must determine whether there are any nonlease components to be separated. An allocation of contract consideration is required for both lease and nonlease components, since they transfer a good or service to the customer. However, allocation of contract consideration does not extend to activities that do not transfer a good or service to the customer (e.g., administrative tasks and reimbursement or payment of the lessor's costs).

Understanding the difference between lease components, nonlease components, and "noncomponents" (i.e., activities paid for by the customer that do not transfer a good or service to the customer) is critical. The table below outlines these three types of components in greater detail.

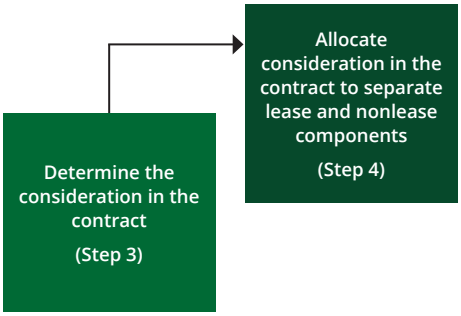
Lease Component	The right to use an underlying asset is considered a separate lease component if (1) a lessee can benefit from the use of the underlying asset either on its own or with other resources that are readily available and (2) the underlying asset is not highly dependent on or highly interrelated with other assets in the arrangement.
Nonlease Component	An activity that transfers a separate good or service to the customer is a nonlease component. For example, maintenance services consumed by the customer and bundled with the lease component in the contract would be a separate nonlease component because the performance of the maintenance transfers a service to the customer that is separate from the right to use the asset.
Noncomponent	Any activity in a contract that does not transfer a separate good or service to the lessee is neither a lease component nor a nonlease component; therefore, consideration in the contract would not be allocated to such an activity. For example, payments made by the customer for property taxes or insurance that covers the supplier's interests would not represent a component in the contract.

ASC 842 affords lessees a practical expedient related to separating (and allocating consideration to) lease and nonlease components. That is, lessees may elect to account for the nonlease components in a contract as part of the single lease component to which they are related. The practical expedient is an accounting policy election that must be made by class of underlying asset (e.g., vehicles, information technology (IT) equipment — see the Connecting the Dots discussion below). Accordingly, when a lessee elects the practical expedient, any portion of consideration in the contract that would otherwise be allocated to the nonlease components will instead be accounted for as part of the related lease component for classification, recognition, and measurement purposes. In addition, any payments related to noncomponents would be accounted for as part of the related lease component (i.e., the associated payments would not be allocated between the lease and nonlease components).

In July 2018, the FASB approved amendments containing a new practical expedient under which lessors can elect *not* to separate lease and nonlease components (see ASU 2018-11 for details).

At this point, entities have identified their separate lease and nonlease components to which consideration in the contract will be allocated. Noncomponents have also been identified to ensure that consideration in the contract is not allocated to them. Next, entities must:

- Determine the consideration in the contract.
- Allocate the consideration in the contract to the separate lease and nonlease components.



Connecting the Dots

ASC 842 provides lessees with the following two practical expedients that may be elected as an accounting policy by "class of underlying asset":

- It allows lessees not to separate lease and nonlease components.
- It allows lessees not to recognize lease liabilities and ROU assets for short-term leases (those under 12 months).

However, ASC 842 does not address what is meant by the phrase "class of underlying asset." We have received a number of questions about this topic from various stakeholders, and two views have emerged:

- *View 1* — The class of underlying asset is determined on the basis of the physical nature and characteristics of the asset. For example, real estate, manufacturing equipment, and vehicles would all be reasonable classes of underlying assets given their differences in physical nature. Therefore, irrespective of whether there are different types of similar assets (e.g., within the real estate class, there may be retail stores, warehouses, and distribution centers), the class of underlying asset would be limited to the physical nature as described above.
- *View 2* — The class of underlying asset is determined on the basis of the risks associated with the asset. While an asset's physical nature may be similar to that of other assets (e.g., retail stores, warehouses, and distribution centers are all real estate, as discussed above), each has a different purpose and use to the lessee and would therefore have a separate risk profile. Therefore, for example, it could be appropriate for the lessee to disaggregate real estate assets into separate asset classes by "type" of real estate — to the extent that the different types are subject to different risks — when applying the practical expedients in ASC 842-10-15-37 and ASC 842-20-25-2.

