

FOR PUBLICATION

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

JAMES EVERETT HUNT; JUAN
RODRIGUEZ; KURT VOUTAZ;
JOEL WHITE; ANDREW AUSTIN;
SCOTT KLINE; RYAN FISHMAN,

Plaintiffs - Appellants,

v.

PRICEWATERHOUSECOOPERS
LLP (PWC),

Defendant - Appellee,

and

BLOOM ENERGY
CORPORATION, JP MORGAN
SECURITIES, LLC, MORGAN
STANLEY SMITH BARNEY, LLC,
CREDIT SUISSE SECURITIES
(USA) LLC, KEYBANC CAPITAL
MARKETS INC., MERRILL
LYNCH, PIERCE, FENNER &
SMITH INCORPORATED,
ROBERT W. BAIRD & CO.
INCORPORATED, COWEN AND
COMPANY, LLC, HSBC

No. 24-3568

D.C. No.
4:19-cv-02935-
HSG

OPINION

SECURITIES (USA) INC.,
OPPENHEIMER & CO. INC.,
RAYMOND JAMES &
ASSOCIATES, INC.,

Defendants.

Appeal from the United States District Court
for the Northern District of California
Haywood S. Gilliam, Jr., District Judge, Presiding

Argued and Submitted June 11, 2025
San Francisco, California

Filed November 10, 2025

Before: Milan D. Smith, Jr. and N. Randy Smith, Circuit
Judges, and Douglas L. Rayes, District Judge.*

Opinion by Judge N. Randy Smith

* The Honorable Douglas L. Rayes, United States District Judge for the District of Arizona, sitting by designation.

SUMMARY**

Securities Law

The panel affirmed the district court’s dismissal of claims under § 11 of the Securities Act of 1933 against PriceWaterhouseCoopers LLP (PwC), an outside accountant for Bloom Energy Corp., based on an audit opinion on Bloom Energy’s financial statements included with its registration statement for an initial public stock offering.

At issue was the manner in which Bloom Energy, a designer, manufacturer, and seller of fuel-cell servers that converted natural gas or biogas into electricity for on-site power generation, accounted for Managed Services Agreements (MSAs), a type of sale-leaseback arrangement. On appeal, plaintiffs challenged the alleged incorrect statements of revenue, net loss, and net loss per share in Bloom Energy’s 2017 financial statement, due to the improper treatment of MSAs as operating rather than capital leases.

The panel held that under § 11, an independent accountant is not strictly liable for the information in a registration statement or a client’s financial statements simply because the accountant certified the financial statements prepared by the issuer. Instead, under 15 U.S.C. § 77k(b)(3)(B)(i), an independent accountant certifies the underlying statements without liability if, “after reasonable investigation, [the accountant has a] reasonable ground to believe and did believe, at the time such part of the

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

registration because effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading." Under *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175 (2015), an independent accountant is also protected from liability for its opinions (not factual statements) made about those underlying documents as long as the opinion was sincerely held.

The panel held that PwC was not liable as a preparer of Bloom Energy's financial statements. PwC also was not liable as a certifier of Bloom Energy's financial statements because PwC's audit opinion did not make any material misstatements of fact or omissions but rather was merely a statement of opinion based upon the subjective judgment of the MSA classification. The panel held that the district court's decision also must be affirmed because, under *Omnicare*, Bloom Energy's financial statements regarding classification of the MSAs were opinions.

COUNSEL

Nicholas I. Porritt (argued), Levi & Korsinsky LLP, Washington, D.C.; Adam M. Apton, Levi & Korsinsky LLP, San Francisco, California; Reed R. Kathrein and Lucas Gilmore, Hagens Berman Sobol Shapiro LLP, Berkeley, California; Kevin K. Green, Hagens Berman Sobol Shapiro LLP, San Diego, California; for Plaintiffs-Appellants.

E. Joshua Rosenkranz (argued), Eliza Lehner, and Jodie C. Liu, Orrick Herrington & Sutcliffe LLP, New York, New York; Edward H. Williams II, Orrick Herrington & Sutcliffe LLP, Washington, D.C.; Lisa Bugni, King & Spalding LLP, San Francisco, California; for Defendant-Appellee.

Linda T. Coberly, Winston & Strawn LLP, Chicago, Illinois; Lauren Gailey, Winston & Strawn LLP, Washington, D.C.; Janet Galeria and Tyler S. Badgley, U.S. Chamber Litigation Center, Washington, D.C.; Kevin Carroll, Securities Industry and Financial Markets Association, Washington, D.C.; for Amici Curiae the Chamber of Commerce of the United States of America and the Securities Industry and Financial Markets Association.

David M. Parker and Elizabeth K. Brightwell, Hunton Andrews Kurth LLP, Richmond, Virginia; Matthew P. Bosher, Hunton Andrews Kurth LLP, Washington, D.C.; for Amicus Curiae American Institute of Certified Public Accountants.

OPINION

N.R. SMITH, Circuit Judge:

Under § 11 of the Securities Act of 1933, an independent accountant is not strictly liable for the information in a Registration Statement or a client’s financial statements simply because the accountant certified the financial statements prepared by the issuer. Instead, an independent accountant certifies the underlying statements without liability if, “after reasonable investigation, [the accountant has a] reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” 15 U.S.C. § 77k(b)(3)(B)(i). Moreover, an independent accountant is also protected from liability for its opinions (not factual statements) made about those underlying documents as long as the opinion was sincerely held. *See Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 187–88 (2015).

FACTUAL BACKGROUND

Bloom Energy designs, manufactures, sells, and (in some instances) installs fuel-cell servers (Energy Servers) that convert natural gas or biogas into electricity for on-site power generation.

This case arises because of the manner in which Bloom Energy accounted for a type of contract that it used in connection with these Energy Servers; such contracts are known as Managed Services Agreements (MSA). MSAs are a type of sale-leaseback arrangement, where Bloom Energy

first sells the Energy Server to a bank and then leases it back from the bank. Bloom Energy then subleases the Energy Server to a customer, whereby Bloom Energy becomes the lessee (from the bank) and the lessor (to the customer) of the Energy Server. At the time of the lease to the customer, Bloom Energy also enters into another contract with the customer to service the Energy Server (from which customer payment for the service, Bloom Energy pays its lease to the bank and generates income for servicing the Energy Server).

Bloom Energy can account for these types of sale-leaseback arrangements in either of two ways: (1) as an “operating lease,” accounting for the revenue it earns when it sells the Energy Server to the bank; or (2) as a “capital lease,” accounting for the revenue it earns when it gets the payment from the customer over the course of the service agreement with the customer. MSAs are classified as either an operating lease or a capital lease based on specific criteria. A capital lease is recognized if it meets any of the following criteria: (1) ownership is transferred to the lessee by the end of the lease term; (2) the lease contains a bargain purchase option; (3) the lease term is at least 75% of the property’s estimated remaining economic life; or (4) the present value of the minimum lease payments is 90% or more of the fair value of the leased property. *See* Accounting Standards Codification (ASC) 840-10-25-1¹. If none of these

¹ ASC 840-10-25-1 was superseded by Topic 842 in the Accounting Standards Update 2016-02. *See* <https://asc.fasb.org/1943274/1855311/GUID-4073757B-B23C-4931-ABE0-8A1DF61EAFE4> ((last visited Oct. 29, 2025). Lease classification, as of February 25, 2016, can be found at ASC 842-10-25-2. This section does not use 75% as a benchmark but rather a majority standard (ASC 842-10-25-2(c): “[t]he lease term is for the major part of the remaining economic life of the underlying asset”). However, the

criteria are met, the MSA is classified as an operating lease. Under an operating lease, an Energy Server would not be recognized as an asset on Bloom Energy's books (because the Energy Server was sold to the bank); instead, lease payments to the bank would be recorded as an expense and payments from the customer would be recorded as revenue. In contrast, a capital lease would be recorded on Bloom Energy's balance sheet by recognizing the Energy Server as an asset with a corresponding liability to the bank.

Initially, Bloom Energy accounted for MSAs as operating leases. Bloom Energy determined that the MSAs were best classified as operating leases because the Energy Servers were not "integral equipment," as the cost to remove and relocate an Energy Server would not exceed 10% of its original installation value. Bloom Energy also determined that its MSAs failed to meet the capital lease criteria because Bloom Energy determined that Energy Servers had useful lives of 15–21 years, with typical MSAs for each Energy Server having a lease term of 6–10 years—less than 75% of the estimated life, thus not triggering capital lease treatment.

In 2018 (after more than 15 years as a private company), Bloom Energy decided to go public. To go public, it had to conduct an initial public stock offering (IPO) and file a Registration Statement with the Securities and Exchange Commission (SEC). To prepare the materials for the IPO and Registration Statement, Bloom Energy had already prepared

February 2016 amendments were not effective for public business entities until fiscal years beginning after December 15, 2018, and the parties and the district court relied upon ASC 840-10-25-1. Moreover, the district court did not find the ASC to be dispositive: "ASC 840-10-10-1 merely states the 'objectives' underlying the more detailed provisions that follow," and "[d]espite Plaintiffs' urging, it does not appear to provide the definitive method for classifying a lease."

its own financial statements for 2016, 2017, and the first quarter of 2018. It also retained responsibility for preparing all other financial statements for the IPO and Statement. However, Bloom Energy engaged PricewaterhouseCoopers LLP (PwC), as an outside accountant, to audit its 2016 and 2017 financial statements, so it could include that audit opinion with the Registration Statement.

PwC was hired to express an opinion on Bloom Energy's 2016 and 2017 financial statements based on audits. In its audits, PwC would investigate the business, operations, financial statements, and accounting of Bloom Energy. Those audits included "performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks" and "examining, on a test basis, evidence regarding the amounts and disclosure of consolidated financial statements." It also "conducted [its] audits of the[] consolidated financial statements in accordance with standards of the" Public Company Accounting Oversight Board (PCAOB).²

Following the audit, PwC concluded:

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and December 31, 2016, and the result of its operations and its cash flows for each of the two years in the period ended December 31, 2017 in conformity with accounting

² Again, PwC did not prepare the 2016 and 2017 financial statements because Bloom Energy's management had prepared them.

principles generally accepted in the United States of America.

PwC's audit did not identify any issue with Bloom Energy classifying the MSAs as operating leases under Generally Accepted Accounting Principles (GAAP) or Generally Accepted Auditing Standards (GAAS).

When Bloom Energy prepared the Registration Statement, it included the PwC audit opinion. The Registration Statement also described an MSA and how the sale-leaseback arrangement operated. The Statement expressly stated an MSA may be "classified as a capital lease or an operating lease"; that Bloom Energy "[d]etermine[d] if the leaseback [was] classified as a capital lease or an operating lease," and stated that its MSA "are classified as operating leases"; and it explained that this classification affected Bloom Energy's recognition of revenue and liabilities.

Its Registration Statement registered over 20.7 million Bloom Energy shares for sale. These shares were sold in the IPO at \$15 per share and began trading on July 25, 2018. Bloom Energy received proceeds of \$284.3 million, net of underwriting discounts, commissions, and estimated offering costs.

In 2019, Bloom Energy reviewed the accounting for an MSA that had "closed on November 27, 2019 under an MSA financing . . . , [wherein] PwC identified an issue it had not previously identified related to the accounting for the Impacted MSA transactions." Based upon this review, Bloom Energy reevaluated its MSAs and determined the MSAs should be treated as capital leases (loans from the bank rather than sales). Thus, Bloom Energy (with the

advice of its Audit Committee and PwC) reclassified certain MSAs as capital leases. To reflect these new classifications, Bloom Energy revised its 2016 and 2017 financial statements, and restated its 2018 and 2019 financial statements.³ The next day, the price of Bloom Energy stock dropped by 13.8%.

PROCEDURAL BACKGROUND

In 2019, Plaintiffs (consisting of former and current stockholders) filed a class action against Bloom Energy, nine of its officers and directors, and ten underwriters of the IPO. PwC was not a named defendant in the class action complaint. The complaint asserted claims under § 10(b) and § 11 of the Securities Exchange Act of 1934, based on alleged misstatements Bloom Energy made from 2018 to 2019 and alleged misstatements in the Registration Statement. None of the allegations involved PwC or the classification of MSAs.

A year into the litigation, Bloom Energy announced the restatements of the 2018 and 2019 financial statements that it deemed material and revisions of the 2016 and 2017 financial statements that it deemed immaterial. After the amendment, Plaintiffs amended their complaint to add allegations, under § 10(b) and § 11, regarding the classifications of the MSAs. As a part of that amendment, PwC was added as a defendant. Plaintiffs alleged that PwC was liable under § 11 for the actionable statements and omissions in the Registration Statement because it purported to have “conducted an adequate and reasonable investigation

³ A restatement corrects a material error in prior financial statements, whereas a revision corrects an error that is “immaterial to the prior year financial statements.” SEC Staff Accounting Bulletin No. 108, 71 Fed. Reg. 54,580, 54,582 (Sept. 18, 2006).

into the business, operations, financial statements, and accounting of Bloom Energy.”

All Defendants moved to dismiss all claims against them. PwC moved to dismiss the § 11 claims against it. The district court partially dismissed the claims against the other defendants and dismissed the claims against PwC.

As to PwC, the court found that PwC’s audit opinion was an inactionable opinion under *Omnicare*; that the PwC opinion said only that the financial statements “present fairly, in all material respects, the financial position of the Company . . . in conformity [with GAAP]”; that “the financial statements are the responsibility of [Bloom Energy’s] management”; that PwC only had the responsibility “to express an opinion on [Bloom Energy’s] consolidated financial statements based on [its] audits”; that the classification of “MSAs are complex”; and thus, PwC was not liable. The district court also rejected Plaintiffs’ argument that PwC’s opinions contained within them, as “embedded statements of fact,” the financial statements prepared by Bloom Energy. Lastly, the district court held that PwC’s certification of the financial statements was not a guarantee that they were accurate but rather was limited to the conclusions of the audit opinion.

After the district court ruled on Defendants’ motions to dismiss, Plaintiffs settled their claims with all Defendants except PwC. Following the settlement, the district court entered a final judgment, dismissing all claims against PwC. However, the district court granted Plaintiffs leave to amend as to PwC, but Plaintiffs conceded that an amendment would be futile.

Instead, Plaintiffs filed this timely appeal, challenging the alleged incorrect statements of revenue, net loss, and net

loss per share in Bloom Energy’s 2017 financial statement (due to the improper treatment of the MSAs as operating rather than capital leases).⁴

STANDARD OF REVIEW

We review de novo a district court’s order granting a motion to dismiss for failure to state a claim. *Dunn v. Castro*, 621 F.3d 1196, 1198 (9th Cir. 2010). We must accept sufficient factual allegations in the complaint as true and construe them in the light most favorable to the plaintiff. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009); *In re Gilead Scis. Sec. Litig.*, 536 F.3d 1049, 1055 (9th Cir. 2008).

ANALYSIS

Under *Omnicare*, an accountant’s opinion is actionable under § 11 if: (1) “the speaker did not hold the belief she professed” and the supporting fact she supplied is objectively untrue; (2) the opinion contains false “embedded statements of fact”; or (3) the opinion omits facts “whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context.” 575 U.S. at 185–86, 194. Before the district court, Plaintiffs focused their arguments primarily on the assertion that PwC’s audit opinion contained material

⁴ In their opening brief, Plaintiffs admit that they do not challenge the dismissal of claims arising from their allegations concerning: (1) the alleged incorrect disclosure in Bloom Energy’s 2017 financial statements of contingent liabilities arising from MSAs; or (2) the alleged misrepresentations contained in PwC’s audit opinion on Bloom Energy 2017 financial statements, meaning they do not challenge the district court’s dismissal of claims that the audit opinion itself was false or misleading apart from its certification of the financial statements. Accordingly, those issues are waived. *See McKay v. Ingleson*, 558 F.3d 888, 891 n.5 (9th Cir. 2009).

misrepresentations or omissions that met one or more of the three exceptions under *Omnicare*. Because Plaintiffs' allegations did not meet any of the *Omnicare* exceptions, the district court dismissed their case.

On appeal, Plaintiffs have abandoned those arguments. Plaintiffs do not deny that Bloom Energy prepared its own financial statements or that PwC neither prepared the statements nor repeated those statements in its opinion. Instead, they ask us to adopt the position that PwC is strictly liable under § 11(a)(4) for Bloom Energy's 2017 financial statement.

I. Section 11 of the Securities Exchange Act does not provide for strict liability for accountants.

Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, provides a private cause of action for investors who purchase securities pursuant to a registration statement containing “an untrue statement of a material fact” or a registration statement that omits “to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” *Id.* § 77k(a). Section 11 allows purchasers to file an action against anyone who signed or helped prepare the registration statement, including the issuer, underwriter, director, partner, accountant, engineer, or appraiser. *See id.* However, § 11 does not impose the same type of liability on all of these potential defendants.

Section 11 is a strict liability statute with respect to issuers of securities, company directors, and partners of issuers, without requiring proof of intent, negligence, or scienter. *Id.* § 77k(a). However, the statute provides defenses for other non-issuer defendants, such as experts, based on their reasonable investigation and belief in the accuracy of

the registration statement. *Id.* § 77k(b). We have also said that only “issuers are held strictly liable under § 11 for damages resulting from misrepresentations in a registration statement.” *Monroe v. Hughes*, 31 F.3d 772, 774 (9th Cir. 1994).

Relevant here, § 11(a)(4) imposes liability on an accountant “who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him.”⁵ However, the statute allows accountants to raise a defense to liability if they employed due diligence in preparing or certifying statements the registration statement, by showing that they “had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”⁶ *Id.* § 77k(b)(3)(B)(i). Courts have interpreted § 77k(b)(3)(B)(i) to require accountants “to investigate, to various degrees, facts supporting and contradicting inclusions in registration statements. They must undertake that investigation which a reasonably prudent man in that position would conduct.” *Endo v. Albertine*, 863 F. Supp.

⁵ “The term certified, when used in regard to financial statements, means examined and reported upon with an opinion expressed by an independent public or certified public accountant.” 17 C.F.R. § 230.405.

⁶ PwC did not raise a due diligence defense in this case because Plaintiffs did not identify any statements of fact made by PwC.

708, 728 (N.D. Ill. 1994) (citation omitted); *see* 15 U.S.C. § 77k(c) (defining “standard of reasonableness” as “that required of a prudent man in the management of his own property”). In other words, accountants must exercise due diligence in investigating the materials provided to them using the accepted practices of their profession.

However, “[a]ccountants cannot be held liable under Section 11 unless the misleading information can be expressly attributed to them.” *In re Worlds of Wonder Sec. Litig.*, 694 F. Supp. 1427, 1434 (N.D. Cal. 1988). Thus, while, § 11(a)(4) outlines that investors may sue accountants for materially false registration statements, accountants are only subject to suit “with respect to the statement in such registration statement . . . , which purports to have been prepared or certified by [that accountant].” *Id.* § 77k(a)(4). The statute distinguishes between “prepar[ing]” and “certif[y]ing.” This distinction limits liability for certifiers and expands it for preparers, who may be subject to more general liability for the content they create. *See id.*

Nevertheless, the statute does not impose strict liability on accountants for the statements or omissions regardless of whether they prepared or certified them. § 77k(b)(3)(B)(i). Instead, because “an accountant has a due diligence defense; § 11 therefore imposes a negligence standard for an accountant’s liability.” *Monroe*, 31 F.3d at 774 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208 (1976)); *see also In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 379 (S.D.N.Y. 2011) (“[A]lthough issuers are subject to virtually absolute liability under Section 11, experts such as accountants who have prepared portions of the registration statement are accorded a due diligence defense.” (cleaned up)).

As the Second Circuit correctly explained, strict liability is limited to those persons involved in “enumerated distributional activities.” See *In re Lehman Bros. Mortg.-Backed Sec. Litig.*, 650 F.3d 167, 181 (2d Cir. 2011). “This approach avoids the implausible result of transforming every lawyer, accountant, and other professional whose work is theoretically ‘necessary’ to bringing a security to market into an ‘underwriter’ subject to strict liability under § 11, a dramatic outcome that Congress provided no sign of intending.” *Id.*

This approach is consistent with *Omnicare* and extending its holding to accountants does not negate the due diligence defense. In *Omnicare*, the Supreme Court examined § 11 and addressed an issuer’s liability for statements of opinion, because “Congress effectively incorporated . . . [a] distinction [between facts and opinions] in § 11’s first part by exposing issuers to liability not for ‘untrue statement[s]’ . . . (which would have included ones of opinion), but only for ‘untrue statement[s] of fact.’” 575 U.S. at 183 (quoting § 77k(a)) (alterations in original). Focusing on the language of the statute, the Supreme Court excluded statements of opinions from liability. Under the Supreme Court’s reasoning, accountants may be liable for statements of fact if they did not act with due diligence; however, accountants will not be liable for statements of opinion, even if they reflect a subjective belief that admits there is a possibility of error, as long as the statement of opinion was sincerely held. See *id.* As the Supreme Court aptly explained:

A fact is “a thing done or existing” or “[a]n actual happening.” Webster’s New International Dictionary 782 (1927). An

opinion is “a belief[,] a view,” or a “sentiment which the mind forms of persons or things.” Most important, a statement of fact (“the coffee is hot”) expresses certainty about a thing, whereas a statement of opinion (“I think the coffee is hot”) does not. . . . Indeed, that difference between the two is so ingrained in our everyday ways of speaking and thinking as to make resort to old dictionaries seem a mite silly. And Congress effectively incorporated just that distinction in § 11’s first part by exposing issuers to liability not for “untrue statement[s]” full stop (which would have included ones of opinion), but only for “untrue statement[s] of . . . fact.”

Id. (citations omitted). The Supreme Court further explained a statement of opinion is not an “untrue statement of a *material fact*” simply because it is later determined to be incorrect (as here). *Id.* at 186–88.

That said, *Omnicare* did not insulate accountants from liability. Accountants may instead be challenged based on their audit opinion as *Omnicare* outlines. The opinion can still be subject to liability under § 11 as a material misstatement, where (1) “the speaker did not hold the belief she professed”; (2) “the supporting fact[s] [the speaker] supplied were untrue”; or (3) the opinion omits facts “whose omission makes the opinion statement at issue misleading.” *See id.* at 186, 194. In the district court, Plaintiffs attempted to establish liability for PwC under these standards and failed. Rather than appeal that decision, they abandon those arguments.

Simply stated, an accountant's liability is limited to "statement[s] in such registration statement, report, or valuation, which purports to have been prepared or certified by him." § 77k(a)(4). Here, the PwC audit report did not incorporate the alleged misstatements or untrue facts, and clearly stated, in relevant part, that "[i]n our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of [Bloom Energy] as of December 31, 2017 and December 31, 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America."

Thus, in order for Plaintiffs to prevail, they must establish that PwC did not have a "reasonable ground to believe and did [not] believe, at the time such part of the registration statement became effective, that the statements therein were true." § 77(k)(b)(3)(A). As explained below, PwC made statements of opinion protected under *Omnicare*. PwC did not make or prepare any statements of material fact or omit any material statements.

A. *PwC is not liable as a preparer.*

In this case, Plaintiffs argue that, because PwC certified Bloom Energy's financial statements, it became liable for any misstatements contained therein. However, no one disputes that PwC did not prepare the financial statements for 2017, or that Bloom Energy was responsible for preparing the consolidated financial statements. Frankly, PwC was not permitted (under the regulations) to prepare the financial statements. The regulations make clear that an accountant, who prepares the financial statements, is

disqualified from being the independent accountant authorized to certify it. *See* 17 C.F.R. § 230.405.

Although PwC expressed an opinion in its audit with regard to Bloom Energy’s 2016–2017 financial statements, there is no evidence that PwC *prepared* materially false statements. Accountants do not, “by virtue of auditing a company’s financial statements, somehow make, own or adopt the assertions contained therein.” *Deephaven Priv. Placement Trading, Ltd. v. Grant Thornton & Co.*, 454 F.3d 1168, 1174 (10th Cir. 2006). Instead, PwC merely affirmed that, in its opinion, Bloom Energy followed the proper accounting principles, and those statements of opinions are protected under *Omnicare*.

B. PwC is not liable as a certifier.

Plaintiffs also seek to have us impose strict liability for PwC for Bloom Energy’s financial statements that they certified in their audit opinion. We decline to interpret the term “certify” so broadly.

Bloom Energy prepared “consolidated financial statements,” which included the “accompanying consolidated balance sheets of Bloom Energy Corporation and its subsidiaries as of December 31, 2016 and December 31, 2017, and the related consolidated statements of operations, of comprehensive loss, of convertible redeemable preferred stock and stockholders’ deficit and of cash flows for each of the two years in the period ended December 31, 2017, including the related notes.” PwC certified the “consolidated financial statements” using audit procedures aimed to obtain reasonable assurance. Section 11 does not require that PwC, by certifying the financial statements, guarantee that the documents provided by Bloom Energy were free from error. Instead, PwC was

required to act in compliance with GAAP and GAAS, by performing a reasonable investigation and having reasonable grounds to believe, and did believe, that the statements provided by Bloom Energy were true and that there were no omissions that made the statement misleading. *See* 15 U.S.C. § 77k(b)(3). It was not the job of PwC to “guarantee or insure” the financial statements. *Deephaven Priv. Placement Trading, Ltd.*, 454 F.3d at 1174 (internal quotation marks omitted); *see also Dronsejko v. Thornton*, 632 F.3d 658, 663 (10th Cir. 2011) (“A company’s management—not the auditor—is responsible for the information contained in its financial statements and the propriety of its underlying accounting policies, including compliance with GAAP.”); *Fehribach v. Ernst & Young LLP*, 493 F.3d 905, 910 (7th Cir. 2007) (“The purpose of an audit report is to make sure the audited company’s financial statements—which are prepared by the company, not by the auditor, . . .—correspond to reality, lest they either have been doctored by a defalcating employee or innocently misrepresent the company’s financial situation.”).

An accountant “is in a position to express an unqualified opinion on the financial statements when the auditor conducted an audit in accordance with the standards of the Public Company Accounting Oversight Board (“PCAOB”) and concludes that the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.” AS 3101.02.⁷ “Misstatements arising from fraudulent financial

⁷ AS references the Codification of Accounting Standards and Procedures, Statement on Auditing Standards No. 1, § 150 (American Inst. of Certified Pub. Accountants 2001). Relevant here, the PCAOB auditing standards were reorganized and went into effect after Dec. 30, 2016, and were applicable to audits of financial statements for fiscal

reporting are intentional misstatements or omissions of amounts or disclosures in financial statements designed to deceive financial statement users where the effect causes the financial statements not to be presented, in all material respects, in conformity with [GAAP].” AS 2401.06. The independent accountant’s objective is to express “an opinion on the fairness with which [he or she] present[s], in all material respects, [the company’s] financial position, results of operations, and its cash flows in conformity with [GAAP].” AS 1001.01. However, “[e]ven with good faith and integrity, mistakes and errors in judgment can be made.” AS 1015.11. “[A]ccounting presentations contain accounting estimates, the measurement of which is inherently uncertain and depends on the outcome of future events. The auditor exercises professional judgment in evaluating the reasonableness of accounting estimates based on information that could reasonably be expected to be available prior to the completion of field work.” *Id.* To be sure, the division of responsibility is based on practical realities: Bloom Energy “operate[s] the business daily” and has superior knowledge of transactions, assets, and liabilities, whereas PwC’s function was confined to reasonable assurance through its audit. These limits placed on accountants to assess a company’s financial statements

years ending before Dec. 15, 2017. See <https://pcaobus.org/oversight/standards/auditing-standards> (last visited Oct. 29, 2025). Other revisions occurred after December 15, 2017. However, the reorganized standards are substantially the same and would not alter PwC’s review of the 2016 or 2017 financial statements.

preclude its ability to ensure that there are no misstatements, and thus, accountants should consider risk factors such as:

conditions in the company's industry and environment, and company-specific factors, such as the nature of the company, its activities, and internal control over financial reporting. For example, external or company-specific factors can affect the judgments involved in determining accounting estimates or create pressures to manipulate the financial statements to achieve certain financial targets. Also, risks of material misstatement may relate to, e.g., personnel who lack the necessary financial reporting competencies, information systems that fail to accurately capture business transactions, or financial reporting processes that are not adequately aligned with the requirements in the applicable financial reporting framework.

AS 2110.05.

Again, "an accountant is not a guarantor of the reports he prepares and is only duty bound to act honestly, in good faith and with reasonable care in the discharge of his professional obligations." *SEC v. Arthur Young & Co.*, 590 F.2d 785, 788 (9th Cir. 1979) (citation omitted). Nor does § 11 make accountants guarantors of every statement made by the issuer; to make such a holding would turn the whole accounting world upside down. Holding accountants strictly liable as if they were preparers would transform audits, making them prohibitively expensive. This was not Congress's goal. When Congress enacted the statute,

Congress was clear that it was limiting the liability of accountants by only requiring a “reasonable investigation and reasonable ground for belief, [for which] the standard of reasonableness shall be that required of a prudent man in the management of his own property.” § 77k(c).

Moreover, an accountant’s certification of financial statements is nothing more than an opinion. The term “certify” has been defined to mean that an independent public or certified public accountant has “examined and reported upon [the financial statements] with an opinion.” 17 C.F.R. § 230.405. *Omnicare* protects opinions from liability unless one of the three exceptions is met. *Omnicare* made clear that “whether a statement is ‘misleading’ depends on the perspective of a reasonable investor.” 575 U.S. at 186. “Reasonable investors understand that opinions sometimes rest on a weighing of competing facts; indeed, the presence of such facts is one reason why an issuer may frame a statement as an opinion, thus conveying uncertainty.” *Id.* at 189–90; *see also Deephaven Priv. Placement Trading, Ltd.*, 454 F.3d at 1175 (explaining that “the phrase ‘in our opinion’ indicates that there may be some information risk associated with the [reviewed] financial statements, even though the statements have been audited”).

In this case, PwC did just that. It conveyed its opinion as to Bloom Energy’s financial statements. There may have been some differing opinions with regard to the Energy Server’s useful life, but “[a] reasonable investor does not expect that every fact known to an [accountant] supports its opinion statement.” *Omnicare*, 575 U.S. at 176. And in this case, the classification and reasons for classification were provided to the investor. Thus, PwC’s “statement of opinion [was not] viewed in a vacuum,” but rather allowed each investor to “read[] each statement within such a document,

whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information.” *Id.* at 190.

In summary, Plaintiffs’ attempts to hold PwC liable fail. PwC’s audit opinion did not make any material misstatements of *fact* or omissions but rather was merely a statement of opinion based, again, upon the subjective judgment of the MSA classification. Plaintiffs made no allegation that PwC did not sincerely believe that Bloom Energy’s classification of the MSAs aligned with proper accounting principles based on the evidence available at that time. *See id.* at 186.

Accordingly, PwC is not liable for the statements in its audit opinion.

II. The district court’s decision should also be affirmed because Bloom Energy’s financial statements regarding classification of the MSAs were opinions.

In this appeal, Plaintiffs challenge only the three line items referenced in the Registration Statement that related to whether MSAs should be classified as operating or capital leases. These line items in Bloom Energy’s financial report were based on Bloom Energy’s subjective judgments (not statements of fact) concerning the actual useful life of the Energy Server. Under ASC 840-10-25-1, an MSA qualifies as a capital lease if “[t]he lease term is at least 75% of the property’s [i.e., the Energy Servers’] estimated remaining economic life.” Plaintiffs allege that the lease terms were 6 to 10 years; that Bloom Energy improperly estimated that the Energy Servers’ useful lives were 15-21 years. However, there is no dispute that Bloom Energy was basing its estimates on newly designed Energy Servers whose useful

life was unknown. Nevertheless, Plaintiffs allege that the actual useful lives of these Energy Servers were “much shorter.” With that shorter lease term, Plaintiffs claim that the 75% rule required a capital lease classification.

However, the district court correctly concluded that Plaintiffs failed to allege sufficient facts to establish that Bloom Energy’s judgments were untrue. Throughout the district court opinion, it properly outlines that Bloom Energy’s classification of its MSAs was based on an exercise of judgment related to its information about its Energy Servers, which Bloom Energy used to classify MSAs as operating or capital leases. For example, the district court highlighted that “Plaintiffs contend that the service contracts ‘typically last[] from 10 to 21 years and can last as long as 25 years,’ in total, and are renewed each year at the customer’s option,” but failed “to explain how Defendants could meaningfully estimate the length of future contracts from such a large range.” “Plaintiffs also suggest that Bloom knew the estimated life of its Energy Servers and fuel cells because it had to replace some of its earlier generation systems,” but “acknowledge[d], Bloom also had newer systems in place, and Plaintiffs [did] not explain how Defendants could extrapolate to determine the life or replacement schedule for all its Energy Servers.”

Thus, the district court correctly concluded that Plaintiffs failed to adequately plead that the challenged line items were statements of fact. Instead, the district court recognized that Bloom Energy’s classification of the MSAs was the product of accounting judgments; it determined that those judgments “involve[d] complex consideration[]” of various GAAP provisions in determining how to evaluate the term of the MSAs and the value of the Energy Servers. Thus, the district court found those three line items to be opinions. Then,

because Plaintiff failed to plead nor argue any of the *Omnicare* exceptions to establish liability, the district court concluded that those three line items were not actionable. We agree.

On appeal Plaintiffs argue that “statements of revenue, net loss, and net loss per share contained within a company’s financial statements” cannot be opinions because they are always statements of fact. However, again Plaintiffs ignore the language in *Omnicare*.

Omnicare does not limit an opinion to words over figures. To be sure, the language of the statute is limited to *facts*, not *opinions*. Thus, as long as Bloom Energy’s statements were opinions and not facts, it is irrelevant whether the subject matter being opined about were words or figures. Instead, we need only determine whether Bloom Energy had a “sincere statement of pure opinion.” *Omnicare*, 575 U.S. at 186. If it did, then it does not qualify as an “untrue statement of material fact,” regardless whether an investor can ultimately prove the belief wrong.” *Id.*

An “untrue statement of a material fact,” 15 U.S. C § 77k(a), “limited as it is to *factual* statements, does not allow investors to second-guess inherently subjective and uncertain assessments.” *Omnicare*, 575 U.S. at 186 (emphasis added). Although figures, by themselves, do not clearly convey whether it is an opinion or a fact, “an investor [should] read[] each statement within such a document, whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information[,] . . . tak[ing] into account the customs and practices of the relevant industry.” *Id.* at 190. “Section 11’s omissions clause, as applied to statements of both opinion and fact, necessarily brings the reasonable

person into the analysis, and asks what she would naturally understand a statement to convey beyond its literal meaning.” *Id.* at 193–94.

The district court correctly applied *Omnicare*’s reasoning to conclude that numbers can sometimes be facts and other times be opinions, depending on whether “the considerations underlying the figures—such as which GAAP provisions apply and how to apply them— . . . require the exercise of judgment.”

Plaintiffs do not explain what additional actions PwC should have taken in its audit, nor do they allege any facts that establish that PwC overlooked or disregarded warning signs about the Energy Server’s useful life or Bloom Energy’s MSA accounting.

Because Plaintiffs failed to show that Bloom Energy’s subjective opinions were based on untrue facts or information that it did not believe, *see Omnicare*, 575 U.S. at 187, Plaintiffs cannot demonstrate that PwC certified untrue facts or information. Accordingly, Plaintiffs have failed to establish liability for PwC’s opinion. The record demonstrates that the classification of MSAs was a judgment call, and the Registration Statement thoroughly explained how it reached the classification. PwC was reasonable under the circumstances to certify Bloom Energy’s classification based on the evidence at that time.⁸

AFFIRMED.

⁸ Based on the foregoing, we need not decide whether the line item errors were material.

Ex. 740-10-25-1

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The amendments in this Update create Topic 842, *Leases*, and supersede the leases requirements in Topic 840, *Leases*. Topic 842 specifies the accounting for leases. The objective of Topic 842 is to establish the principles that lessees and lessors shall apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease.

This Accounting Standards Update is the final version of Proposed Accounting Standards Update (Revised) 2013-270—Leases (Topic 842), which has been deleted.

Accounting Standards Update 2016-02

[Section A](#) —Summary and Amendments to the Accounting Standards Codification

[Section B](#) —Conforming Amendments to Other Topics and Subtopics in the Codification and Status Tables

[Section C](#) —Background Information and Basis for Conclusions

Issued: February 25, 2016

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

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FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2016-02
February 2016

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025
Lease 4 (Topic 842)

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

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Accounting Standards Update 2016-02

Leases (Topic 842)

February 2016

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The FASB is issuing this Update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB is amending the *FASB Accounting Standards Codification*[®] and creating Topic 842, Leases. This Update, along with IFRS 16, *Leases*, are the results of the FASB's and the International Accounting Standards Board's (IASB's) efforts to meet that objective and improve financial reporting.

Leasing is utilized by many entities. It is a means of gaining access to assets, of obtaining financing, and/or of reducing an entity's exposure to the full risks of asset ownership. The prevalence of leasing, therefore, means that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. Previous leases accounting was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, it did not require lessees to recognize assets and liabilities arising from operating leases on the balance sheet. As a result, there had been long-standing requests from many users of financial statements and others to change the accounting requirements so that lessees would be required to recognize the rights and obligations resulting from leases as assets and liabilities.