To support their position, proponents of View 2 refer to paragraph BC341 of ASU 2016-02, which states:

> The Board decided that a lessor should treat assets subject to operating leases as a major class of depreciable assets, further distinguished by significant class of underlying asset. Accordingly, a lessor should provide the required property, plant, and equipment disclosures for assets subject to operating leases separately from owned assets held and used by the lessor. **In the Board's view, leased assets often are subject to different risks than owned assets that are held and used** (for example, the decrease in the value of the underlying asset in a lease could be due to several factors that are not within the control of the lessor), and, therefore, users will benefit from lessors segregating their disclosures related to assets subject to operating leases from disclosures related to other owned property, plant, and equipment. **The Board further considered that to provide useful information to users, the lessor should disaggregate its disclosures in this regard by significant class of underlying asset subject to lease because the risk related to one class of underlying asset (for example, airplanes) may be very different from another (for example, land or buildings).** [Emphasis added]

Views on these questions are still developing. Therefore, we recommend that entities with concerns about such matters discuss them with their accounting advisers.

Irrespective of the views noted above, we do not think that it would be appropriate to determine the "class of underlying asset" on the basis of the lease contract with which it is associated. For example, we believe that it would be inappropriate to break real estate assets into different classes on the basis of whether they are related to gross leases or triple net leases. In that situation, the asset underlying the contract could be the same while the contract terms differ. We do not believe that such an approach is consistent with the intent of the guidance in ASC 842-10-15-37 or ASC 842-20-25-2.

11.3 Lease Classification — Lessee

Under ASC 842, at lease commencement, a lease is classified as a finance lease (for a lessee) or a sales-type lease (for a lessor) if any of the following criteria are met:

- "The lease transfers ownership of the underlying asset to the lessee by the end of the lease term."
- "The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise."
- "The lease term is for the major part of the remaining economic life of the underlying asset."
- "The present value of the sum of the lease payments and any residual value guaranteed by the lessee . . . equals or exceeds substantially all of the fair value of the underlying asset."
- "The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term."

Finance leases are accounted for in a manner similar to how entities account for a financed purchase arrangement. The lessee recognizes interest expense and amortization of the ROU asset, which result in a greater expense in the early years of the lease than in the later years of the lease. The ROU asset related to an operating lease is amortized to expense on a straight-line basis unless another systematic and rational basis is more representative of the pattern in which benefit is expected to be derived from the right to use the underlying asset. For both types of leases, the lessee recognizes an ROU asset for its interest in the underlying asset and a corresponding lease liability.

Connecting the Dots

While many aspects of the lease classification criteria under ASC 842 are consistent with existing guidance, bright-line tests (i.e., whether the lease term is for 75 percent or more of the economic life of the asset or whether the present value of the lease payments, including any guaranteed residual value, is at least 90 percent of the fair value of the leased asset) are noticeably absent. However, ASC 842-10-55-2 states that these tests are "one reasonable approach to assessing the criteria." On the basis of this implementation guidance, entities often can use bright-line thresholds as policy elections when evaluating the classification of a lease arrangement under the new leases standard. However, as with all policy elections, it is important for entities to consider the full range of impact and the need for policy elections to be consistently applied.

11.4 Lessor Accounting

After proposing multiple different amendments to lessor accounting, the FASB ultimately decided to make only minor modifications to the current lessor model. The most significant changes (1) align the profit recognition requirements under the lessor model with the new revenue standard and (2) amend the lease classification criteria for a lessor to make them consistent with those for a lessee. Accordingly, the new leases standard requires a lessor to use the classification criteria discussed above to classify a lease, at its commencement, as a sales-type lease, a direct financing lease, or an operating lease.

Accounting for existing leveraged leases (leases that met the criteria in ASC 840-10-25-43(c)) is grandfathered during transition. Otherwise, leveraged lease accounting is eliminated going forward from the date of adoption.

Q&A 11-2 Commencement Loss Resulting From Significant Variable Payments in a Sales-Type or Direct Financing Lease

While the FASB's goal was to align lessor accounting with the revenue guidance in ASC 606, an important distinction between the two may affect lessors in the life sciences industry. Under ASC 606, variable payments are estimated and included in the transaction price, subject to a constraint. By contrast, under ASC 842, variable lease payments not linked to an index or rate are generally excluded from the determination of a lessor's lease receivable. Accordingly, sales-type or direct financing leases that have a significant variable lease payment may result in recognition of a loss at commencement because the measurement of the lease receivable plus the unguaranteed residual asset is less than the net carrying value of the underlying asset.

For example, it is not uncommon for a hospital to contract with a medical device owner for the use of specific medical equipment for a major part of the economic life of the equipment. This type of arrangement is often priced in such a way that the consideration is based entirely on the hospital's ongoing purchase of "consumables," which allow the equipment to function as designed, and may have no minimum volume requirement. The medical device owner is willing to accept variable consideration in the arrangement because demand for the associated health care services suggests that a sufficient volume of consumables will be purchased by the hospital over the term of the contract to make the arrangement profitable.