Many of the criticisms associated with previous leases guidance related to the accounting for operating leases in the financial statements of lessees, and addressing those concerns with lessee accounting was the main focus of the Boards. As such, the Boards decided to not fundamentally change lessor accounting with the amendments in this Update. However, some changes have been made to lessor accounting to conform and align that guidance with the lessee guidance and other areas within generally accepted accounting principles (GAAP), such as Topic 606, Revenue from Contracts with Customers.

Who Is Affected by the Amendments in This Update?

Topic 842 affects any entity that enters into a lease (as that term is defined in this Update), with some specified scope exemptions. The guidance in this Update supersedes Topic 840, Leases.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The main difference between previous GAAP and Topic 842 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. During redeliberations, the Board considered the feedback received throughout the project and in response to the different models proposed in the FASB Discussion Paper, *Leases: Preliminary Views*, the 2010 proposed Accounting Standards Update, *Leases (Topic 840)*, and the 2013 proposed Accounting Standards Update, *Leases (Topic 842)*. The Board decided that, consistent with all three proposals, lessees should be required to recognize the assets and liabilities arising from leases on the balance sheet. Throughout the project, the Board consulted extensively on the approach to lease expense recognition and considered a number of alternatives. The feedback received indicated that stakeholders had various views about the economics of lease transactions. The Board ultimately reached the conclusion that the economics of leases can vary for a lessee and that those economics should be reflected in the financial statements; therefore, Topic 842 retains a distinction between finance leases and operating leases. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous leases guidance. The result of retaining a distinction between finance leases and operating leases is that under the lessee accounting model in Topic 842, the effect of leases in the statement of comprehensive income and the statement of cash flows is largely unchanged from previous GAAP.

Other differences between the previous leases guidance and Topic 842 are described below. Throughout redeliberations, the Board introduced a number of simplifications from what were previously proposed; some of those simplifications were to keep the requirements in Topic 842 similar to those in the previous leases guidance in order to reduce the cost and complexity of transition to the new guidance. In addition to simplifications from the previous leases proposals, certain aspects of lease accounting have been simplified in Topic 842 as compared with the previous leases guidance in Topic 840.

Lessee Accounting

The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases.

A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. When measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. Similarly, optional payments to purchase the underlying asset should be included in the measurement of lease assets and lease liabilities only if the lessee is reasonably certain to exercise that purchase option. *Reasonably certain* is a high threshold that is consistent with and intended to be applied in the same way as the *reasonably assured* threshold in the previous leases guidance. In addition, also consistent with the previous leases guidance, a lessee (and a lessor) should exclude most variable lease payments in measuring lease assets and lease liabilities, other than those that depend on an index or a rate or are in substance fixed payments.

For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. There continues to be a differentiation between finance leases and operating leases. However, the principal difference from previous guidance is that the lease assets and lease liabilities arising from operating leases should be recognized in the statement of financial position.

For finance leases, a lessee is required to do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
2. Recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income
3. Classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows.

For operating leases, a lessee is required to do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
2. Recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis

3. Classify all cash payments within operating activities in the statement of cash flows.

Lessor Accounting

The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. For example, the vast majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. However, some changes to the lessor accounting guidance were made to align both of the following:

1. The lessor accounting guidance with specific changes made to the lessee accounting guidance. For example, certain glossary terms that are applied by lessees and lessors and that will affect a lessee applying the lessor guidance as a sublessor were updated so that lessees and lessors apply the same terms.
2. Key aspects of the lessor accounting model with the revenue recognition guidance in Topic 606. Leasing is fundamentally a revenue-generating activity for lessors, and many aspects of the previous lessor accounting guidance aligned with, or were derived from, the revenue recognition guidance that preceded Topic 606 (for example, specific aspects of the lessor accounting guidance for real estate assets were designed to conform with the revenue recognition guidance specific to sales of real estate, and both the previous leasing and certain revenue recognition guidance in GAAP utilized a risk-and-rewards principle for determining when the sale of an asset occurred). Topic 842 retains alignment in key respects between the lessor accounting guidance and the revenue recognition guidance in Topic 606. For example, whether a lease is similar to a sale of the underlying asset depends on whether the lessee, in effect, obtains control of the underlying asset as a result of the lease (consistent with the transfer of control principle for a sale in Topic 606), and a lessor is precluded from recognizing selling profit or sales revenue at lease commencement for a lease that does not transfer control of the underlying asset to the lessee. Also consistent with the guidance in Topic 606, the lessor accounting model in Topic 842 does not differentiate between leases of real estate and leases of other assets.

Leveraged Leases

In addition to the changes outlined above, the previous accounting model for leveraged leases continues to apply only to those leveraged leases that commenced before the effective date of the guidance in this Update. The accounting model for leveraged leases in Topic 840 is not retained for leases that commence after the effective date of the guidance in this Update.

Definition of a Lease

At inception of a contract, an entity should determine whether the contract is or contains a lease. Topic 842 defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. Control over the use of the identified asset means that the customer has both (1) the right to obtain substantially all of the economic benefits from the use of the asset and (2) the right to direct the use of the asset.

Under the lessee accounting model in previous GAAP, the critical determination was whether a lease was a capital lease or an operating lease because lease assets and lease liabilities were recognized only for capital leases. Under Topic 842, the critical determination is whether a contract is or contains a lease because lessees are required to recognize lease assets and lease liabilities for all leases—finance and operating—other than short-term leases (that is, if the entity elects the short-term lease recognition and measurement exemption). Topic 842 provides detailed guidance and several examples to illustrate the application of the definition of a lease to assist entities in making this critical determination.

Components

Topic 842 requires an entity to separate the lease components from the nonlease components (for example, maintenance services or other activities that transfer a good or service to the customer) in a contract. Although this was a requirement in previous GAAP, Topic 842 provides more guidance on how to identify and separate components than previous GAAP. Only the lease components must be accounted for in accordance with Topic 842. The consideration in the contract is allocated to the lease and nonlease components on a relative standalone price basis (for lessees) or in accordance with the allocation guidance in Topic 606 (for lessors). Consideration attributable to nonlease components is not a lease payment and, therefore, is not included in the measurement of lease assets or lease liabilities. Entities should account for nonlease components in accordance with other applicable Topics. Activities that do not transfer a good or service to the lessee or amounts paid solely to reimburse costs of the lessor are not components in a contract and are not allocated any of the consideration in the contract.

The above notwithstanding, Topic 842 provides a practical expedient for lessees as it relates to separating lease components from nonlease components. Lessees may make an accounting policy election by class of underlying asset not to separate lease components from nonlease components. If an entity makes that accounting policy election, it is required to account for the nonlease components together with the related lease components as a single lease component.

Sale and Leaseback Transactions

For a sale to occur in the context of a sale and leaseback transaction, the transfer of the asset must meet the requirements for a sale in Topic 606. If there is no sale

for the seller-lessee, the buyer-lessor also does not account for a purchase. Any consideration paid for the asset is accounted for as a financing transaction by both the seller-lessee and the buyer-lessor. There could be circumstances in which a transaction would have qualified for a sale under the previous leases guidance but will not qualify for a sale under Topic 606, or vice versa. In particular, many sale and leaseback transactions involving real estate will qualify for sale and leaseback accounting that would not have qualified for sale and leaseback accounting under the previous leases guidance. In contrast, some sale and leaseback transactions involving assets other than real estate that previously would have qualified for sale and leaseback accounting will not qualify for sale and leaseback accounting under Topic 842. Topic 842 includes implementation guidance to assist entities in determining whether the transfer of an asset in the context of a sale and leaseback transaction is a sale. In particular, Topic 842 specifies that if the leaseback is classified as a finance/sales-type lease, no sale has occurred. Topic 842 also specifies that a repurchase option (that is, for the seller-lessee to repurchase the asset from the buyer-lessor) precludes sale accounting unless (1) the asset is nonspecialized and (2) the exercise price of the option is the fair value of the asset on the date the option is exercised.

For transactions previously accounted for as a sale and a leaseback under previous GAAP, the transition guidance in Topic 842 does not require an entity to reassess whether the transaction would have qualified as a sale and a leaseback in accordance with Topic 842.

Disclosures

Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. To meet that objective, the Board decided to require qualitative disclosures along with specific quantitative disclosures. The Board's intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities.

Transition

In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset.

An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to

recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP.

The transition guidance in Topic 842 also provides specific guidance for sale and leaseback transactions, build-to-suit leases, leveraged leases, and amounts previously recognized in accordance with the business combinations guidance for leases.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for any of the following:

1. A public business entity
2. A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market
3. An employee benefit plan that files financial statements with the U.S. Securities and Exchange Commission (SEC)

For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Early application of the amendments in this Update is permitted for all entities.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

The leases project began as a joint project with the IASB, and many of the requirements in Topic 842 are the same as the requirements in IFRS 16. The main differences between Topic 842 and IFRS 16 are in relation to certain aspects of the lessee accounting model. In contrast to the lessee accounting model in Topic 842, which distinguishes between finance leases and operating leases in the financial statements, the lessee accounting model in IFRS 16 requires all leases to be accounted for consistent with the Topic 842 approach for finance leases. Consequently, leases classified as operating leases under Topic 842 will be accounted for differently under GAAP than under IFRS and will have a different effect on the statement of comprehensive income and the statement of cash flows under IFRS 16 than under previous IFRSs. The following are the other notable requirements of IFRS 16 that are not consistent with the requirements in Topic 842:

1. Lessee accounting model

- a. IFRS 16 has a lessee recognition and measurement exemption for leases of assets with values of less than \$5,000.
2. Lessor accounting model
 - a. IFRS 16 does not distinguish between sales-type and direct financing leases; therefore, IFRS 16 permits recognition of selling profit on direct financing leases at lease commencement.
 - b. IFRS 16 does not include any explicit guidance on collectibility of the lease payments and amounts necessary to satisfy a residual value guarantee.
 - c. IFRS 16 applies a model to modifications of sales-type and direct financing leases that is predicated on IFRS financial instruments guidance.
3. Measurement of the right-of-use asset
 - a. IFRS 16 allows alternative measurement bases for the right-of-use asset (for example, the fair value model under IAS 40, *Investment Property*, or at a revalued amount in accordance with IAS 16, *Property, Plant and Equipment*).
4. Variable lease payments
 - a. IFRS 16 requires reassessment of variable lease payments that depend on an index or a rate when there is a change in the cash flows resulting from a change in the reference index or rate (that is, when an adjustment to the lease payments takes effect).
5. Subleases
 - a. When classifying a sublease, IFRS 16 requires an intermediate lessor to determine the classification of the sublease with reference to the right-of-use asset arising from the head lease.
6. Sale and leaseback transactions
 - a. IFRS 16 does not include application guidance on whether the transfer of an asset in a sale and leaseback transaction is a sale, other than to state that if the seller-lessee has a substantive repurchase option regarding the underlying asset, then no sale has occurred.
 - b. IFRS 16 restricts the gain recognized by a seller-lessee in a sale and leaseback transaction to the amount of the gain that relates to the buyer-lessor's residual interest in the underlying asset at the end of the leaseback.
7. Private companies
 - a. IFRS 16 does not have guidance specifically for private companies; however, Topic 842 permits an accounting policy election for private companies to use a risk-free rate to discount the lease liability for each lease.
8. Statement of cash flows
 - a. IFRS 16 accounts for payments of interest in accordance with IAS 7, *Statement of Cash Flows*. IAS 7 allows interest to be classified within operating, investing, or financing activities.

9. Disclosure
 - a. IFRS 16 has similar but not identical qualitative and quantitative disclosure requirements to Topic 842.
10. Transition
 - a. IFRS 16 has different transition provisions than Topic 842 as a result of the differences in the lessee and lessor accounting provisions.
11. Existing differences in other areas of GAAP and IFRS that affect the accounting for leases
 - a. The key areas of difference are the existing requirements for impairment (of financial instruments and long-lived assets other than goodwill) and the accounting for investment properties.

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

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Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. This Update is organized into two sections:
 - a. Leases—Amendments in this section codify the Board’s decision in the leases project and create a new Topic 842. For those amendments, see Section A.
 - b. Conforming Amendments—Amendments in this section conform guidance throughout the Accounting Standards Codification as a result of the Board’s decisions in the leases project. For those amendments, see Section B.
2. The Accounting Standards Codification is amended as described in paragraphs 3–185. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are linked in bold type the first time they appear in each Section and the first time they appear after a “>” symbol and a “>>” symbol heading. In the Implementation Guidance part of Section 55, Glossary terms are linked the first time they appear after a “>>” symbol heading and a “>>>” symbol heading. Added text is underlined, and deleted text is ~~struck out~~.

Section A—Leases: Amendments to the Accounting Standards Codification

Addition of Topic 842

3. Add Subtopic 842-10, with a link to transition paragraph 842-10-65-1, as follows.

[For ease of readability, the new Subtopic is not underlined.]

Leases—Overall

Overview and Background

General

842-10-05-1 The **Leases** Topic includes the following Subtopics:

- a. Overall
- b. **Lessee**
- c. **Lessor**
- d. Sale and Leaseback Transactions
- e. **Leveraged Lease Arrangements**.

842-10-05-2 The Subtopics listed in paragraph 842-10-05-1 establish the requirements of financial accounting and reporting for lessees and lessors.

Objectives

General

842-10-10-1 This Topic specifies the accounting for **leases**. An entity should consider the terms and conditions of the **contract** and all relevant facts and circumstances when applying this Topic. An entity should apply this Topic consistently to leases with similar characteristics and in similar circumstances.

842-10-10-2 The objective of this Topic is to establish the principles that **lessees** and **lessors** shall apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease.

Scope and Scope Exceptions

General

842-10-15-1 An entity shall apply this Topic to all **leases**, including **subleases**. Because a lease is defined as a **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration, this Topic does not apply to any of the following:

- a. Leases of intangible assets (see Topic 350, Intangibles—Goodwill and Other).
- b. Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources (see Topics 930, Extractive Activities—Mining, and 932, Extractive Activities—Oil and Gas). This includes the intangible right to explore for those natural resources and rights to use the land in which those natural resources are contained (that is, unless those rights of use include more than the right to explore for natural resources), but not equipment used to explore for the natural resources.
- c. Leases of biological assets, including timber (see Topic 905, Agriculture).
- d. Leases of **inventory** (see Topic 330, Inventory).
- e. Leases of assets under construction (see Topic 360, Property, Plant, and Equipment).

> Identifying a Lease

842-10-15-2 At inception of a **contract**, an entity shall determine whether that contract is or contains a **lease**.

842-10-15-3 A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).

842-10-15-4 To determine whether a contract conveys the right to control the use of an identified asset (see paragraphs 842-10-15-17 through 15-26) for a period of time, an entity shall assess whether, throughout the **period of use**, the customer has both of the following:

- a. The right to obtain substantially all of the economic benefits from use of the identified asset (see paragraphs 842-10-15-17 through 15-19)
- b. The right to direct the use of the identified asset (see paragraphs 842-10-15-20 through 15-26).

If the customer in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

842-10-15-5 If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

842-10-15-6 An entity shall reassess whether a contract is or contains a lease only if the terms and conditions of the contract are changed.

842-10-15-7 In making the determination about whether a contract is or contains a lease, an entity shall consider all relevant facts and circumstances.

842-10-15-8 Paragraph 842-10-55-1 includes a flowchart that depicts the decision process for evaluating whether a contract is or contains a lease.

> > Identified Asset

842-10-15-9 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 that the asset is made available for use by the customer.

> > > Substantive Substitution Rights

842-10-15-10 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- a. The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting an asset, and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time).
- b. The supplier would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

842-10-15-11 An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include, but are not limited to, the following:

- a. An agreement by a future customer to pay an above-market rate for use of the asset
- b. The introduction of new technology that is not substantially developed at inception of the contract
- c. A substantial difference between the customer's use of the asset, or the performance of the asset and the use or performance considered likely at inception of the contract
- d. A substantial difference between the market price of the asset during the period of use and the market price considered likely at inception of the contract.

842-10-15-12 If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

842-10-15-13 If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

842-10-15-14 The supplier's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the customer from having the right to use an identified asset.

842-10-15-15 If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

> > > Portions of Assets

842-10-15-16 A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single customer to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

> > Right to Control the Use of the Identified Asset

> > > Right to Obtain the Economic Benefits from the Use of the Identified Asset

842-10-15-17 To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.

842-10-15-18 When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset in the contract (see paragraph 842-10-15-23). For example:

- a. If a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle within that territory and not beyond.
- b. If a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle for the permitted mileage and not beyond.

842-10-15-19 If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if a customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. That is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the supplier as consideration for the right to use that space.

> > Right to Direct the Use of the Identified Asset

842-10-15-20 A customer has the right to direct the use of an identified asset throughout the period of use in either of the following situations:

- a. The customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs 842-10-15-24 through 15-26).
- b. The relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph 842-10-15-21) and at least one of the following conditions exists:
 1. The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the supplier having the right to change those operating instructions.
 2. The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

842-10-15-21 The relevant decisions about how and for what purpose an asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

842-10-15-22 In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use unless the customer designed the asset (or specific aspects of the asset) in accordance with paragraph 842-10-15-20(b)(2).

Consequently, unless that condition exists, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

> > > Protective Rights

842-10-15-23 A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may specify the maximum amount of use of an asset or limit where or when the customer can use the asset, may require a customer to follow particular operating practices, or may require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.

> > > How and for What Purpose an Asset Is Used

842-10-15-24 A customer has the right to direct how and for what purpose an asset is used throughout the period of use if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout that period. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose an asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

842-10-15-25 Examples of decision-making rights that, depending on the circumstances, grant the right to direct how and for what purpose an asset is used, within the defined scope of the customer's right of use, include the following:

- a. The right to change the type of output that is produced by the asset (for example, deciding whether to use a shipping container to transport goods or for storage, or deciding on the mix of products sold from a retail unit)
- b. The right to change when the output is produced (for example, deciding when an item of machinery or a power plant will be used)
- c. The right to change where the output is produced (for example, deciding on the destination of a truck or a ship or deciding where a piece of equipment is used or deployed)
- d. The right to change whether the output is produced and the quantity of that output (for example, deciding whether to produce energy from a power plant and how much energy to produce from that power plant).

842-10-15-26 Examples of decision-making rights that do not grant the right to direct how and for what purpose an asset is used include rights that are limited to operating or maintaining the asset. Although rights such as those to operate or maintain an asset often are essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and often are dependent on the decisions about how and for what purpose the asset is used. Such rights (that is, to operate or maintain the asset) can be held by the customer or the supplier. The supplier often holds those rights to protect its investment in the asset. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph 842-10-15-20(b)(1)).

842-10-15-27 See Examples 1 through 10 (paragraphs 842-10-55-41 through 55-130) for illustrations of the requirements for identifying a lease.

> Separating Components of a Contract

842-10-15-28 After determining that a **contract** contains a **lease** in accordance with paragraphs 842-10-15-2 through 15-27, an entity shall identify the separate lease components within the contract. An entity shall consider the right to use an **underlying asset** to be a separate lease component (that is, separate from any other lease components of the contract) if both of the following criteria are met:

- a. The **lessee** can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the **lessor** or other suppliers) or resources that the lessee already has obtained (from the lessor or from other transactions or events).
- b. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

842-10-15-29 The guidance in paragraph 842-10-15-28 notwithstanding, to classify and account for a lease of land and other assets, an entity shall account for the right to use land as a separate lease component unless the accounting effect of doing so would be insignificant (for example, separating the land element would have no effect on lease classification of any lease component or the amount recognized for the land lease component would be insignificant).

842-10-15-30 The **consideration in the contract** shall be allocated to each separate lease component and nonlease component of the contract (see paragraphs 842-10-15-33 through 15-37 for lessee allocation guidance and paragraphs 842-10-15-38 through 15-42 for lessor allocation guidance). Components of a contract include only those items or activities that transfer a good

or service to the lessee. Consequently, the following are not components of a contract and do not receive an allocation of the consideration in the contract:

- a. Administrative tasks to set up a contract or initiate the lease that do not transfer a good or service to the lessee
- b. Reimbursement or payment of the lessor's costs. For example, a lessor may incur various costs in its role as a lessor or as owner of the underlying asset. A requirement for the lessee to pay those costs, whether directly to a third party or as a reimbursement to the lessor, does not transfer a good or service to the lessee separate from the right to use the underlying asset.

842-10-15-31 An entity shall account for each separate lease component separately from the nonlease components of the contract (that is, unless a lessee makes the accounting policy election described in paragraph 842-10-15-37). Nonlease components are not within the scope of this Topic and shall be accounted for in accordance with other Topics.

842-10-15-32 See Examples 11 through 14 (paragraphs 842-10-55-131 through 55-158) for illustrations of the requirements for allocating consideration to components of a contract.

> > Lessee

842-10-15-33 A lessee shall allocate (that is, unless the lessee makes the accounting policy election described in paragraph 842-10-15-37) the **consideration in the contract** to the separate **lease** components determined in accordance with paragraphs 842-10-15-28 through 15-31 and the nonlease components as follows:

- a. The lessee shall determine the relative **standalone price** of the separate lease components and the nonlease components on the basis of their observable standalone prices. If observable standalone prices are not readily available, the lessee shall estimate the standalone prices, maximizing the use of observable information. A residual estimation approach may be appropriate if the standalone price for a component is highly variable or uncertain.
- b. The lessee shall allocate the consideration in the contract on a relative standalone price basis to the separate lease components and the nonlease components of the **contract**.

Initial direct costs should be allocated to the separate lease components on the same basis as the **lease payments**.

842-10-15-34 A price is observable if it is the price that either the **lessor** or similar suppliers sell similar lease or nonlease components on a standalone basis.

842-10-15-35 The consideration in the contract for a lessee includes all of the payments described in paragraph 842-10-30-5, as well as all of the following payments that will be made during the **lease term**:

- a. Any fixed payments (for example, monthly service charges) or in substance fixed payments, less any incentives paid or payable to the lessee, other than those included in paragraph 842-10-30-5
- b. Any other variable payments that depend on an index or a rate, initially measured using the index or rate at the **commencement date**.

842-10-15-36 A lessee shall remeasure and reallocate the consideration in the contract upon either of the following:

- a. A remeasurement of the **lease liability** (for example, a remeasurement resulting from a change in the lease term or a change in the assessment of whether a lessee is or is not reasonably certain to exercise an option to purchase the **underlying asset**) (see paragraph 842-20-35-4)
- b. The effective date of a contract modification that is not accounted for as a separate contract (see paragraph 842-10-25-8).

842-10-15-37 As a practical expedient, a lessee may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component.

>> **Lessor**

842-10-15-38 A lessor shall allocate the **consideration in the contract** to the separate **lease** components and the nonlease components using the requirements in paragraphs 606-10-32-28 through 32-41. A lessor also shall allocate any capitalized costs (for example, **initial direct costs** or **contract** costs capitalized in accordance with Subtopic 340-40 on other assets and deferred costs—contracts with customers) to the separate lease components or nonlease components to which those costs relate.

842-10-15-39 The consideration in the contract for a lessor includes all of the amounts described in paragraph 842-10-15-35 and any other variable payment amounts that would be included in the transaction price in accordance with the guidance on variable consideration in Topic 606 on revenue from contracts with customers that specifically relates to either of the following:

- a. The lessor's efforts to transfer one or more goods or services that are not leases
- b. An outcome from transferring one or more goods or services that are not leases.

Any variable payment amounts accounted for as consideration in the contract shall be allocated entirely to the nonlease component(s) to which the variable payment

specifically relates if doing so would be consistent with the transaction price allocation objective in paragraph 606-10-32-28.

842-10-15-40 If the terms of a variable payment amount other than those in paragraph 842-10-15-35 relate to a lease component, even partially, the lessor shall recognize those payments as income in profit or loss in the period when the changes in facts and circumstances on which the variable payment is based occur (for example, when the **lessee's** sales on which the amount of the variable payment depends occur).

842-10-15-41 A lessor shall remeasure and reallocate the remaining consideration in the contract when there is a contract modification that is not accounted for as a separate contract in accordance with paragraph 842-10-25-8.

842-10-15-42 If the consideration in the contract changes, a lessor shall allocate those changes in accordance with the requirements in paragraphs 606-10-32-42 through 32-45.

> Other Considerations

842-10-15-43 Paragraph 815-10-15-79 explains that **leases** that are within the scope of this Topic are not derivative instruments subject to Subtopic 815-10 on derivatives and hedging although a derivative instrument embedded in a lease may be subject to the requirements of Section 815-15-25. Paragraph 815-10-15-80 explains that **residual value guarantees** that are subject to the guidance in this Topic are not subject to the guidance in Subtopic 815-10. Paragraph 815-10-15-81 requires that a third-party residual value guarantor consider the guidance in Subtopic 815-10 for all residual value guarantees that it provides to determine whether they are derivative instruments and whether they qualify for any of the scope exceptions in that Subtopic.

Glossary

Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and

liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

Advance Refunding

A transaction involving the issuance of new debt to replace existing debt with the proceeds from the new debt placed in trust or otherwise restricted to retire the existing debt at a determinable future date or dates.

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Consideration in the Contract

See paragraph 842-10-15-35 for what constitutes the consideration in the **contract** for **lessees** and paragraph 842-10-15-39 for what constitutes consideration in the contract for **lessors**.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Direct Financing Lease

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b).

Discount Rate for the Lease

For a **lessee**, the discount rate for the **lease** is the **rate implicit in the lease** unless that rate cannot be readily determined. In that case, the lessee is required to use its **incremental borrowing rate**.

For a **lessor**, the discount rate for the lease is the rate implicit in the lease.

Economic Life

Either the period over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more users.

Effective Date of the Modification

The date that a **lease modification** is approved by both the **lessee** and the **lessor**.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Fiscal Funding Clause

A provision by which the lease is cancellable if the legislature or other funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the lease agreement.

Incremental Borrowing Rate

The rate of interest that a **lessee** would have to pay to borrow on a collateralized basis over a similar term an amount equal to the **lease payments** in a similar economic environment.

Initial Direct Costs

Incremental costs of a **lease** that would not have been incurred if the lease had not been obtained.

Inventory

The aggregate of those items of tangible personal property that have any of the following characteristics:

- a. Held for sale in the ordinary course of business
- b. In process of production for such sale
- c. To be currently consumed in the production of goods or services to be available for sale.

The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies). This definition of inventories excludes long-term assets subject to depreciation accounting, or goods which, when put into use, will be so classified. The fact that a depreciable asset is retired from regular use and held for sale does not indicate that the item should be classified as part of the inventory. Raw materials and supplies purchased for production may be used or consumed for the construction of long-term assets or other purposes not related to production, but the fact that inventory items representing a small portion of the total may not be absorbed ultimately in the production process does not require separate classification. By trade practice, operating materials and supplies of certain types of entities such as oil producers are usually treated as inventory.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Liability

A **lessee's** obligation to make the **lease payments** arising from a **lease**, measured on a discounted basis.

Lease Modification

A change to the terms and conditions of a **contract** that results in a change in the scope of or the consideration for a **lease** (for example, a change to the terms and conditions of the contract that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term).

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Receivable

A **lessor's** right to receive **lease payments** arising from a **sales-type lease** or a **direct financing lease** plus any amount that a lessor expects to derive from the underlying asset following the end of the **lease term** to the extent that it is guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Leveraged Lease

From the perspective of a **lessor**, a lease that was classified as a leveraged lease in accordance with the lease guidance in effect before the effective date and for which the **commencement date** is before the effective date.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Net Investment in the Lease

For a **sales-type lease**, the sum of the **lease receivable** and the **unguaranteed residual asset**.

For a **direct financing lease**, the sum of the lease receivable and the unguaranteed residual asset, net of any deferred selling profit.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any lease other than a **sales-type lease** or a **direct financing lease**.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Penalty

Any requirement that is imposed or can be imposed on the **lessee** by the **lease** agreement or by factors outside the lease agreement to do any of the following:

- a. Disburse cash
- b. Incur or assume a liability
- c. Perform services
- d. Surrender or transfer an asset or rights to an asset or otherwise forego an economic benefit, or suffer an economic detriment. Factors to consider in determining whether an economic detriment may be incurred include, but are not limited to, all of the following:

1. The uniqueness of purpose or location of the **underlying asset**
2. The availability of a comparable replacement asset
3. The relative importance or significance of the underlying asset to the continuation of the lessee's line of business or service to its customers
4. The existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the underlying asset
5. Adverse tax consequences
6. The ability or willingness of the lessee to bear the cost associated with relocation or replacement of the underlying asset at market rental rates or to tolerate other parties using the underlying asset.

Period of Use

The total period of time that an asset is used to fulfill a **contract** with a customer (including the sum of any nonconsecutive periods of time).

Probable (second definition)

The future event or events are likely to occur.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Rate Implicit in the Lease

The rate of interest that, at a given date, causes the aggregate present value of (a) the **lease payments** and (b) the amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** to equal the sum of (1) the **fair value** of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and (2) any deferred **initial direct costs** of the lessor.

Related Parties

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Remote

The chance of the future event or events occurring is slight.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Right-of-Use Asset

An asset that represents a **lessee's** right to use an **underlying asset** for the **lease term**.

Sales-Type Lease

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Selling Profit or Selling Loss

At the **commencement date**, selling profit or selling loss equals:

- a. The **fair value** of the **underlying asset** or the sum of (1) the **lease receivable** and (2) any **lease payments** prepaid by the lessee, if lower; minus
- b. The carrying amount of the underlying asset net of any **unguaranteed residual asset**; minus
- c. Any deferred **initial direct costs** of the lessor.

Short-Term Lease

A **lease** that, at the **commencement date**, has a **lease term** of 12 months or less and does not include an option to purchase the **underlying asset** that the **lessee** is reasonably certain to exercise.

Standalone Price

The price at which a customer would purchase a component of a **contract** separately.

Sublease

A transaction in which an **underlying asset** is re-leased by the **lessee** (or intermediate **lessor**) to a third party (the sublessee) and the original (or head) **lease** between the lessor and the lessee remains in effect.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Unguaranteed Residual Asset

The amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** that is not guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Variable Interest Entity

A **legal entity** subject to consolidation according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an **underlying asset** that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

Warranty

A guarantee for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party. The obligation may be incurred in connection with the sale of goods or services; if so, it may require further performance by the seller after the sale has taken place.

Recognition

General

> Lease Classification

842-10-25-1 An entity shall classify each separate **lease** component at the **commencement date**. An entity shall not reassess the lease classification after the commencement date unless the **contract** is modified and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8. In addition, a **lessee** also shall reassess the lease classification after the commencement date if there is a change in the **lease term** or the assessment of whether the lessee is reasonably certain to exercise an option to purchase the **underlying asset**.

842-10-25-2 A lessee shall classify a lease as a **finance lease** and a **lessor** shall classify a lease as a **sales-type lease** when the lease meets any of the following criteria at lease commencement:

- a. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- b. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- c. The lease term is for the major part of the remaining **economic life** of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion shall not be used for purposes of classifying the lease.
- d. The present value of the sum of the **lease payments** and any residual value guaranteed by the lessee that is not already reflected in the lease payments in accordance with paragraph 842-10-30-5(f) equals or exceeds substantially all of the **fair value** of the underlying asset.

- e. 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.

842-10-25-3 When none of the criteria in paragraph 842-10-25-2 are met:

- a. A lessee shall classify the lease as an **operating lease**.
- b. A lessor shall classify the lease as either a **direct financing lease** or an operating lease. A lessor shall classify the lease as an operating lease unless both of the following criteria are met, in which case the lessor shall classify the lease as a direct financing lease:
 - 1. The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments in accordance with paragraph 842-10-30-5(f) and/or any other third party unrelated to the lessor equals or exceeds substantially all of the fair value of the underlying asset.
 - 2. It is **probable** that the lessor will collect the lease payments plus any amount necessary to satisfy a **residual value guarantee**.

842-10-25-4 A lessor shall assess the criteria in paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1) using the **rate implicit in the lease**. For purposes of assessing the criterion in paragraph 842-10-25-2(d), a lessor shall assume that no **initial direct costs** will be deferred if, at the commencement date, the fair value of the underlying asset is different from its carrying amount.

842-10-25-5 If a single lease component contains the right to use more than one underlying asset (see paragraphs 842-10-15-28 through 15-29), an entity shall consider the remaining economic life of the predominant asset in the lease component for purposes of applying the criterion in paragraph 842-10-25-2(c).

842-10-25-6 When classifying a **sublease**, an entity shall classify the sublease with reference to the underlying asset (for example, the item of property, plant, or equipment that is the subject of the lease) rather than with reference to the **right-of-use asset**.

842-10-25-7 See paragraphs 842-10-55-2 through 55-15 for implementation guidance on lease classification.

> Lease Modifications

842-10-25-8 An entity shall account for a modification to a **contract** as a separate contract (that is, separate from the original contract) when both of the following conditions are present:

- a. The modification grants the **lessee** an additional right of use not included in the original **lease** (for example, the right to use an additional asset).
- b. The **lease payments** increase commensurate with the **standalone price** for the additional right of use, adjusted for the circumstances of the particular contract. For example, the standalone price for the lease of one floor of an office building in which the lessee already leases other floors

in that building may be different from the standalone price of a similar floor in a different office building, because it was not necessary for a **lessor** to incur costs that it would have incurred for a new lessee.

842-10-25-9 If a lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8, the entity shall reassess the classification of the lease as of the **effective date of the modification** based on its modified terms and conditions and the facts and circumstances as of that date (for example, the **fair value** and remaining **economic life** of the **underlying asset** as of that date).

842-10-25-10 An entity shall account for **initial direct costs**, lease incentives, and any other payments made to or by the entity in connection with a modification to a lease in the same manner as those items would be accounted for in connection with a new lease.

> > Lessee

842-10-25-11 A **lessee** shall reallocate the remaining **consideration in the contract** and remeasure the **lease liability** using a **discount rate for the lease** determined at the **effective date of the modification** if a contract modification does any of the following:

- a. Grants the lessee an additional right of use not included in the original contract (and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8)
- b. Extends or reduces the term of an existing **lease** (for example, changes the **lease term** from five to eight years or vice versa), other than through the exercise of a contractual option to extend or terminate the lease (as described in paragraph 842-20-35-5)
- c. Fully or partially terminates an existing lease (for example, reduces the assets subject to the lease)
- d. Changes the consideration in the contract only.

842-10-25-12 In the case of (a), (b), or (d) in paragraph 842-10-25-11, the lessee shall recognize the amount of the remeasurement of the lease liability for the modified lease as an adjustment to the corresponding **right-of-use asset**.

842-10-25-13 In the case of (c) in paragraph 842-10-25-11, the lessee shall decrease the carrying amount of the right-of-use asset on a basis proportionate to the full or partial termination of the existing lease. Any difference between the reduction in the lease liability and the proportionate reduction in the right-of-use asset shall be recognized as a gain or a loss at the effective date of the modification.

842-10-25-14 If a **finance lease** is modified and the modified lease is classified as an **operating lease**, any difference between the carrying amount of the right-of-use asset after recording the adjustment required by paragraph 842-10-25-12 or 842-10-25-13 and the carrying amount of the right-of-use asset that would result

from applying the initial operating right-of-use asset measurement guidance in paragraph 842-20-30-5 to the modified lease shall be accounted for in the same manner as a rent prepayment or a lease incentive.

>> Lessor

842-10-25-15 If an **operating lease** is modified and the modification is not accounted for as a separate **contract** in accordance with paragraph 842-10-25-8, the **lessor** shall account for the modification as if it were a termination of the existing **lease** and the creation of a new lease that commences on the **effective date of the modification** as follows:

- a. If the modified lease is classified as an operating lease, the lessor shall consider any prepaid or accrued lease rentals relating to the original lease as a part of the **lease payments** for the modified lease.
- b. If the modified lease is classified as a **direct financing lease** or a **sales-type lease**, the lessor shall derecognize any deferred rent liability or accrued rent asset and adjust the **selling profit or selling loss** accordingly.

842-10-25-16 If a direct financing lease is modified and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8, the lessor shall account for the modified lease as follows:

- a. If the modified lease is classified as a direct financing lease, the lessor shall adjust the discount rate for the modified lease so that the initial net investment in the modified lease equals the carrying amount of the net investment in the original lease immediately before the effective date of the modification.
- b. If the modified lease is classified as a sales-type lease, the lessor shall account for the modified lease in accordance with the guidance applicable to sales-type leases in Subtopic 842-30, with the **commencement date** of the modified lease being the effective date of the modification. In calculating the selling profit or selling loss on the lease, the **fair value** of the **underlying asset** is its fair value at the effective date of the modification and its carrying amount is the carrying amount of the net investment in the original lease immediately before the effective date of the modification.
- c. If the modified lease is classified as an operating lease, the carrying amount of the underlying asset equals the net investment in the original lease immediately before the effective date of the modification.

842-10-25-17 If a sales-type lease is modified and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8, the lessor shall account for the modified lease as follows:

- a. If the modified lease is classified as a sales-type or a direct financing lease, in the same manner as described in paragraph 842-10-25-16(a)

- b. If the modified lease is classified as an operating lease, in the same manner as described in paragraph 842-10-25-16(c).

842-10-25-18 See Examples 15 through 22 (paragraphs 842-10-55-159 through 55-209) for illustrations of the requirements on **lease modifications**.

> **Contract Combinations**

842-10-25-19 An entity shall combine two or more **contracts**, at least one of which is or contains a **lease**, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

- a. The contracts are negotiated as a package with the same commercial objective(s).
- b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- c. The rights to use **underlying assets** conveyed in the contracts (or some of the rights of use conveyed in the contracts) are a single lease component in accordance with paragraph 842-10-15-28.