Question

Should a lessor recognize a loss at lease commencement when its initial measurement of the net investment in a sales-type or direct financing lease is less than the carrying value of the underlying asset?

Answer

Yes. At the FASB's November 30, 2016, meeting, the Board acknowledged that a lessor's initial measurement of a sales-type or direct financing lease that includes a significant variable lease payment component may result in a loss at lease commencement if the lease receivable plus the unguaranteed residual asset is less than the net carrying value of the underlying asset being leased. The Board discussed whether a loss at commencement would be appropriate in these situations or whether other possible approaches would be acceptable, such as (1) incorporating variable lease payments subject to a constraint (by reference to ASC 606) or (2) using a negative discount rate to avoid the loss at commencement. The Board expressed its belief that while stakeholders may disagree with the outcome of recognizing a loss at commencement, the new leases standard is clear about how the initial measurement guidance should be applied to sales-type and direct financing leases.

11.5 Lease Modifications

A lease modification is any change to the contractual terms and conditions of a lease. Under the new leases standard, a lease modification is accounted for as follows:

- A lessee or lessor accounts for a lease modification as a separate contract (i.e., separate from the original lease) when the modification (1) grants the lessee an additional ROU asset and (2) the price of the additional ROU asset is commensurate with its stand-alone price.
- A lessee accounts for a lease modification that is not a separate contract by using the discount rate as of the modification effective date to adjust the lease liability and ROU asset for the change in the lease payments. The modification may result in a gain or loss if the modification results in a full or partial termination of an existing lease.
- A lessor accounts for a lease modification in a manner that is generally consistent with the contract modification guidance in ASC 606.

Example 11-3

Lease Modifications

Scenario 1 — Modification Resulting in a Separate Contract

Company A, a pharmaceutical entity (the lessee), enters into an arrangement to lease 15,000 square feet of office space in a complex for 20 years. At the beginning of year 10, A and the lessor agree to amend the original lease to include an additional 5,000 square feet of space adjacent to the existing space currently being leased when the current tenant vacates the property in 18 months. The increase in lease consideration as a result of the amendment is commensurate with the market rate for the additional 5,000 square feet of space in the complex. Company A would account for this modification (i.e., the lease of the additional 5,000 square feet) as a separate contract because the modification provides A with a new ROU asset at a price that reflects that asset's stand-alone price. While A would be required to disclose certain information about the lease modification, it would not be required to separately record any amounts in its statement of financial position until the separate lease's commencement date (i.e., 18 months from entering into the modification).

Scenario 2 — Modification Not Resulting in a Separate Contract

Company A, a pharmaceutical entity (the lessee), enters into an arrangement to lease 15,000 square feet of office space in a complex for 20 years. At the beginning of year 10, A and the lessor agree to amend the original lease by reducing the annual rental payments from $60,000 to $50,000 for the remaining 10 years of the agreement. Because the modification results in a change only to the lease consideration (i.e., the modification does not result in an additional ROU asset), A would remeasure its lease liability to reflect (1) a 10-year lease term, (2) annual lease payments of $50,000, and (3) A's incremental borrowing rate (or the rate the lessor charges the lessee if such rate is readily determinable) as of the modification effective date. Company A would recognize the difference between the new and old lease liabilities as an adjustment to the ROU asset.

11.6 Subleases

When the original lessee subleases the leased asset to an unrelated third party, the lessee becomes the intermediate lessor in the sublease arrangement. As the intermediate lessor of a leased asset, the entity would determine the classification of the sublease independently from its determination of the classification of the original lease (i.e., the head lease). Under the new leases standard, the intermediate lessor would classify the sublease on the basis of the underlying asset (i.e., it would assess the term of the sublease relative to the remaining economic life of the underlying asset). When evaluating lease classification and measuring the net investment in a sublease classified as a sales-type or direct financing lease, the original lessee (as a sublessor) should use the rate implicit in the lease if it is determinable. If the implicit rate is not determinable, the original lessee would use the discount rate that it used to determine the classification of the original lease.

In addition, offsetting is generally prohibited on the balance sheet and in the income statement unless the arrangement meets the offsetting requirements of ASC 210-20.

Example 11-4

Accounting for a Sublease Under ASC 842

As a lessee, Company A, a life sciences entity, enters into a building lease with a 30-year term. The building has a depreciable life of 40 years. At the end of year 5, A enters into an agreement with Company B, a generics and consumer health entity, under which A subleases the building to B for 20 years.