Initial Measurement

General

> **Lease Term and Purchase Options**

842-10-30-1 An entity shall determine the **lease term** as the noncancellable period of the **lease**, together with all of the following:

- a. Periods covered by an option to extend the lease if the **lessee** is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

842-10-30-2 At the **commencement date**, an entity shall include the periods described in paragraph 842-10-30-1 in the lease term having considered all relevant factors that create an economic incentive for the lessee (that is, **contract-based**, **asset-based**, **entity-based**, and **market-based** factors). Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee is reasonably certain to exercise or not to exercise an option.

842-10-30-3 At the commencement date, an entity shall assess an option to purchase the **underlying asset** on the same basis as an option to extend or not to terminate a lease, as described in paragraph 842-10-30-2.

842-10-30-4 See paragraphs 842-10-55-19 through 55-21 for implementation guidance on commencement date and paragraphs 842-10-55-23 through 55-27 for implementation guidance on lease term and purchase options. See Examples 23 through 24 (paragraphs 842-10-55-210 through 55-224) for illustrations of the requirements on purchase options.

> Initial Measurement of the Lease Payments

842-10-30-5 At the **commencement date**, the **lease payments** shall consist of the following payments relating to the use of the **underlying asset** during the **lease term**:

- a. Fixed payments, including in substance fixed payments, less any lease incentives paid or payable to the **lessee** (see paragraphs 842-10-55-30 through 55-31).
- b. **Variable lease payments** that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate at the commencement date.
- c. The exercise price of an option to purchase the underlying asset if the lessee is reasonably certain to exercise that option (assessed considering the factors in paragraph 842-10-55-26).
- d. Payments for **penalties** for terminating the **lease** if the lease term (as determined in accordance with paragraph 842-10-30-1) reflects the lessee exercising an option to terminate the lease.
- e. Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction. However, such fees shall not be included in the **fair value** of the underlying asset for purposes of applying paragraph 842-10-25-2(d).
- f. For a lessee only, amounts **probable** of being owed by the lessee under **residual value guarantees** (see paragraphs 842-10-55-34 through 55-36).

842-10-30-6 Lease payments do not include any of the following:

- a. Variable lease payments other than those in paragraph 842-10-30-5(b)
- b. Any guarantee by the lessee of the **lessor's** debt
- c. Amounts allocated to nonlease components in accordance with paragraphs 842-10-15-33 through 15-42.

842-10-30-7 Paragraph 410-20-15-3(e) addresses the scope application of Subtopic 410-20 on asset retirement obligations to obligations of a lessee in connection with a lease (see paragraph 842-10-55-37).

842-10-30-8 See Example 25 (paragraphs 842-10-55-225 through 55-234) for an illustration of the requirements on lessee accounting for variable lease payments and Example 26 (paragraphs 842-10-55-235 through 55-238) for an illustration of the requirements on termination penalties.

> > Initial Direct Costs

842-10-30-9 Initial direct costs for a **lessee** or a **lessor** may include, for example, either of the following:

- a. Commissions
- b. Payments made to an existing tenant to incentivize that tenant to terminate its **lease**.

842-10-30-10 Costs to negotiate or arrange a lease that would have been incurred regardless of whether the lease was obtained, such as fixed employee salaries, are not initial direct costs. The following items are examples of costs that are not initial direct costs:

- a. General overheads, including, for example, depreciation, occupancy and equipment costs, unsuccessful origination efforts, and idle time
- b. Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities
- c. Costs related to activities that occur before the lease is obtained, such as costs of obtaining tax or legal advice, negotiating lease terms and conditions, or evaluating a prospective lessee's financial condition.

Subsequent Measurement

General

> Lease Term and Purchase Options

842-10-35-1 A **lessee** shall reassess the **lease term** or a lessee option to purchase the **underlying asset** only if and at the point in time that any of the following occurs:

- a. There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the **lease** or to purchase the underlying asset.
- b. There is an event that is written into the **contract** that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.
- c. The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.
- d. The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

842-10-35-2 See paragraphs 842-10-55-28 through 55-29 for implementation guidance on reassessing the lease term and lessee options to purchase the underlying asset.

842-10-35-3 A **lessor** shall not reassess the lease term or a lessee option to purchase the underlying asset unless the lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8. When a lessee exercises an option to extend or terminate the lease or purchase the underlying asset, the lessor shall account for the exercise of that option in the same manner as a **lease modification**.

> Subsequent Measurement of the Lease Payments

842-10-35-4 A **lessee** shall remeasure the **lease payments** if any of the following occur:

- a. The **lease** is modified, and that modification is not accounted for as a separate **contract** in accordance with paragraph 842-10-25-8.
- b. A contingency upon which some or all of the **variable lease payments** that will be paid over the remainder of the **lease term** are based is resolved such that those payments now meet the definition of lease payments. For example, an event occurs that results in variable lease payments that were linked to the performance or use of the **underlying asset** becoming fixed payments for the remainder of the lease term.
- c. There is a change in any of the following:
 1. The lease term, as described in paragraph 842-10-35-1. A lessee shall determine the revised lease payments on the basis of the revised lease term.
 2. The assessment of whether the lessee is reasonably certain to exercise or not to exercise an option to purchase the underlying asset, as described in paragraph 842-10-35-1. A lessee shall determine the revised lease payments to reflect the change in the assessment of the purchase option.
 3. Amounts **probable** of being owed by the lessee under **residual value guarantees**. A lessee shall determine the revised lease payments to reflect the change in amounts probable of being owed by the lessee under residual value guarantees.

842-10-35-5 When a lessee remeasures the lease payments in accordance with paragraph 842-10-35-4, variable lease payments that depend on an index or a rate shall be measured using the index or rate at the remeasurement date.

842-10-35-6 A **lessor** shall not remeasure the lease payments unless the lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8.

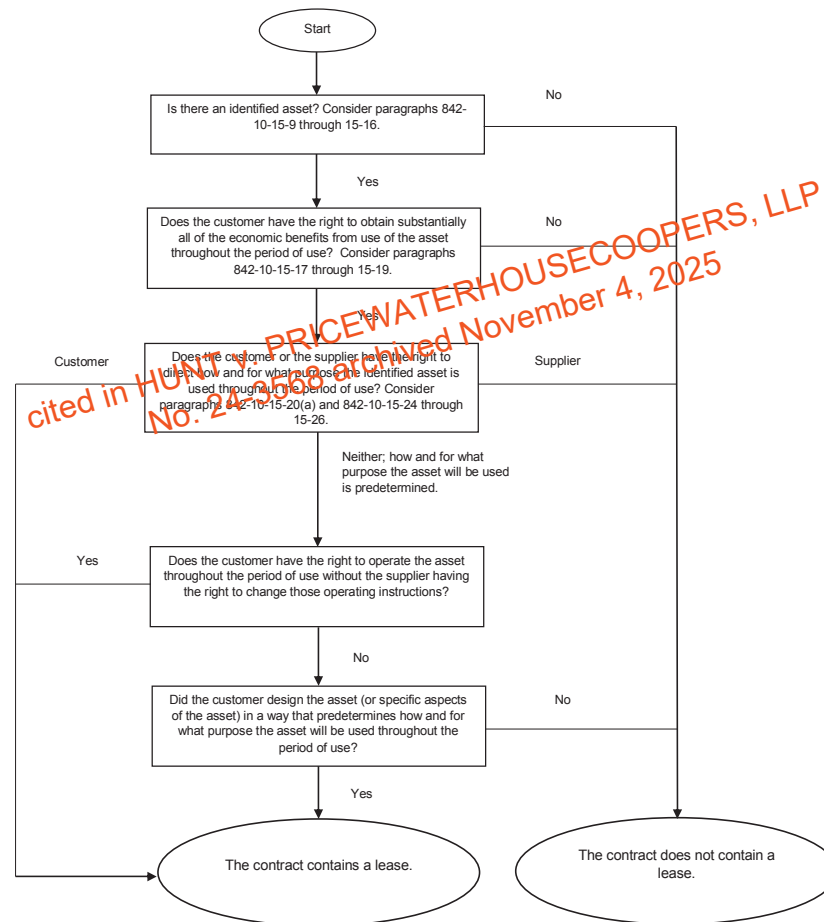
Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Identifying a Lease

842-10-55-1 The following flowchart depicts the decision process to follow in identifying whether a **contract** is or contains a **lease**. The flowchart does not include all of the guidance on identifying a lease in this Subtopic and is not intended as a substitute for the guidance on identifying a lease in this Subtopic.



> > Lease Classification

842-10-55-2 When determining **lease** classification, one reasonable approach to assessing the criteria in paragraphs 842-10-25-2(c) through (d) and 842-10-25-3(b)(1) would be to conclude:

- a. Seventy-five percent or more of the remaining **economic life** of the **underlying asset** is a major part of the remaining economic life of that underlying asset.
- b. A commencement date that falls at or near the end of the economic life of the underlying asset refers to a commencement date that falls within the last 25 percent of the total economic life of the underlying asset.
- c. Ninety percent or more of the **fair value** of the underlying asset amounts to substantially all the fair value of the underlying asset.

842-10-55-3 In some cases, it may not be practicable for an entity to determine the fair value of an underlying asset. In the context of this Topic, practicable means that a reasonable estimate of fair value can be made without undue cost or effort. It is a dynamic concept; what is practicable for one entity may not be practicable for another, what is practicable in one period may not be practicable in another, and what is practicable for one underlying asset (or class of underlying asset) may not be practicable for another. In those cases in which it is not practicable for an entity to determine the fair value of an underlying asset, lease classification should be determined without consideration of the criteria in paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1).

> > > Transfer-of-Ownership Criterion

842-10-55-4 The criterion in paragraph 842-10-25-2(a) is met in **leases** that provide, upon the **lessee's** performance in accordance with the terms of the lease, that the **lessor** should execute and deliver to the lessee such documents (including, if applicable, a bill of sale) as may be required to release the **underlying asset** from the lease and to transfer ownership to the lessee.

842-10-55-5 The criterion in paragraph 842-10-25-2(a) also is met in situations in which the lease requires the payment by the lessee of a nominal amount (for example, the minimum fee required by the statutory regulation to transfer ownership) in connection with the transfer of ownership.

842-10-55-6 A provision in a lease that ownership of the underlying asset is not transferred to the lessee if the lessee elects not to pay the specified fee (whether nominal or otherwise) to complete the transfer is an option to purchase the underlying asset. Such a provision does not satisfy the transfer-of-ownership criterion in paragraph 842-10-25-2(a).

> > > Alternative Use Criterion

842-10-55-7 In assessing whether an **underlying asset** has an alternative use to the **lessor** at the end of the **lease term** in accordance with paragraph 842-10-25-

2(e), an entity should consider the effects of contractual restrictions and practical limitations on the lessor's ability to readily direct that asset for another use (for example, selling it or leasing it to an entity other than the **lessee**). A contractual restriction on a lessor's ability to direct an underlying asset for another use must be substantive for the asset not to have an alternative use to the lessor. A contractual restriction is substantive if it is enforceable. A practical limitation on a lessor's ability to direct an underlying asset for another use exists if the lessor would incur significant economic losses to direct the underlying asset for another use. A significant economic loss could arise because the lessor either would incur significant costs to rework the asset or would only be able to sell or re-lease the asset at a significant loss. For example, a lessor may be practically limited from redirecting assets that either have design specifications that are unique to the lessee or that are located in remote areas. The possibility of the **contract** with the customer being terminated is not a relevant consideration in assessing whether the lessor would be able to readily direct the underlying asset for another use.

> > Effect of Investment Tax Credits

842-10-55-8 When evaluating the **lease** classification criteria in paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1), the **fair value** of the **underlying asset** should exclude any related investment tax credit retained by the lessor and expected to be realized by the lessor.

> > Residual Value Guarantees for a Portfolio of Underlying Assets

842-10-55-9 Lessors may obtain **residual value guarantees** for a portfolio of **underlying assets** for which settlement is not solely based on the residual value of the individual underlying assets. In such cases, the lessor is economically assured of receiving a minimum residual value for a portfolio of assets that are subject to separate **leases** but not for each individual asset. Accordingly, when an asset has a residual value in excess of the "guaranteed" amount, that excess is offset against shortfalls in residual value that exist in other assets in the portfolio.

842-10-55-10 Residual value guarantees of a portfolio of underlying assets preclude a lessor from determining the amount of the guaranteed residual value of any individual underlying asset within the portfolio. Consequently, no such amounts should be considered when evaluating the lease classification criteria in paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1).

> > Lease of an Acquiree

842-10-55-11 In a **business combination** or an **acquisition by a not-for-profit entity**, the acquiring entity should retain the previous **lease** classification in accordance with this Subtopic unless there is a **lease modification** and that modification is not accounted for as a separate **contract** in accordance with paragraph 842-10-25-8.

> > > Lease of a Related Party

842-10-55-12 Leases between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease. In the separate financial statements of the related parties, the classification and accounting for the leases should be the same as for leases between unrelated parties.

> > > Lease Involving Facilities Owned by a Government Unit or Authority

842-10-55-13 Because of special provisions normally present in **leases** involving terminal space and other airport facilities owned by a governmental unit or authority, the **economic life** of such facilities for purposes of classifying a lease is essentially indeterminate. Likewise, it may not be practicable to determine the **fair value** of the **underlying asset**. If it is impracticable to determine the fair value of the underlying asset and such leases also do not provide for a transfer of ownership or a purchase option that the **lessee** is reasonably certain to exercise, they should be classified as **operating leases**. This guidance also applies to leases of other facilities owned by a governmental unit or authority in which the rights of the parties are essentially the same as in a lease of airport facilities. Examples of such leases may be those involving facilities at ports and bus terminals. The guidance in this paragraph is intended to apply to leases only if all of the following conditions are met:

- a. The underlying asset is owned by a governmental unit or authority.
- b. The underlying asset is part of a larger facility, such as an airport, operated by or on behalf of the **lessor**.
- c. The underlying asset is a permanent structure or a part of a permanent structure, such as a building, that normally could not be moved to a new location.
- d. The lessor, or in some circumstances a higher governmental authority, has the explicit right under the lease agreement or existing statutes or regulations applicable to the underlying asset to terminate the lease at any time during the **lease term**, such as by closing the facility containing the underlying asset or by taking possession of the facility.
- e. The lease neither transfers ownership of the underlying asset to the lessee nor allows the lessee to purchase or otherwise acquire ownership of the underlying asset.
- f. The underlying asset or equivalent asset in the same service area cannot be purchased or leased from a nongovernmental unit or authority. An equivalent asset in the same service area is an asset that would allow continuation of essentially the same service or activity as afforded by the underlying asset without any appreciable difference in economic results to the lessee.

842-10-55-14 Leases of underlying assets not meeting all of the conditions in paragraph 842-10-55-13 are subject to the same criteria for classifying leases

under this Subtopic that are applicable to leases not involving government-owned property.

> > > Lessee Indemnification for Environmental Contamination

842-10-55-15 A provision that requires **lessee** indemnification for environmental contamination, whether for environmental contamination caused by the lessee during its use of the **underlying asset** over the **lease term** or for preexisting environmental contamination, should not affect the classification of the **lease**.

> > Lease Modifications

> > > Lease Modifications in Connection with the Refunding of Tax-Exempt Debt

842-10-55-16 In some situations, tax-exempt debt is issued to finance construction of a facility, such as a plant or hospital, that is transferred to a user of the facility by **lease**. A lease may serve as collateral for the guarantee of payments equivalent to those required to service the tax-exempt debt. Payments required by the terms of the lease are essentially the same, as to both amount and timing, as those required by the tax-exempt debt. A **lease modification** resulting from a refunding by the **lessor** of tax-exempt debt (including an **advance refunding**) should be accounted for in the same manner (that is, in accordance with paragraphs 842-10-25-8 through 25-18) as any other lease modification. For example, if the perceived economic advantages of the refunding are passed through to the **lessee** in the form of reduced **lease payments**, the lessee should account for the modification in accordance with paragraph 842-10-25-12, while the lessor should account for the modification in accordance with the applicable guidance in paragraphs 842-10-25-15 through 25-17.

> > > Master Lease Agreements

842-10-55-17 Under a master **lease** agreement, the **lessee** may gain control over the use of additional **underlying assets** during the term of the agreement. If the agreement specifies a minimum number of units or dollar value of equipment, the lessee obtaining control over the use of those additional underlying assets is not a **lease modification**. Rather, the entity (whether a lessee or a **lessor**) applies the guidance in paragraphs 842-10-15-28 through 15-42 when identifying the separate lease components and allocating the **consideration in the contract** to those components. Paragraph 842-10-55-22 explains that a master lease agreement may, therefore, result in multiple **commencement dates**.

842-10-55-18 If the master lease agreement permits the lessee to gain control over the use of additional underlying assets during the term of the agreement but does not commit the lessee to doing so, the lessee's taking control over the use of an additional underlying asset should be accounted for as a lease modification in accordance with paragraphs 842-10-25-8 through 25-18.

> > Commencement Date

842-10-55-19 In some **lease** arrangements, the **lessor** may make the **underlying asset** available for use by the **lessee** (for example, the lessee may take possession of or be given control over the use of the underlying asset) before it begins operations or makes **lease payments** under the terms of the lease. During this period, the lessee has the right to use the underlying asset and does so for the purpose of constructing a lessee asset (for example, leasehold improvements).

842-10-55-20 The **contract** may require the lessee to make lease payments only after construction is completed and the lessee begins operations. Alternatively, some contracts require the lessee to make lease payments when it takes possession of or is given control over the use of the underlying asset. The timing of when lease payments begin under the contract does not affect the **commencement date** of the lease.

842-10-55-21 Lease costs (or income) associated with building and ground leases incurred (earned) during and after a construction period are for the right to use the underlying asset during and after construction of a lessee asset. There is no distinction between the right to use an underlying asset during a construction period and the right to use that asset after the construction period. Therefore, lease costs (or income) associated with ground or building leases that are incurred (earned) during a construction period should be recognized by the lessee (or lessor) in accordance with the guidance in Subtopics 842-20 and 842-30, respectively. That guidance does not address whether a lessee that accounts for the sale or rental of real estate projects under Topic 970 should capitalize rental costs associated with ground and building leases.

> > > Master Lease Agreements

842-10-55-22 There may be multiple **commencement dates** resulting from a master **lease** agreement. That is because a master lease agreement may cover a significant number of **underlying assets**, each of which are made available for use by the **lessee** on different dates. Although a master lease agreement may specify that the lessee must take a minimum number of units or dollar value of equipment, there will be multiple commencement dates unless all of the underlying assets subject to that minimum are made available for use by the lessee on the same date.

> > Lease Term and Purchase Options

842-10-55-23 An entity should determine the noncancellable period of a **lease** when determining the **lease term**. When assessing the length of the noncancellable period of a lease, an entity should apply the definition of a **contract** and determine the period for which the contract is enforceable. A lease is no longer enforceable when both the **lessee** and the **lessor** each have the right to terminate the lease without permission from the other party with no more than an insignificant **penalty**.