As the lessor in its agreement with B, A would account for the lease to B (the sublease) as an operating lease because (1) the term of the sublease is not for a major part of the remaining life of the underlying asset of the sublease (i.e., the sublease term of 20 years represents only 57 percent of the remaining 35-year life of the building) and (2) A has concluded that no other classification criteria would result in the transfer of control of the underlying asset.

11.7 Sale-and-Leaseback Transactions

The seller-lessee in a sale-and-leaseback transaction must evaluate the transfer of the underlying asset (sale) under the requirements of ASC 606 to determine whether the transfer qualifies as a sale (i.e., whether control has been transferred to the customer). The existence of a leaseback by itself would not preclude the transaction from qualifying as a sale (i.e., it would not indicate that control has not been transferred) unless the leaseback is classified as a finance lease. In addition, if the arrangement includes an option for the seller-lessee to repurchase the asset, the transaction would not qualify as a sale unless both of the following criteria are met:

- The option is priced at the fair value of the asset on the date of exercise (see below regarding sale-and-leaseback transactions involving real estate).
- There are alternative assets that are substantially the same as the transferred asset and readily available in the marketplace.

If the transaction does not qualify as a sale, the seller-lessee and buyer-lessor would account for the transaction as a financing arrangement (i.e., the buyer-lessor would account for its payment as a financial asset and the seller-lessee would record a financial liability).

If the transaction qualifies as a sale, the leaseback is accounted for in the same manner as all other leases (i.e., the seller-lessee and buyer-lessor would account for the leaseback under the new accounting guidance for lessees and lessors, respectively).

Q&A 11-3 Whether a Seller-Lessee Repurchase Option in a Sale and Leaseback of Real Estate Precludes Treatment of the Transfer as a Sale

Question

Would the inclusion of a seller-lessee repurchase option in a sale and leaseback of real estate preclude the transfer from qualifying as a sale under ASC 606?

Answer

Yes. Sale-and-leaseback transactions involving real estate that include a repurchase option will not meet the criteria of a sale under ASC 606 regardless of whether the repurchase option is priced at fair value. During the FASB's redeliberations on ASU 2016-02, the Board noted that sale-and-leaseback transactions involving real estate that include a repurchase option would not meet the second criterion in ASC 842-40-25-3. Paragraph BC352(c) of ASU 2016-02 states, in part:

> When the Board discussed [ASC 842-40-25-3], Board members generally observed that real estate assets would not meet criterion (2). This is because real estate is, by nature, "unique" (that is, no two pieces of land occupy the same space on this planet) such that no other similar real estate asset is "substantially the same."

Therefore, regardless of whether the repurchase option is priced at fair value, the unique nature of real estate would prevent a sale-and-leaseback transaction involving real estate that includes a repurchase option from satisfying the second criterion in ASC 842-40-25-3 since there would be no alternative asset that is substantially the same as the one being leased. Accordingly, in a manner similar to current U.S. GAAP, the new leases standard would preclude sale-and-leaseback accounting for transactions involving any repurchase options on real estate.

11.8 Effective Date and Transition

For PBEs, the new leases standard is effective for fiscal years beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), including interim periods therein. For all other entities, the standard is effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods beginning after December 15, 2020. Early adoption is permitted. Entities are required to use a modified retrospective transition method of adoption. The FASB also issued ASU 2018-11 so that entities may elect not to recast their comparative periods in transition (the "Comparatives Under 840 Option"). See Section 11.9.

11.8.1 Additional Implementation Considerations

Discussed below are some of the additional implementation considerations that life sciences entities should thoughtfully address while transitioning to ASC 842. For further discussion, see Deloitte's October 17, 2018; August 7, 2018; December 5, 2017; April 25, 2017; and March 1, 2016 (updated July 12, 2016), *Heads Up* newsletters.

11.8.1.1 Operational Considerations

To implement the lessee accounting requirements, all individual contracts and arrangements will need to be collected, maintained, and evaluated, including information related to real estate contracts and equipment contracts (e.g., manufacturing equipment, laboratory equipment). In addition, it may be necessary to obtain information outside of contractual arrangements, including (1) the fair value of an asset, (2) the asset's estimated useful life, (3) the incremental borrowing rate, and (4) certain judgments related to lease options. The ability to acquire this data may be particularly challenging when contract documentation is prepared in a foreign language and could vary as a result of local business practices.

11.8.1.1.1 Materiality Threshold

When implementing the lessee accounting requirements, life sciences companies are likely to consider a materiality threshold, especially for high volume, low value, leased assets (e.g., laptops). As discussed further in Q&A 2-1 of Deloitte's *A Roadmap to Applying the New Leasing Standard*, ASC 842 does not contain a "small-ticket item" exception similar to that in IFRS 16. Although materiality is generally a consideration in the application of all accounting standards, life sciences entities should not simply default to their existing capitalization threshold for PP&E for the following reasons:

- The existing capitalization threshold for PP&E is unlikely to include the effect of the additional asset base introduced by the ASU. That is, the addition of another set of ROU assets not previously recognized on an entity's balance sheet may require a refreshed analysis of the entity's capitalization thresholds to ensure that the aggregated amounts will not become material.
- The existing capitalization threshold for PP&E does not take into account the liability impact to the balance sheet. Under ASC 842, if an entity wishes to establish a threshold that will be used to avoid accounting for both ROU assets and lease liabilities on the balance sheet, it must consider the materiality, in the aggregate, of all of its ROU assets and related lease liabilities that would be excluded when it adopts such a threshold.

One reasonable approach to developing a capitalization threshold for leases may be to use the **lesser** of the following:

- A capitalization threshold for PP&E, including ROU assets (i.e., the threshold takes into account the effect of leased assets determined in accordance with ASU 2016-02).
- A recognition threshold for liabilities that takes into account the effect of lease liabilities determined in accordance with the ASU.

Another reasonable approach to developing a capitalization threshold for leases may be to record all lease liabilities but to subject the related ROU assets to such a threshold. Under this approach, if an ROU asset is below the established capitalization threshold, it would immediately be recognized as an expense. In subsequent periods, entities would amortize the lease liability by using the effective interest method, under which a portion of the periodic lease payments would reduce the liability and the remainder would be recognized as interest expense.

11.8.1.1.2 Variable Expense

Life sciences entities will mostly likely have contracts with variable lease payments (e.g., international real estate contracts with index-based payment escalations). Entities may find it necessary to create a new general ledger account to track variable lease costs for disclosure purposes in accordance with ASC 842-20-50-4 and to consider impacts of variable lease payments on the accounts payable process.

11.8.1.2 Application of Judgment and Estimation

Entities must use judgment and make estimates under a number of the new as well as current leases requirements. Judgment is often required in the assessment of a lease's term, which would affect whether the lease qualifies for the short-term exemption and therefore for off-balance-sheet treatment. In addition, since almost all leases will be recognized on the balance sheet, judgment in distinguishing between leases and services becomes more critical under the new guidance.

11.8.1.2.1 Discount Rates

In particular, upon transition, entities will need to recognize ROU assets and lease obligations by using an appropriate discount rate on the date of transition. Compliance with this requirement may be difficult for entities with a significant number of leases since they will need to identify the appropriate incremental borrowing rate for each lease on the basis of factors associated with the underlying lease terms (e.g., lease tenor, asset type, residual value guarantees). That is, entities would not be permitted to use the same discount rate for all of their leases unless the leased assets and related terms are similar.

Additional considerations include:

- *Secured versus unsecured rate* — The definition of the incremental borrowing rate under ASC 842 requires lessees to obtain a collateralized or secured borrowing rate. Unsecured rates are likely to be higher, which would result in a lower lease liability. If a lessee does not borrow on a secured basis, it will most likely need to make adjustments to its unsecured borrowing rates to reflect a rate of a secured borrowing.
- *Parent versus subsidiary rate* — Sometimes it may be appropriate for a subsidiary to use an incremental borrowing rate other than its own. This will depend on the nature of the lease negotiations and the resulting terms and conditions (e.g., a consolidated group with a centralized treasury function that negotiates on behalf of all of its subsidiaries to benefit from its superior credit).
- *Leases denominated in a foreign currency* — When determining an incremental borrowing rate for a lease denominated in a foreign currency, entities should use assumptions that are consistent with a rate that the entities would obtain to borrow in the same currency in which the lease is denominated. The incremental borrowing rate should still reflect a collateralized rate in the relevant foreign environment.
- *Discount rate in transition* — Entities should determine the discount rate as of the effective date of ASC 842 when initially measuring lease liabilities (assuming the entities continue to account for comparative periods under ASC 840). When selecting a discount rate, entities should elect as an accounting policy (and consistently apply to all contracts) to use either an interest rate corresponding to the original lease term or an interest rate corresponding to the remaining lease term.
- *Developing a method* — Life sciences entities should define a method for calculating the incremental borrowing rate that is auditable and supportable as of the transition date and on an ongoing basis.