842-10-55-24 If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term, as described in paragraph 842-10-30-1. If only a lessor has the right to terminate a lease, the noncancellable period of the lease includes the period covered by the option to terminate the lease.

842-10-55-25 The lease term begins at the **commencement date** and includes any rent-free periods provided to the lessee by the lessor.

> > Reasonably Certain

842-10-55-26 At the **commencement date**, an entity assesses whether the **lessee** is reasonably certain to exercise or not to exercise an option by considering all economic factors relevant to that assessment—contract-based, asset-based, market-based, and entity-based factors. An entity's assessment often will require the consideration of a combination of those factors because they are interrelated. Examples of economic factors to consider include, but are not limited to, any of the following:

- a. Contractual terms and conditions for the optional periods compared with current market rates, such as:
 1. The amount of **lease payments** in any optional period
 2. The amount of any **variable lease payments** or other contingent payments, such as payments under termination penalties and **residual value guarantees**
 3. The terms and conditions of any options that are exercisable after initial optional periods (for example, the terms and conditions of a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
- b. Significant leasehold improvements that are expected to have significant economic value for the lessee when the option to extend or terminate the **lease** or to purchase the **underlying asset** becomes exercisable.
- c. Costs relating to the termination of the lease and the signing of a new lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's operations, or costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.
- d. The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset and the location of the underlying asset.

> > Fiscal Funding Clauses

842-10-55-27 The existence of a **fiscal funding clause** in a **lease** agreement requires an assessment of the likelihood of lease cancellation through exercise of the fiscal funding clause. If it is more than **remote** that the fiscal funding clause will be exercised, the **lease term** should include only those periods for which funding is reasonably certain.

> > Reassessing the Lease Term and Purchase Options

842-10-55-28 Examples of significant events or significant changes in circumstances that a **lessee** should consider in accordance with paragraph 842-10-35-1 include, but are not limited to, the following:

- a. Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable
- b. Making significant modifications or customizations to the **underlying asset**
- c. Making a business decision that is directly relevant to the lessee's ability to exercise or not to exercise an option (for example, extending the **lease** of a complementary asset or disposing of an alternative asset)
- d. Subleasing the underlying asset for a period beyond the exercise date of the option.

842-10-55-29 A change in market-based factors (such as market rates to lease or purchase a comparable asset) should not, in isolation, trigger reassessment of the **lease term** or a lessee option to purchase the underlying asset.

> > Lease Payments

> > > Lease Incentives

842-10-55-30 Lease incentives include both of the following:

- a. Payments made to or on behalf of the **lessee**
- b. Losses incurred by the **lessor** as a result of assuming a lessee's preexisting lease with a third party. In that circumstance, the lessor and the lessee should independently estimate any loss attributable to that assumption. For example, the lessee's estimate of the lease incentive could be based on a comparison of the new lease with the market rental rate available for similar **underlying assets** or the market rental rate from the same lessor without the lease assumption. The lessor should estimate any loss on the basis of the total remaining costs reduced by the expected benefits from the **sublease** of use of the assumed underlying asset.

> > > In Substance Fixed Payments

842-10-55-31 Lease payments include in substance fixed lease payments. In substance fixed payments are payments that may, in form, appear to contain variability but are, in effect, unavoidable. In substance fixed payments for a **lessee** or a **lessor** may include, for example, any of the following:

- a. Payments that do not create genuine variability (such as those that result from clauses that do not have economic substance)

- b. The lower of the payments to be made when a lessee has a choice about which set of payments it makes, although it must make at least one set of payments.

> > > Guarantees and Indemnifications

842-10-55-32 Paragraph 460-10-15-4(c) states that, except as provided in paragraph 460-10-15-7, the provisions of Subtopic 460-10 on guarantees apply to indemnification agreements (**contracts**) that contingently require an indemnifying party (guarantor) to make payments to an indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party. Paragraph 460-10-55-23A provides related implementation guidance for a tax indemnification provided to a **lessor**.

842-10-55-33 A lessor should evaluate a commitment to guarantee performance of the **underlying asset** or to effectively protect the **lessee** from obsolescence of the underlying asset in accordance with paragraphs 606-10-55-30 through 55-35 on **warranties**. If the lessor's commitment is more extensive than a typical product warranty, it might indicate that the commitment is providing a service to the lessee that should be accounted for as a nonlease component of the contract.

> > > > Residual Value Guarantees

842-10-55-34 A lease provision requiring the lessee to make up a residual value deficiency that is attributable to damage, extraordinary wear and tear, or excessive usage is similar to variable lease payments in that the amount is not determinable at the commencement date. Such a provision does not constitute a lessee guarantee of the residual value.

842-10-55-35 If the lessor has the right to require the lessee to purchase the underlying asset by the end of the lease term, the stated purchase price is included in lease payments. That amount is, in effect, a guaranteed residual value that the lessee is obligated to pay on the basis of circumstances outside its control.

842-10-55-36 A residual value guarantee obtained by the lessee from an unrelated third party for the benefit of the lessor should not be used to reduce the amount of the lessee's lease payments under paragraph 842-10-30-5(f) except to the extent that the lessor explicitly releases the lessee from obligation, including the secondary obligation, which is if the guarantor defaults, a residual value deficiency must be made up. Amounts paid in consideration for a guarantee by an unrelated third party are executory costs and are not included in the lessee's lease payments.

> > > > Obligations to Return an Underlying Asset to its Original Condition

842-10-55-37 Obligations imposed by a lease agreement to return an underlying asset to its original condition if it has been modified by the lessee (for example, a requirement to remove a lessee-installed leasehold improvement) generally would not meet the definition of lease payments or variable lease payments and would be accounted for in accordance with Subtopic 410-20 on asset retirement and

environmental obligations. In contrast, costs to dismantle and remove an underlying asset at the end of the lease term that are imposed by the lease agreement generally would be considered lease payments or variable lease payments.

> > > Indemnification Clauses for Certain Tax Benefits

842-10-55-38 Some leases contain indemnification clauses that indemnify lessors on an after-tax basis for certain tax benefits that the lessor may lose if a change in the tax law precludes realization of those tax benefits. Although the indemnification payments may appear to meet the definition of variable lease payments, those payments are not of the nature normally expected to arise under variable lease payment provisions.

842-10-55-39 Because of the close association of the indemnification payments to specific aspects of the tax law, any payments should be accounted for in a manner that recognizes the tax law association. The lease classification should not be changed.

842-10-55-40 Paragraph 842-30-55-16 discusses a lessor's accounting for guarantee payments received.

> Illustrations

> > Illustration of Identifying a Lease

842-10-55-41 Examples 1 through 10 illustrate the identification of a lease.

> > > Example 1—Rail Cars

> > > > Case A—Contract Contains a Lease

842-10-55-42 A contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for 5 years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where, and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period.

842-10-55-43 The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfill each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (for example, if other

customers require the transport of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).

842-10-55-44 The contract contains leases of rail cars. Customer has the right to use 10 rail cars for 5 years.

842-10-55-45 There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired. The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

842-10-55-46 Customer has the right to control the use of the 10 rail cars throughout the 5-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.
- b. Customer has the right to direct the use of the cars. The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

842-10-55-47 Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

> > > Case B—Contract Does Not Contain a Lease

842-10-55-48 The contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified are equivalent to Customer having the use of 10 rail cars for 5 years. Supplier provides the rail cars, driver, and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfill the requirements of the contract.

Similarly, Supplier can choose to use any one of a number of engines to fulfill each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.

842-10-55-49 The contract does not contain a lease of rail cars or of an engine.

842-10-55-50 The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

- a. Supplier has the practical ability to substitute each car and the engine throughout the period of use. Alternative cars and engines are readily available to Supplier, and Supplier can substitute each car and the engine without Customer's approval.
- b. Supplier would benefit economically from substituting each car and the engine. There would be minimal, if any, cost associated with substituting each car or the engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting each car or the engine in contracts of this nature because substitution allows Supplier to, for example, (1) use cars or an engine to fulfill a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (2) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

842-10-55-51 Accordingly, Customer does not direct the use and does not have the right to obtain substantially all of the economic benefits from use of an identified car or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

> > > Example 2—Concession Space

842-10-55-52 A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

842-10-55-53 The contract does not contain a lease.

842-10-55-54 Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However,

the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

- a. Supplier has the practical ability to change the space used by Customer throughout the period of use. There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer's approval.
- b. Supplier would benefit economically from substituting the space. There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

> > Example 3—Fiber-Optic Cable

> > > Case A—Contract Contains a Lease

842-10-55-55 Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use 3 specified, physically distinct dark fibers within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic equipment (for example, Customer “lights” the fibers and decides what data and how much data those fibers will transport). If the fibers are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance, or malfunction (and is obliged to substitute the fibers in these cases).

842-10-55-56 The contract contains a lease of dark fibers. Customer has the right to use the 3 dark fibers for 15 years.

842-10-55-57 There are three identified fibers. The fibers are explicitly specified in the contract and are physically distinct from other fibers within the cable. Supplier cannot substitute the fibers other than for reasons of repairs, maintenance, or malfunction.

842-10-55-58 Customer has the right to control the use of the fibers throughout the 15-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the fibers over the 15-year period of use. Customer has exclusive use of the fibers throughout the period of use.
- b. Customer has the right to direct the use of the fibers. Customer makes the relevant decisions about how and for what purpose the fibers are used by deciding when and whether to light the fibers and when and how much output the fibers will produce (that is, what data and how much data those

fibers will transport). Customer has the right to change these decisions during the 15-year period of use.

842-10-55-59 Although Supplier's decisions about repairing and maintaining the fibers are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibers are used. Consequently, Supplier does not control the use of the fibers during the period of use.

> > > Case B—Contract Does Not Contain a Lease

842-10-55-60 Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of 3 strands within the cable (the cable contains 15 fibers with similar capacities). Supplier makes decisions about the transmission of data (that is, Supplier lights the fibers and makes decisions about which fibers are used to transmit Customer's traffic and about the electronic equipment that Supplier owns and connects to the fibers).

842-10-55-61 The contract does not contain a lease.

842-10-55-62 Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable. Consequently, Customer does not have the right to use an identified asset.

> > > Example 4—Retail Unit

842-10-55-63 Customer enters into a contract with property owner (Supplier) to use Retail Unit A for a five-year period. Retail Unit A is part of a larger retail space with many retail units.

842-10-55-64 Customer is granted the right to use Retail Unit A. Supplier can require Customer to relocate to another retail unit. In that case, Supplier is required to provide Customer with a retail unit of similar quality and specifications to Retail Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of retail space at a rate sufficiently favorable to cover the costs of relocating Customer and other tenants in the retail space that the new tenant will occupy. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise. For example, whether a major new tenant will decide to lease a large amount of retail space at a rate that would be sufficiently favorable to cover the costs of relocating Customer is highly susceptible to factors outside Supplier's influence.

842-10-55-65 The contract requires Customer to use Retail Unit A to operate its well-known store brand to sell its goods during the hours that the larger retail space

is open. Customer makes all of the decisions about the use of the retail unit during the period of use. For example, Customer decides on the mix of goods sold from the unit, the pricing of the goods sold, and the quantities of inventory held. Customer also controls physical access to the unit throughout the five-year period of use.

842-10-55-66 The contract requires Customer to make fixed payments to Supplier as well as variable payments that are a percentage of sales from Retail Unit A.

842-10-55-67 Supplier provides cleaning and security services as well as advertising services as part of the contract.

842-10-55-68 The contract contains a lease of retail space. Customer has the right to use Retail Unit A for five years.

842-10-55-69 Retail Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the retail unit, but could benefit economically from substitution only in specific circumstances. Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise.

842-10-55-70 Customer has the right to control the use of Retail Unit A throughout the five-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of Retail Unit A over the five-year period of use. Customer has exclusive use of Retail Unit A throughout the period of use. Although a portion of the cash flows derived from sales from Retail Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the retail unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits from use of Retail Unit A.
- b. Customer has the right to direct the use of Retail Unit A. The contractual restrictions on the goods that can be sold from Retail Unit A and when Retail Unit A is open define the scope of Customer's right to use Retail Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Retail Unit A is used by being able to decide, for example, the mix of products that will be sold in the retail unit and the sale price for those products. Customer has the right to change these decisions during the five-year period of use.

842-10-55-71 Although cleaning, security, and advertising services are essential to the efficient use of Retail Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Retail Unit A is used. Consequently, Supplier does not control the use of Retail Unit A during the period of use, and Supplier's decisions do not affect Customer's control of the use of Retail Unit A.

> > > **Example 5—Truck Rental**

842-10-55-72 Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, and so forth) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.

842-10-55-73 The cargo to be transported and the timing and location of pickup in New York and delivery in San Francisco are specified in the contract.

842-10-55-74 Customer is responsible for driving the truck from New York to San Francisco.

842-10-55-75 The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.

842-10-55-76 There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

842-10-55-77 Customer has the right to control the use of the truck throughout the period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from the use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.
- b. Customer has the right to direct the use of the truck. How and for what purpose the truck will be used (that is, the transport of specified cargo from New York to San Francisco within a specified time frame) are predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, and rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

842-10-55-78 Because the duration of the contract is one week, this lease meets the definition of a short-term lease.

> > > Example 6—Ship

> > > > Case A—Contract Does Not Contain a Lease

842-10-55-79 Customer enters into a contract with a ship owner (Supplier) for the transport of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract, and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.

842-10-55-80 Supplier operates and maintains the ship and is responsible for the safe passage of the cargo onboard the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

842-10-55-81 The contract does not contain a lease.

842-10-55-82 There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

842-10-55-83 Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits from use of the ship.

842-10-55-84 However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (that is, the transport of specified cargo from Rotterdam to Sydney within a specified time frame) are predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were one of multiple customers transporting cargo on the ship.

> > > **Case B—Contract Contains a Lease**

842-10-55-85 Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract, and Supplier does not have substitution rights.

842-10-55-86 Customer decides what cargo will be transported and whether, when, and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.

842-10-55-87 Supplier operates and maintains the ship and is responsible for the safe passage of the cargo onboard the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

842-10-55-88 The contract contains a lease. Customer has the right to use the ship for five years.

842-10-55-89 There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

842-10-55-90 Customer has the right to control the use of the ship throughout the five-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
- b. Customer has the right to direct the use of the ship. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where, and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

842-10-55-91 Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent on Customer's decisions about how and for what purpose the ship is used.

> > > Example 7—Aircraft

842-10-55-92 Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.

842-10-55-93 There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly and which passengers and cargo will be transported on the aircraft.

842-10-55-94 Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft or operating the aircraft itself during the term of the contract.

842-10-55-95 Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier's fleet to meet Customer's specifications.

842-10-55-96 The contract contains a lease. Customer has the right to use the aircraft for two years.

842-10-55-97 There is an identified asset. The aircraft is explicitly specified in the contract, and although Supplier can substitute the aircraft, its substitution right is

not substantive. Supplier's substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

842-10-55-98 Customer has the right to control the use of the aircraft throughout the two-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.
- b. Customer has the right to direct the use of the aircraft. The restrictions on where the aircraft can fly define the scope of Customer's right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where, and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

842-10-55-99 Although the operation of the aircraft is essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use, and Supplier's decisions do not affect Customer's control of the use of the aircraft.

> > > **Example 8—Contract for Shirts**

842-10-55-100 Customer enters into a contract with a manufacturer (Supplier) to purchase a particular type, quality, and quantity of shirts for a three-year period. The type, quality, and quantity of shirts are specified in the contract.

842-10-55-101 Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third-party supplier. The capacity of the factory exceeds the output for which Customer has contracted (that is, Customer has not contracted for substantially all of the capacity of the factory).

842-10-55-102 Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfill with the output of the factory that is not used to fulfill Customer's contract.

842-10-55-103 The contract does not contain a lease.

842-10-55-104 The factory is an identified asset. The factory is implicitly specified because Supplier can fulfill the contract only through the use of this asset.

842-10-55-105 However, Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits from

use of the factory. This is because Supplier could decide to use the factory to fulfill other customer contracts during the period of use.

842-10-55-106 Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year period of use. Customer's rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (that is, Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfill with the output produced).

842-10-55-107 Either the fact that Customer does not have the right to obtain substantially all of the economic benefits from use of the factory or the fact that Customer does not have the right to direct the use of the factory would be sufficient in isolation to conclude that Customer does not control the use of the factory.

> > > Example 9—Contract for Energy/Power

> > > > Case A—Contract Contains a Lease

842-10-55-108 A utility company (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract, and Supplier has no substitution rights. The solar farm is owned by Supplier, and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications and then operating and maintaining it. There are no decisions to be made about whether, when, or how much electricity will be produced because the design of the asset has predetermined these decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.

842-10-55-109 The contract contains a lease. Customer has the right to use the solar farm for 20 years.

842-10-55-110 There is an identified asset because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.

842-10-55-111 Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 20-year period of use. Customer has

exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will be receiving economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.

- b. Customer has the right to direct the use of the solar farm. Neither Customer nor Supplier decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (that is, the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm (as described in paragraph 842-10-15-20(b)(2)). Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

>>>> Case B—Contract Does Not Contain a Lease

842-10-55-112 Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by Supplier. Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer; Customer had no involvement in that design.

842-10-55-113 The contract does not contain a lease.

842-10-55-114 There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

842-10-55-115 Customer has the right to obtain substantially all of the economic benefits from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year term of the contract.

842-10-55-116 However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does

not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (that is, whether, when, and how much power the plant will produce) are predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use, nor does it have any other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

> > > Case C—Contract Contains a Lease

842-10-55-117 Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant (that is, Supplier cannot use the plant to fulfill other contracts).

842-10-55-118 Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.

842-10-55-119 Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.

842-10-55-120 The contract contains a lease. Customer has the right to use the power plant for 10 years.

842-10-55-121 There is an identified asset. The power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

842-10-55-122 Customer has the right to control the use of the power plant throughout the 10-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.
- b. Customer has the right to direct the use of the power plant. Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when, and how much power the plant will produce (that is, the timing and quantity, if any, of power produced) throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer's decision making about the timing and quantity of power produced, in effect, determines when and whether the plant produces output.

842-10-55-123 Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier's decisions are dependent on Customer's decisions about how and for what purpose the power plant is used.

> > > Example 10—Contract for Network Services

> > > > Case A—Contract Does Not Contain a Lease

842-10-55-124 Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. To provide the services, Supplier installs and configures servers at Customer's premises; Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.

842-10-55-125 The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

842-10-55-126 Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding on the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used. Supplier is the only party that can make decisions about the use of the servers during the period of use. Supplier has the right to decide how data are transported using the servers, whether to reconfigure the servers, and whether to use the servers for another purpose. Accordingly, Supplier controls the use of the servers in providing network services to Customer. There is no need to assess whether the servers are identified assets because Customer does not have the right to control the use of the servers.