11.8.1.3 Information Technology Systems

As a result of implementing the requirements of the new leases standard, life sciences entities will most likely need to enhance their existing IT systems. The extent of the enhancements will be based on the size and complexity of an entity's lease portfolio and its existing leasing systems. As with any change to existing systems, an entity will need to consider the business ramifications (i.e., the potential impact on existing processes, systems, and controls) and the requirements of system users (e.g., the entity's legal, tax, financial planning and analysis, real estate, treasury, and financial reporting functions). Also, management may need to consider system changes that will enable the entity to estimate, before adoption of ASU 2016-02, the ASU's effect on key performance indicators and metrics, tax filings, debt covenants, or other filings. In addition, to the extent that an entity prepares IFRS statutory reports for foreign subsidiaries, its systems will need to distinguish between ASU 2016-02 and IFRS 16 and will need to be equipped to handle the differences between the two standards.

11.8.1.4 Income Taxes

A lease's classification for accounting purposes does not affect its classification for tax purposes. A life sciences entity will therefore continue to be required to determine the tax classification of a lease under the applicable tax laws. While the classification may be similar for either purpose, the differences in tax and accounting principles and guidance often result in book/tax differences. Thus, once an entity implements the new leases standard, it will need to establish a process to account for these differences. The requirement that entities reevaluate their leases under the new guidance also presents an opportunity for entities to reassess the tax treatment of such leases as well as their data collection and processes. Since the IRS considers a taxpayer's tax treatment of leases to be a method of accounting, any changes to existing methods may require IRS consent. Entities should also consider the potential state tax issues that may arise as a result of the new guidance, including how the classification of the ROU asset may affect the apportionment formula in the determination of state taxable income and how the significant increase in recorded lease assets could affect the determination of franchise tax payable.

11.8.1.5 Covenant Considerations

Given the requirement to bring most leases onto the balance sheet, many companies, including those in the life sciences industry, will reflect additional liabilities on their balance sheets after adopting the new leases standard. An entity's determination of whether the increased leverage will negatively affect any key metrics or potentially cause debt covenant violations is a critical aspect of its planning for the new standard's implementation. This determination may depend, in part, on how various debt agreements define and limit indebtedness as well as on whether the debt agreements use "frozen GAAP" covenants (i.e., covenants that are based on GAAP at the time the debt was issued). ASU 2016-02 requires presentation of operating lease liabilities outside traditional debt, which may provide relief. Regardless, we believe that it will be critical for all life sciences entities to determine the potential effects of ASU 2016-02 on debt covenants and begin discussions with lenders early if they believe that violations are likely to occur as a result of adopting the ASU.

11.9 Amendments to New Leases Standard

The FASB received comments on ASC 842 and deliberated on several issues that had been raised. As a result of these discussions, the Board issued the following ASUs that amend certain aspects of ASC 842:

- *ASU 2018-10 on improvements to ASC 842* — In July 2018, the FASB issued ASU 2018-10, which makes 16 narrow-scope amendments (i.e., minor changes and clarifications) to certain aspects of ASC 842.
- *ASU 2018-11 on targeted improvements to ASC 842* — In July 2018, the FASB issued ASU 2018-11 to provide entities with relief from the costs of implementing certain aspects of the new leases standard. Specifically, under the amendments in ASU 2018-11:
  - Entities may elect not to recast the comparative periods presented when transitioning to ASC 842.
  - Lessors may elect not to separate lease and nonlease components when certain conditions are met.

For further discussion, see Deloitte's August 7, 2018, *Heads Up*.

11.10 Land Easement Practical Expedient for Transition to ASC 842 (ASU 2018-01)

11.10.1 Background

Various stakeholders raised questions about how ASC 842 should be applied to land easements. Also known as rights of way, land easements represent the right to use, access, or cross another entity's land for a specified purpose. In January 2018, the FASB issued ASU 2018-01, which allows an entity, as an optional transition practical expedient, not to apply ASC 842 to existing or expired land easements that it did not previously account for as leases under ASC 840.

11.10.2 Key Provisions

An entity that elects to use the practical expedient in ASU 2018-01 should evaluate under ASC 842 new or modified land easements (i.e., land easements that were entered into or modified on or after the date of adoption of ASC 842). An entity that does not elect to use this practical expedient should evaluate all existing or expired land easements under ASC 842 to determine whether they meet the new leases standard's definition of a lease.

11.10.3 Effective Date

The amendments in ASU 2018-01 affect the amendments in ASU 2016-02. The effective date and transition requirements are the same for both ASUs. An entity that early adopted ASC 842 should apply the guidance in ASU 2018-01 as of the issuance date of that ASU.

Appendix A — Titles of Standards and Other Literature

The standards and other literature below were cited or linked to in this publication.