> > > > Case B—Contract Contains a Lease

842-10-55-127 Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server

and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.

842-10-55-128 The contract contains a lease. Customer has the right to use the server for three years.

842-10-55-129 There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning.

842-10-55-130 Customer has the right to control the use of the server throughout the three-year period of use because:

- a. Customer has the right to obtain substantially all of the economic benefits from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.
- b. Customer has the right to direct the use of the server. Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

> > Illustrations of Allocating Consideration to Components of a Contract

842-10-55-131 Examples 11 through 14 illustrate separating components of a contract.

> > > Example 11—Allocation of Consideration to Lease and Nonlease Components of a Contract

> > > > Case A—Allocation of Consideration in the Contract

842-10-55-132 Lessor leases a bulldozer, a truck, and a crane to Lessee to be used in Lessee's construction operations for three years. Lessor also agrees to maintain each piece of equipment throughout the lease term. The total consideration in the contract is \$600,000, payable in \$200,000 annual installments.

842-10-55-133 Lessee and Lessor both conclude that the leases of the bulldozer, the truck, and the crane are each separate lease components because both of the criteria in paragraph 842-10-15-28 are met. That is:

- a. The criterion in paragraph 842-10-15-28(a) is met because Lessee can benefit from each of the three pieces of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative truck or crane to use with the bulldozer).
- b. The criterion in paragraph 842-10-15-28(b) is met because, despite the fact that Lessee is leasing all three machines for one purpose (that is, to engage in construction operations), the machines are not highly dependent on or highly interrelated with each other. The machines are not, in effect, inputs to a combined single item for which Lessee is

contracting. Lessor can fulfill each of its obligations to lease one of the underlying assets independently of its fulfillment of the other lease obligations, and Lessee's ability to derive benefit from the lease of each piece of equipment is not significantly affected by its decision to lease or not lease the other equipment from Lessor.

842-10-55-134 In accordance with paragraph 842-10-15-31, Lessee and Lessor will account for the nonlease maintenance services components separate from the three separate lease components (unless Lessee elects the practical expedient—see Case B [paragraphs 842-10-55-138 through 55-140]). In accordance with the identifying performance obligations guidance in paragraphs 606-10-25-19 through 25-22, Lessor further concludes that its maintenance services for each piece of leased equipment are distinct and therefore separate performance obligations, resulting in the conclusion that there are three separate lease components and three separate nonlease components (that is, three maintenance service performance obligations).

842-10-55-135 Lessor allocates the consideration in the contract to the separate lease components and nonlease components by applying the guidance in paragraphs 606-10-32-28 through 32-41. The consideration allocated to each separate lease component constitutes the lease payments for purposes of Lessor's accounting for those components.

842-10-55-136 Lessee allocates the consideration in the contract to the separate lease and nonlease components. Several suppliers provide maintenance services that relate to similar equipment such that there are observable standalone prices for the maintenance services for each piece of leased equipment. In addition, even though Lessor, who is the manufacturer of the equipment, requires that all leases of its equipment include maintenance services, Lessee is able to establish observable standalone prices for the three lease components on the basis of the price other lessors lease similar equipment on a standalone basis. The standalone prices for the separate lease and nonlease components are as follows.

	<u>Lease</u>	<u>Maintenance</u>
Bulldozer	\$ 200,000	\$ 50,000
Truck	120,000	20,000
Crane	240,000	70,000
	<u>\$ 560,000</u>	<u>\$ 140,000</u>

842-10-55-137 Lessee first allocates the consideration in the contract (\$600,000) to the lease and nonlease components on a relative basis, utilizing the observable standalone prices determined in paragraph 842-10-55-136. Lessee then accounts

for each separate lease component in accordance with Subtopic 842-20, treating the allocated consideration as the lease payments for each lease component. The nonlease components are accounted for by Lessee in accordance with other Topics. The allocation of the consideration to the lease and nonlease components is as follows.

	<u>Lease</u>	<u>Maintenance</u>
Bulldozer	\$ 171,429	\$ 42,857
Truck	102,857	17,143
Crane	205,714	60,000
	<u>\$ 480,000</u>	<u>\$ 120,000</u>

> > > Case B—Lessee Elects Practical Expedient to Not Separate Lease from Nonlease Components

842-10-55-138 Assume the same facts and circumstances as in Case A (paragraphs 842-10-55-132 through 55-137), except that Lessee has made an accounting policy election to use the practical expedient to not separate nonlease from lease components for its leased construction equipment. Consequently, Lessee does not separate the maintenance services from the related lease components but, instead, accounts for the contract as containing only three lease components.

842-10-55-139 Because Lessor regularly leases each piece of equipment bundled together with maintenance services on a standalone basis, there are observable standalone prices for each of the three combined components, each of which includes the lease and the maintenance services. Because each of the three separate lease components includes the lease of the equipment and the related maintenance services, the observable standalone price for each component in this scenario is greater than the observable standalone price for each separate lease component that does not include the maintenance services in Case A.

842-10-55-140 Lessee allocates the consideration in the contract (\$600,000) to the three separate lease components on a relative basis utilizing the observable standalone selling price of each separate lease component (inclusive of maintenance services) and then accounts for each separate lease component in accordance with the guidance in Subtopic 842-20, treating the allocated consideration as the lease payments for each separate lease component. The standalone prices for each of the three combined lease components is as follows.

	Standalone Price	Relative Standalone Price
Bulldozer	\$ 230,000	\$ 215,625
Truck	130,000	121,875
Crane	280,000	262,500
	<u>\$ 640,000</u>	<u>\$ 600,000</u>

> > > Example 12—Activities or Costs That Are Not Components of a Contract

> > > > Case A—Payments for Taxes and Insurance Are Variable

842-10-55-141 Lessor and Lessee enter into a five-year lease of a building. The contract designates that Lessee is required to pay for the costs relating to the asset, including the real estate taxes and the insurance on the building. The real estate taxes would be owed by Lessor regardless of whether it leased the building and who the lessee is. Lessor is the named insured on the building insurance policy (that is, the insurance protects Lessor's investment in the building, and Lessor will receive the proceeds from any claim). The annual lease payments are fixed at \$10,000 per year, while the annual real estate taxes and insurance premium will vary and be billed to Lessee each year.

842-10-55-142 The real estate taxes and the building insurance are not components of the contract. The contract includes a single lease component—the right to use the building. Lessee's payments of those amounts solely represent a reimbursement of Lessor's costs and do not represent payments for goods or services in addition to the right to use the building. However, because the real estate taxes and insurance premiums during the lease term are variable, those payments are variable lease payments that do not depend on an index or a rate and are excluded from the measurement of the lease liability and recognized in profit or loss in accordance with paragraph 842-20-25-5 or 842-20-25-6.

> > > > Case B—Payment for Taxes and Insurance Are Fixed

842-10-55-143 Assume the same facts and circumstances as in Case A (paragraphs 842-10-55-141 through 55-142), except that the fixed annual lease payment is \$13,000. There are no additional payments for real estate taxes or building insurance; however, the fixed payment is itemized in the contract (that is, \$10,000 for rent, \$2,000 for real estate taxes, and \$1,000 for building insurance). Consistent with Case A, the taxes and insurance are not components of the contract. The contract includes a single lease component, the right to use the

building. The \$65,000 in payments Lessee will make over the 5-year lease term are all lease payments for the single component of the contract and, therefore, are included in the measurement of the lease liability.

> > > Case C—Common Area Maintenance

842-10-55-144 Assume the same facts and circumstances as in Case B (paragraph 842-10-55-143), except that the lease is of space within the building, rather than for the entire building, and the fixed annual lease payment of \$13,000 also covers Lessor's performance of common area maintenance activities (for example, cleaning of common areas, parking lot maintenance, and providing utilities to the building). Consistent with Case B, the taxes and insurance are not components of the contract. However, the common area maintenance is a component because Lessor's activities transfer services to Lessee. That is, Lessee receives a service from Lessor in the form of the common area maintenance activities it would otherwise have to undertake itself or pay another party to provide (for example, cleaning the lobby for its customers, removing snow from the parking lot for its employees and customers, and providing utilities). The common area maintenance is a single component in this contract rather than multiple components, because Lessor performs the activities as needed (for example, plows snow or undertakes minor repairs when and as necessary) over the same period of time.

842-10-55-145 Therefore, the contract in Case C includes two components—a lease component (that is, the right to use the building) and a nonlease component. The consideration in the contract of \$65,000 is allocated between those 2 components; the amount allocated to the lease component is the lease payments in accounting for the lease.

> > > Example 13—Lease of a Turbine Plant

842-10-55-146 Lessor leases a gas-fired turbine plant to Lessee for eight years so that Lessee can produce electricity for its customers. The plant consists of the turbine housed within a building together with the land on which the building sits. The building was designed specifically to house the turbine, has a similar economic life as the turbine of approximately 15 years, and has no alternative use. The lease does not transfer ownership of any of the underlying assets to Lessee or grant Lessee an option to purchase any of the underlying assets. Lessor does not obtain a residual value guarantee from Lessee or any other unrelated third party. The present value of the lease payments is not substantially all of the aggregate fair value of the three underlying assets.

842-10-55-147 While the lease of the plant includes the lease of multiple underlying assets, the leases of those underlying assets do not meet the second criterion necessary to be separate lease components, which is that the right to use the underlying asset is neither dependent on nor highly interrelated with the other rights of use in the contract. Therefore, the contract contains only one lease component. The rights to use the turbine, the building, and the land are highly

interrelated because each is an input to the customized combined item for which Lessee has contracted (that is, the right to use a gas-fired turbine plant that can produce electricity for distribution to Lessee's customers).

842-10-55-148 However, because the contract contains the lease of land, Lessee and Lessor also must consider the guidance in paragraph 842-10-15-29. Lessee and Lessor each conclude that the effect of accounting for the right to use the land as a separate lease component would be insignificant because Lessee's right to use the turbine, the building, and the land is coterminous and separating the right to use the land from the right to use the turbine and the building would not affect the lease classification of the turbine/building lease component. Lessee and Lessor each conclude that a single lease component comprising the turbine, the building, and the land would be classified as an operating lease, as would two separate lease components comprising the land and the turbine/building, respectively.

842-10-55-149 The predominant asset in the single lease component is the turbine. Lessee entered into the lease primarily to obtain the power-generation capabilities of the turbine. The building and land enable Lessee to obtain the benefits from use of the turbine. The land and building would have little, if any, use or value to Lessee in this contract without the turbine. Therefore, the remaining economic life of the turbine is considered in evaluating the classification of the single lease component.

**>>> Example 14—Determining the Consideration in the Contract—
Variable Payments**

**>>> Case A—Variable Payments That Relate to the Lease Component
and the Nonlease Component**

842-10-55-150 Lessee and Lessor enter into a three-year lease of equipment that includes maintenance services on the equipment throughout the three-year lease term. Lessee will pay Lessor \$100,000 per year plus an additional \$7,000 each year that the equipment is operating a minimum number of hours at a specified level of productivity (that is, the equipment is not malfunctioning or inoperable). The potential \$7,000 payment each year is variable because the payment depends on the equipment operating a minimum number of hours at a specified level of productivity. The lease is an operating lease.

842-10-55-151 In accordance with paragraph 842-10-15-35, variable payments other than those that depend on an index or a rate are not accounted for as consideration in the contract by Lessee. Therefore, the consideration in the contract to be allocated by Lessee to the equipment lease and the maintenance services at lease commencement includes only the fixed payments of \$100,000 each year (or \$300,000 in total). Lessee allocates the consideration in the contract to the equipment lease and the maintenance services on the basis of the standalone prices of each, which, for purposes of this example, are \$285,000 and \$45,000, respectively.

	Standalone Price	Relative Standalone Price
Lease	\$ 285,000	\$ 259,091
Maintenance	45,000	40,909
	<u>\$ 330,000</u>	<u>\$ 300,000</u>

Each \$100,000 annual fixed payment and each variable payment are allocated to the equipment lease and the maintenance services on the same basis as the initial allocation of the consideration in the contract (that is, 86.4 percent to the equipment lease and 13.6 percent to the maintenance services). Therefore, annual lease expense, excluding variable expense, is \$86,364. Lessee recognizes the expense related to the variable payments in accordance with paragraphs 842-20-25-6 and 842-20-55-1 through 55-2.

842-10-55-152 In accordance with paragraphs 842-10-15-39 through 15-40, Lessor also concludes that the potential variable payments should not be accounted for as consideration in the contract. That is because the potential variable payment each year is not solely related to performance of the nonlease maintenance services; the quality and condition of the underlying asset also substantively affect whether the Lessor will earn those amounts. Therefore, Lessor's allocation of the consideration in the contract (\$300,000) in this Example is the same as Lessee. Lessor, in the same manner as Lessee, also will recognize the income related to the variable payments and allocate that income between the lease and nonlease maintenance services (on the same basis as the initial allocation of the consideration in the contract), when and if earned.

> > > Case B—Variable Payments That Relate Specifically to a Nonlease Component

842-10-55-153 Assume the same facts and circumstances as in Case A (paragraphs 842-10-55-150 through 55-152), except in this scenario the maintenance services are highly specialized and no entity would expect the equipment to meet the performance metrics without the specialized maintenance services.

842-10-55-154 Lessee would account for the potential variable payments consistent with Case A. The rationale for this accounting also is consistent with that in Case A.

842-10-55-155 In contrast to Case A, Lessor concludes that the variable payments relate specifically to an outcome from Lessor's performance of its maintenance services. Therefore, Lessor evaluates the variable payments in accordance with

the variable consideration guidance in paragraphs 606-10-32-5 through 32-13. If Lessor estimates, using the most likely amount method, that it will be entitled to receive the \$21,000 in variable payments and that it is probable that including that amount in the transaction price for the maintenance services would not result in a significant revenue reversal when the uncertainty of the performance bonus is resolved, the \$21,000 would be included in the consideration in the contract. Because allocating the \$21,000 entirely to the maintenance services would not result in an allocation that is consistent with the allocation objective in paragraph 606-10-32-28 (that is, it would result in allocating \$61,909 to the maintenance services and the remainder to the equipment lease, which would not reasonably depict the consideration to which Lessor expects to be entitled for each component), the entire consideration in the contract of \$321,000 is allocated on a relative standalone price basis as follows.

	Standalone Price	Relative Standalone Price
Lease	\$ 285,000	\$ 277,227
Maintenance	45,000	43,773
	<u>\$ 330,000</u>	<u>\$ 321,000</u>

842-10-55-156 The \$277,227 allocated to the equipment lease is the lease payment in accounting for the lease in accordance with Subtopic 842-30. Lessor will recognize the consideration in the contract allocated to the maintenance services in accordance with the guidance on the satisfaction of performance obligations in paragraphs 606-10-25-23 through 25-37. If the consideration in the contract changes (for example, because Lessor no longer estimates that it will receive the full \$21,000 in potential variable payments), Lessor will allocate the change in the transaction price on the same basis as was initially done.

> > > Case C—Allocating Variable Payments Entirely to a Nonlease Component

842-10-55-157 Assume the same facts and circumstances as in Case B (paragraphs 842-10-55-153 through 55-156), except that in this scenario all of the following apply:

- The potential variable payments are \$14,000 per year (\$42,000 in total), and the annual fixed payments are \$93,000 per year (\$279,000 in total).
- While Lessor's estimate of the variable payments to which it will be entitled is \$42,000, Lessor concludes that it is not probable that including the full \$42,000 in potential variable payments in the consideration in the

contract will not result in a significant revenue reversal (that is, the entity applies the constraint on variable consideration in paragraph 606-10-32-11). Lessor concludes that only \$28,000 is probable of not resulting in a significant revenue reversal. Therefore, the consideration in the contract is initially \$307,000 (\$279,000 + \$28,000).

842-10-55-158 In contrast to Case B, Lessor concludes that allocating the variable payments entirely to the maintenance services and the fixed payments entirely to the equipment lease is consistent with the allocation objective in paragraph 606-10-32-28. This is because \$42,000 (Lessor considers its estimate of the variable payments to which it expects to be entitled exclusive of the constraint on variable consideration in Topic 606 on revenue recognition) and \$279,000 approximate the standalone price of the maintenance services (\$45,000) and the equipment lease (\$285,000), respectively. Because the variable payments are allocated entirely to the maintenance services, if the consideration in the contract changes (for example, because Lessor concludes it is now probable that it will earn the full \$42,000 in variable payments), that change is allocated entirely to the maintenance services component in the contract.

> > Illustrations of Lease Modifications

842-10-55-159 Examples 15 through 22 illustrate the accounting for lease modifications.

> > > Lessee

> > > > Example 15—Modification Accounted for As a Separate Contract

842-10-55-160 Lessee enters into a 10-year lease for 10,000 square feet of office space. At the beginning of Year 6, Lessee and Lessor agree to modify the lease for the remaining 5 years to include an additional 10,000 square feet of office space in the same building. The increase in the lease payments is commensurate with the market rate at the date the modification is agreed for the additional 10,000 square feet of office space.

842-10-55-161 Lessee accounts for the modification as a new contract, separate from the original contract. This is because the modification grants Lessee an additional right of use as compared with the original contract, and the increase in the lease payments is commensurate with the standalone price of the additional right of use. Accordingly, from the effective date of the modification, Lessee would have 2 separate contracts, each of which contain a single lease component—the original, unmodified contract for 10,000 square feet of office space and the new contract for 10,000 additional square feet of office space, respectively. Lessee would not make any adjustments to the accounting for the original lease as a result of this modification.

> > > > Example 16—Modification That Increases the Lease Term

> > > > > Case A—No Change in Lease Classification

842-10-55-162 Lessee and Lessor enter into a 10-year lease for 10,000 square feet of office space in a building with a remaining economic life of 50 years. Annual payments are \$100,000, paid in arrears. Lessee's incremental borrowing rate at the commencement date is 6 percent. The lease is classified as an operating lease. At the beginning of Year 6, Lessee and Lessor agree to modify the lease such that the total lease term increases from 10 years to 15 years. The annual lease payments increase to \$110,000 per year for the remaining 10 years after the modification. Lessee's incremental borrowing rate is 7 percent at the date the modification is agreed to by the parties.

842-10-55-163 At the beginning of Year 6, Lessee's lease liability and its right-of-use asset both equal \$421,236 (that is, because the lease payments are made annually in arrears and because the lease payments are even throughout the lease term, the lease liability and right-of-use asset will be equal).

842-10-55-164 The modification does not grant an additional right of use to the lessee; rather, it changes (modifies) an attribute of the right to use the 10,000 square feet of office space Lessee already controls. That is, after the modification, Lessee still controls only a single right of use transferred to Lessee at the original lease commencement date.