AICPA Literature

Accounting and Valuation Guide

Assets Acquired to Be Used in Research and Development Activities

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Audit and Accounting Guide

Revenue Recognition

Issues Paper

Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories

Other

AICPA Technical Practice Aid, Section 2260.03, "Other Assets; Legal Expenses Incurred to Defend Patent Infringement Suit"

FASB Literature

ASC Topics

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 320, *Investments — Debt and Equity Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 325, *Investments — Other*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 450, *Contingencies*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 830, *Foreign Currency Matters*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 850, *Related Party Disclosures*

ASC 855, *Subsequent Events*

ASC 915, *Development Stage Entities*

ASC 958, *Not-for-Profit Entities*

ASC 985, *Software*

ASUs

2010-20, *Receivables (Topic 310): Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers* — a consensus of the FASB Emerging Issues Task Force

2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers* — a consensus of the FASB Emerging Issues Task Force

2014-02, *Intangibles — Goodwill and Other (Topic 350): Accounting for Goodwill* — a consensus of the Private Company Council

2014-09, *Revenue From Contracts With Customers (Topic 606)*

2014-10, *Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810,* Consolidation

2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*

2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force

2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*

2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*

2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

2016-02, *Leases (Topic 842)*

2016-04, *Liabilities — Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Store-Valued Products* — a consensus of the FASB Emerging Issues Task Force

2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*

2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the FASB Emerging Issues Task Force

2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*

2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*

2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

2016-20, *Technical Corrections and Improvements to Topic 606,* Revenue From Contracts With Customers

2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*

2017-05, *Other Income — Gains and Losses From the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*

2017-07, *Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

2017-11, *Earnings per Share (Topic 260); Distinguishing Liabilities From Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments With Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*

2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

2017-13, *Revenue Recognition (Topic 605), Revenue From Contracts With Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments* (SEC Update)

2017-14, *Income Statement — Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue From Contracts With Customers (Topic 606)* (SEC Update)

2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*

2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*

2018-03, *Technical Corrections and Improvements to Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

2018-07, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

2018-08, *Not-For-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

2018-10, *Codification Improvements to Topic 842,* Leases

2018-11, *Leases (Topic 842): Targeted Improvements*

2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement*

2018-14, *Compensation — Retirement Benefits — Defined Benefit Plans — General (Subtopic 715-20): Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans*

2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction Between Topic 808 and Topic 606*

Concepts Statements

No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

No. 6, *Elements of Financial Statements*

No. 8, *Conceptual Framework for Financial Reporting — Chapter 1,* The Objective of General Purpose Financial Reporting*, and Chapter 3,* Qualitative Characteristics of Useful Financial Information

Proposed ASUs

No. 2015-310, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*

No. 2015-340, *Government Assistance (Topic 832): Disclosures by Business Entities About Government Assistance*

No. 2016-270, *Income Taxes (Topic 740) Disclosure Framework — Changes to the Disclosure Requirements for Income Taxes*

No. 2017-200, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent)*

No. 2017-210, *Inventory (Topic 330): Disclosure Framework — Changes to the Disclosure Requirements for Inventory*

No. 2017-280, *Consolidation (Topic 812): Reorganization*

No. 2018-300, *Codification Improvements — Financial Instruments*

No. 2019-100, *Targeted Transition Relief for Topic 326, Financial Instruments — Credit Losses*

Other FASB Proposal

Proposed Concepts Statement 2014-200, *Conceptual Framework for Financial Reporting: Chapter 8: Notes to Financial Statements*

International Standards

IFRS 3, *Business Combinations*

IFRS 11, *Joint Arrangements*

IFRS 15, *Revenue From Contracts With Customers*

IFRS 16, *Leases*

IAS 10, *Events After the Reporting Period*

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

IRC

Section 78, "Gross Up for Deemed Paid Foreign Tax Credit"

Section 163(j), "Interest; Limitation on Business Interest"

Section 199, "Income Attributable to Domestic Production Activities"

Section 383, "Special Limitations on Certain Excess Credits, etc."

Section 409A "Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans"

Section 422, "Incentive Stock Options"

Section 423, "Employee Stock Purchase Plans"

Section 965, "Treatment of Deferred Foreign Income Upon Transition to Participation Exemption System of Taxation"

Section 4191, "Medical Devices"

PCAOB Literature

Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*

SEC Literature

FRM

Topic 1, "Registrant's Financial Information"

Topic 2, "Other Financial Statements Required"

Topic 3, "Pro Forma Financial Information"

Topic 7, "Related Party Matters"

Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"

Topic 10, "Emerging Growth Companies"

Interpretive Release

33-10403, *Updates to Commission Guidance Regarding Accounting for Sales of Vaccines and Bioterror Countermeasures to the Federal Government for Placement Into the Pediatric Vaccine Stockpile or the Strategic National Stockpile*

Regulation S-K

Item 103, "Business; Legal Proceedings"

Regulation S-X

Rule 1-02(w), "Definitions of Terms Used in Regulation S-X (17 CFR part 210); Significant Subsidiary"

Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired"

Rule 4-08(g), "General Notes to Financial Statements: Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 4-08(h), "General Notes to Financial Statements: Income Tax Expense"

Article 11, "Pro Forma Financial Information"

Rule 11-01 "Presentation Requirements"

SAB Topics

SAB Topic 1.M, "Financial Statements; Materiality"

SAB Topic 5.Y, "Miscellaneous Accounting; Accounting and Disclosures Relating to Loss Contingencies"

SAB Topic 11.A, "Miscellaneous Disclosure; Operating-Differential Subsidies"

SAB Topic 13, "Revenue Recognition"

SAB Topic 14.B, "Share-Based Payment; Transition From Nonpublic to Public Entity Status"

SAB Topic 14.D.1, "Certain Assumptions Used in Valuation Methods; Expected Volatility"

SAB Topic 14.D.2, "Certain Assumptions Used in Valuation Methods; Expected Term"

SAB 116, "Staff Accounting Bulletin No. 116"

Superseded Literature

EITF Issues

Issue 00-21, "Revenue Arrangements With Multiple Deliverables"

Issue 01-8, "Determining Whether an Arrangement Contains a Lease"

Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

Issue 08-6, "Equity Method Investment Accounting Considerations"

Issue 09-2, "Research and Development Assets Acquired in an Asset Acquisition"

Issue 09-4, "Seller Accounting for Contingent Consideration"

FASB Interpretations

No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109

FASB Statements

No. 5, *Accounting for Contingencies*

No. 123(R), *Share-Based Payment*

No. 141(R), *Business Combinations*

No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

Appendix B — Abbreviations

Abbreviation	Description
ABO	accumulated benefit obligation
AFS	available for sale
AICPA	American Institute of Certified Public Accountants
AMT	alternative minimum tax
AOCI	accumulated other comprehensive income
API	active pharmaceutical ingredient
APIC	additional paid-in capital
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
BCF	beneficial conversion feature
BEAT	base erosion anti-abuse tax
BEMTA	base erosion minimum tax amount
BOLI	bank-owned life insurance
BPD	branded prescription drug
CAM	critical audit matter
CAQ	Center for Audit Quality
CDO	chief digital officer
CECL	current expected credit loss
CFC	controlled foreign corporation
CMO	contract manufacturing organization
CODM	chief operating decision maker
COLI	corporate-owned life insurance
CRO	contract research organization
CTA	cumulative translation adjustment

Abbreviation	Description
DTA	deferred tax asset
DTL	deferred tax liability
E&P	earnings and profits
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC electronic data gathering, analysis, and retrieval system
EGC	emerging growth company
EITF	Emerging Issues Task Force
ESPP	employee stock purchase plan
EU	European Union
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FDA	Food and Drug Administration
FDII	foreign derived intangible income
FIFO	first in, first out
FOB	free on board
FRM	SEC Division of Corporation Finance Financial Reporting Manual
GAAP	generally accepted accounting principles
GILTI	global intangible low-taxed income
GPO	group purchasing organization
IAS	International Accounting Standard
IASB	International Accounting Standards Board

Abbreviation	Description
IFRS	International Financial Reporting Standard
IIR	investigator-initiated research
IP	intellectual property
IPO	initial public offering
IPR&D	in-process research and development
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISO	incentive stock option
IT	information technology
JOBS Act	Jumpstart Our Business Startups Act
LIFO	last in, first out
LLC	limited liability company
LP	limited partnership
M&A	merger and acquisition
MD&A	Management's Discussion & Analysis
MDET	medical device excise tax
MSL	medical science liaison
NFP	not-for-profit entity
NOL	net operating loss
NQSO	non-qualified stock option
NSO	nonstatutory option
OCI	other comprehensive income
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturer
PBE	public business entity
PBO	projected benefit obligation

Abbreviation	Description
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PCD asset	purchased financial asset with credit deterioration
PP&E	property, plant, and equipment
PRV	priority review voucher
PTRS	probability of technical and regulatory success
Q&A	question and answer
R&D	research and development
R&E	research and experimentation
REMS	risk evaluation and mitigation strategy
ROI	return on investment
ROU	right of use
SAB	Staff Accounting Bulletin
SAC	subjective acceleration clause
SEC	Securities and Exchange Commission
SFC	specified foreign corporation
SIFMA	Securities Industry and Financial Markets Association
S&P 500	Standard & Poor's 500 Index
TD	Treasury Decision
TPA	AICPA Technical Practice Aid
TRG	transition resource group
UTB	unrecognized tax benefit
VIE	variable interest entity
VWAP	volume-weighted average daily market price