842-10-55-165 Because the modification does not grant Lessee an additional right of use, the modification cannot be a separate contract. Therefore, at the effective date of the modification, Lessee reassesses classification of the lease (which does not change in this Example—see Case B, paragraphs 842-10-55-166 through 55-167] for a change in lease classification) and remeasures the lease liability on the basis of the 10-year remaining lease term, 10 remaining payments of \$110,000, and its incremental borrowing rate at the effective date of the modification of 7 percent. Consequently, the modified lease liability equals \$772,594. The increase to the lease liability of \$351,358 is recorded as an adjustment to the right-of-use asset (that is, there is no income or loss effect from the modification).

> > > > **Case B—Change in Lease Classification**

842-10-55-166 Assume the same facts as in Case A (paragraphs 842-10-55-162 through 55-165), except that the underlying asset is a piece of equipment with a 12-year remaining economic life at the effective date of the modification. Consequently, when the lessee reassesses classification of the lease in accordance with paragraph 842-10-25-1 as of the effective date of the modification based on the modified rights and obligations of the parties, the lessee classifies the modified lease as a finance lease (that is, because the remaining lease term of 10 years is for a major part of the 12-year remaining economic life of the equipment).

842-10-55-167 Consistent with Case A, at the effective date of the modification, the lessee remeasures its lease liability based on the 10-year remaining lease term, 10 remaining payments of \$110,000, and its incremental borrowing rate of 7 percent. Consequently, the modified lease liability equals \$772,594. The increase

to the lease liability of \$351,358 is recorded as an adjustment to the right-of-use asset (that is, there is no income or loss effect from the modification). However, different from Case A, beginning on the effective date of the modification, Lessee accounts for the 10-year modified lease as a finance lease.

> > > Example 17—Modification That Grants an Additional Right of Use

842-10-55-168 Lessee enters into a 10-year lease for 10,000 square feet of office space. The lease payments are \$100,000 per year, paid in arrears. Lessee's incremental borrowing rate at lease commencement is 6 percent. At the beginning of Year 6, Lessee and Lessor agree to modify the contract to include an additional 10,000 square feet of office space on a different floor of the building for the final 4 years of the original 10-year lease term for a total annual fixed payment of \$150,000 for the 20,000 square feet.

842-10-55-169 The increase in the lease payments (of \$50,000 per year) is at a substantial discount to the market rate at the date the modification is agreed to for leases substantially similar to that for the new 10,000 square feet of office space that cannot be attributed solely to the circumstances of the contract. Consequently, Lessee does not account for the modification as a separate contract.

842-10-55-170 Instead, Lessee accounts for the modified contract, which contains 2 separate lease components—first, the original 10,000 square feet of office space and, second, the right to use the additional 10,000 square feet of office space for 4 years that commences 1 year after the effective date of the modification. There are no nonlease components of the modified contract. The total lease payments, after the modification, are \$600,000 (1 payment of \$100,000 + 4 payments of \$150,000).

842-10-55-171 Lessee allocates the lease payments in the modified contract to the 2 separate lease components on a relative standalone price basis, which, in this Example, results in the allocation of \$388,889 to the original space lease and \$311,111 to the additional space lease. The allocation is based on the remaining lease terms of each separate lease component (that is, 5 years for the original 10,000-square-foot lease and 4 years for the additional 10,000-square-foot lease). The remaining lease cost for each separate lease component is equal to the total payments, as allocated, which will be recognized on a straight-line basis over their respective lease terms. Lessee remeasures the lease liability for the original space lease as of the effective date of the modification—the lease classification of which does not change as a result of the modification—on the basis of all of the following:

- a. A remaining lease term of 5 years
- b. Annual allocated lease payments of \$77,778 in Years 6 through 10 (see paragraph 842-10-55-173)
- c. Lessee's incremental borrowing rate at the effective date of the modification of 7 percent.

842-10-55-172 The remeasured lease liability for the original space lease equals \$318,904. Lessee recognizes the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification of \$102,332 (\$421,236 – \$318,904) as an adjustment to the right-of-use asset.

842-10-55-173 During Year 6, Lessee recognizes lease cost of \$77,778. At the end of Year 6, Lessee makes its lease payment of \$100,000, of which \$77,778 is allocated to the lease of the original office space and \$22,222 is allocated to the lease of the additional office space as a prepayment of rent. Lessee allocates the lease payment in this manner to reflect even payments for the even use of the separate lease components over their respective lease terms.

842-10-55-174 At the commencement date of the separate lease component for the additional office space, which is 1 year after the effective date of the modification, Lessee measures and recognizes the lease liability at \$241,896 on the basis of all of the following:

- a. A lease term of 4 years
- b. Four allocated annual payments of \$72,222 ([allocated lease payments of \$311,111 – \$22,222 rent prepayment] ÷ 4 years)
- c. Lessee's incremental borrowing rate at the commencement date of the separate lease component for the additional office space of 7.5 percent.

842-10-55-175 At the commencement date, the right-of-use asset for the additional office space lease component is recognized and measured at \$264,118 (the sum of the lease liability of \$241,896 and the prepaid rent asset of \$22,222).

842-10-55-176 During Years 7–10, Lessee recognizes lease cost of \$77,778 each year for each separate lease component and allocates each \$150,000 annual lease payment of \$77,778 to the original office space lease and \$72,222 to the additional office space lease.

> > > Example 18—Modification That Decreases the Scope of a Lease

842-10-55-177 Lessee enters into a 10-year lease for 10,000 square feet of office space. The annual lease payment is initially \$100,000, paid in arrears, and increases 5 percent each year during the lease term. Lessee's incremental borrowing rate at lease commencement is 6 percent. Lessee does not provide a residual value guarantee. The lease does not transfer ownership of the office space to Lessee or grant Lessee an option to purchase the space. The lease is an operating lease for all of the following reasons:

- a. The lease term is 10 years, while the office building has a remaining economic life of 40 years.
- b. The fair value of the office space is estimated to be significantly in excess of the present value of the lease payments.
- c. The office space is expected to have an alternative use to Lessor at the end of the lease term.

842-10-55-178 At the beginning of Year 6, Lessee and Lessor agree to modify the original lease for the remaining 5 years to reduce the lease to only 5,000 square feet of the original space and to reduce the annual lease payment to \$68,000. That amount will increase 5 percent each year thereafter of the remaining lease term.

842-10-55-179 The classification of the lease does not change as a result of the modification. It is clear based on the terms of the modified lease that it is not a finance lease because the modification reduces both the lease term and the lease payments. Lessee remeasures the lease liability for the modified lease at the effective date of the modification on the basis of all of the following:

- a. A remaining lease term of 5 years
- b. Lease payments of \$68,000 in the year of modification (Year 6), increasing by 5 percent each year thereafter
- c. Lessee's incremental borrowing rate at the effective date of the modification of 7 percent.

842-10-55-180 The remeasured lease liability equals \$306,098.

> > > > Case A—Remeasuring the Right-of-Use Asset Based on Change in Lease Liability

842-10-55-181 The difference between the premodification liability and the modified lease liability is \$284,669 (\$590,767 - \$306,098). That difference is 48.2 percent ($\$284,669 \div \$590,767$) of the premodification lease liability. The decrease in the lease liability reflects the early termination of the right to use 5,000 square feet of space (50 percent of the original leased space), the change in the lease payments, and the change in the discount rate.

842-10-55-182 Lessee decreases the carrying amount of the right-of-use asset to reflect the partial termination of the lease based on the adjustment to the carrying amount of the lease liability, with any difference recognized in profit or loss. The premodification right-of-use asset is \$514,436. Therefore, at the effective date of the modification, Lessee reduces the carrying amount of the right-of-use asset by \$247,888 ($48.2\% \times \$514,436$). Lessee recognizes the difference between the adjustment to the lease liability and the adjustment to the right-of-use asset ($\$284,669 - \$247,888 = \$36,781$) as a gain.

> > > > Case B—Remeasuring the Right-of-Use Asset Based on the Remaining Right of Use

842-10-55-183 Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset (that is, 5,000 square feet corresponding to 50 percent of the original right-of-use asset).

842-10-55-184 Fifty percent of the premodification right-of-use asset is \$257,218 ($50\% \times \$514,436$). Fifty percent of the premodification lease liability is \$295,384 ($50\% \times \$590,767$). Consequently, Lessee decreases the carrying amount of the right-of-use asset by \$257,218 and the carrying amount of the lease liability by

\$295,384. At the effective date of the modification, Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset of \$38,166 (\$295,384 – \$257,218) as a gain.

842-10-55-185 Lessee recognizes the difference between the remaining lease liability of \$295,384 and the modified lease liability of \$306,098 (which equals \$10,714) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

> > > Example 19—Modification That Changes the Lease Payments Only

842-10-55-186 Lessee enters into a 10-year lease for 10,000 square feet of office space. The lease payments are \$95,000 in Year 1, paid in arrears, and increase by \$1,000 every year thereafter. The original discount rate for the lease is 6 percent. The lease is an operating lease. At the beginning of Year 6, Lessee and Lessor agree to modify the original lease for the remaining 5 years to reduce the lease payments by \$7,000 each year (that is, the lease payments will be \$93,000 in Year 6 and will continue to increase by \$1,000 every year thereafter). The modification only changes the lease payments and, therefore, cannot be accounted for as a separate contract. The classification of the lease does not change as a result of the modification.

842-10-55-187 Lessee remeasures the lease liability for the modified lease on the basis of all of the following:

- a. Remaining lease term of 5 years
- b. Payments of \$93,000 in Year 6, increasing by \$1,000 each year for the remainder of the lease term
- c. Lessee's incremental borrowing rate at the effective date of the modification of 7 percent.

842-10-55-188 The remeasured lease liability equals \$388,965. Lessee recognizes the difference between the carrying amount of the modified lease liability and the lease liability immediately before the effective date of the modification of \$40,206 (\$429,171 premodification lease liability – \$388,965 modified lease liability) as a corresponding reduction to the right-of-use asset. Therefore, the adjusted right-of-use asset equals \$376,465 as of the effective date of the modification. Lessee calculates its remaining lease cost as \$462,500 (the sum of the total lease payments, as adjusted for the effects of the lease modification, of \$960,000 reduced by the total lease cost recognized in prior periods of \$497,500), which it will recognize on a straight-line basis over the remaining lease term.

842-10-55-189 During Year 6, Lessee recognizes lease cost of \$92,500 (\$462,500 remaining lease cost ÷ 5 years). As of the end of Year 6, Lessee's lease liability equals \$323,193 (present value of the remaining lease payments, discounted at 7 percent), and its right-of-use asset equals \$311,193 (the balance of the lease liability – the remaining accrued rent balance of \$12,000). Lessee recognizes

additional lease cost of \$92,500 each year of the remaining lease term and measures its lease liability and right-of-use asset in the same manner as at the end of Year 6 each remaining year of the lease term. The following are the balances of the lease liability and the right-of-use asset at the end of Years 7 through 10 of the lease.

	Lease Liability	Right-of-Use Asset
Year 7	\$ 251,816	\$ 241,316
Year 8	\$ 174,443	\$ 166,443
Year 9	\$ 90,654	\$ 86,154
Year 10	\$ -	\$ -

> > > Lessor

> > > > **Example 20—Modification of an Operating Lease That Does Not Change Lease Classification**

842-10-55-190 Lessor enters into a 10-year lease with Lessee for 10,000 square feet of office space. The annual lease payments are \$100,000 in the first year, increasing by 5 percent each year thereafter, payable in arrears. The lease term is not for a major part of the remaining economic life of the office space (40 years), and the present value of the lease payments is not substantially all of the fair value of the office space. Furthermore, the title does not transfer to Lessee as a consequence of the lease, the lease does not contain an option for Lessee to purchase the office space, and the asset is not specialized such that it clearly has an alternative use to Lessor at the end of the lease term. Consequently, the lease is classified as an operating lease.

842-10-55-191 At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining 5 years to include an additional 10,000 square feet of office space in the same building for a total annual fixed payment of \$150,000. The increase in total consideration is at a discount both to the current market rate for the new 10,000 square feet of office space and in the context of that particular contract. The modified lease continues to be classified as an operating lease.

842-10-55-192 At the effective date of the modification (at the beginning of Year 6), Lessor has an accrued lease rental asset of \$76,331 (rental income recognized on a straight-line basis for the first 5 years of the lease of \$628,895 [$\$1,257,789 \div 10$ years = \$125,779 per year] less lease payments for the first 5 years of \$552,564 [that is, \$100,000 in Year 1, \$105,000 in Year 2, \$110,250 in Year 3, \$115,763 in Year 4, and \$121,551 in Year 5]).

842-10-55-193 Because the change in pricing of the lease is not commensurate with the standalone price for the additional right-of-use asset, Lessor does not account for the modification as a new lease, separate from the original 10-year lease. Instead, Lessor accounts for the modified lease prospectively from the effective date of the modification, recognizing the lease payments to be made under the modified lease of \$750,000 ($\$150,000 \times 5$ years), net of Lessor's accrued rent asset of \$76,331, on a straight-line basis over the remaining 5-year lease term ($\$673,669 \div 5$ years = \$134,734 per year). At the end of the lease, Lessor will have recognized as lease income the \$1,302,564 in lease payments it receives from Lessee during the 10-year lease term.

> > > Example 21—Modification of an Operating Lease That Changes Lease Classification

> > > > Case A—Operating Lease to Sales-Type Lease

842-10-55-194 Lessor enters into a four-year lease of a piece of nonspecialized equipment. The annual lease payments are \$81,000 in the first year, increasing by 5 percent each year thereafter, payable in arrears. The estimated residual value of the equipment is \$90,000, of which none is guaranteed. The remaining economic life of the equipment at lease commencement is seven years. The carrying amount of the equipment and its fair value are both \$425,000 at the commencement date. The lease is not for a major part of the remaining economic life of the equipment, and the present value of the lease payments is not substantially all of the fair value of the equipment. Furthermore, title does not transfer to Lessee as a result of the lease, the lease does not contain an option for Lessee to purchase the underlying asset, and because the asset is nonspecialized, it is expected to have an alternative use to Lessor at the end of the lease term. Consequently, the lease is classified as an operating lease.

842-10-55-195 At the beginning of Year 3, Lessee and Lessor agree to extend the lease term by two years. That is, the modified lease is now a six-year lease, as compared with the original four-year lease. The additional two years were not an option when the original lease was negotiated. The modification alters the Lessee's right to use the equipment; it does not grant Lessee an additional right of use. Therefore, Lessor does not account for the modification as a separate contract from the original four-year lease contract.

842-10-55-196 On the effective date of the modification, the fair value of the equipment is \$346,250, and the remaining economic life of the equipment is 5 years. The estimated residual value of the equipment is \$35,000, of which none is guaranteed. The modified lease is for a major part of the remaining economic life of the equipment at the effective date of the modification (four years out of the five-year-remaining economic life of the equipment). Consequently, the modified lease is classified as a sales-type lease.

842-10-55-197 In accounting for the modification, Lessor determines the discount rate for the modified lease (that is, the rate implicit in the modified lease) to be 7.6

percent. Lessor recognizes the net investment in the modified lease of \$346,250 and derecognizes both the accrued rent and the equipment at the effective date of the modification. Lessor also recognizes, in accordance with paragraph 842-10-25-15(b), selling profit of \$34,169 (\$320,139 lease receivable – \$8,510 accrued rent balance – the \$277,460 carrying amount of the equipment derecognized, net of the unguaranteed residual asset [\$277,460 = \$303,571 – \$26,111]). After the effective date of the modification, Lessor accounts for the modified lease in the same manner as any other sales-type lease in accordance with Subtopic 842-30.

> > > > Case B—Operating Lease to Direct Financing Lease

842-10-55-198 At the beginning of Year 3, Lessee and Lessor enter into a modification to extend the lease term by 1 year, and Lessee agrees to make lease payments of \$108,000 per year for each of the remaining 3 years of the modified lease. No other terms of the contract are modified. Concurrent with the execution of the modification, Lessor obtains a residual value guarantee from an unrelated third party for \$40,000. Consistent with Case A (paragraphs 842-10-55-194 through 55-197), at the effective date of the modification the fair value of the equipment is \$346,250, the carrying amount of the equipment is \$303,571 and Lessor's accrued rent balance is \$8,510. The estimated residual value at the end of the modified lease term is \$80,000. The discount rate for the modified lease is 7.356 percent.

842-10-55-199 Lessor reassesses the lease classification as of the effective date of the modification and concludes that the modified lease is a direct financing lease because none of the criteria in paragraph 842-10-25-2 and both criteria in paragraph 842-10-25-3(b) are met.

842-10-55-200 Therefore, at the effective date of the modification, Lessor recognizes a net investment in the modified lease of \$312,081, which is the fair value of the equipment (\$346,250) less the selling profit on the lease (\$34,169 = \$313,922 lease receivable – \$8,510 accrued rent balance – the \$271,243 carrying amount of the equipment derecognized, net of the unguaranteed residual asset [\$271,243 = \$303,571 – \$32,328]), which is deferred as part of the net investment in the lease. After the effective date of the modification, Lessor accounts for the modified lease in the same manner as any other direct financing lease in accordance with Subtopic 842-30.

> > > Example 22—Modification of a Direct Financing Lease

842-10-55-201 Lessor enters into a six-year lease of a piece of new, nonspecialized equipment with a nine-year economic life. The annual lease payments are \$11,000, payable in arrears. The estimated residual value of the equipment is \$21,000, of which \$15,000 is guaranteed by a third-party unrelated to Lessee or Lessor. The lease does not contain an option for Lessee to purchase the equipment, and the title does not transfer to Lessee as a consequence of the lease. The fair value of the equipment at lease commencement is \$65,240, which is equal to its cost (and carrying amount). Lessor incurs no initial direct costs in connection with the lease. The rate implicit in the lease is 7.5 percent such that the present value of the lease payments is \$51,632 and does not amount to substantially all of the fair value of the equipment.

842-10-55-202 The Lessor concludes that the lease is not a sales-type lease because none of the criteria in paragraph 842-10-25-2 are met. However, the sum of the present value of the lease payments and the present value of the residual value of the underlying asset guaranteed by the third-party guarantor is \$61,352, which is substantially all of the fair value of the equipment, and collectibility of the lease payments is probable. Consequently, the lease is classified as a direct financing lease. Lessor recognizes the net investment in the lease of \$65,240 (which includes the lease receivable of \$61,352 and the present value of the unguaranteed residual value of \$3,888 [the present value of the difference between the expected residual value of \$21,000 and the guaranteed residual value of \$15,000]) and derecognizes the equipment with a carrying amount of \$65,240.

842-10-55-203 At the end of Year 1, Lessor receives a lease payment of \$11,000 from Lessee and recognizes interest income of \$4,893 ($\$65,240 \times 7.5\%$). Therefore, the carrying amount of the net investment in the lease is \$59,133 ($\$65,240 + \$4,893 - \$11,000$).

> > > > Case A—Direct Financing Lease to Direct Financing Lease

842-10-55-204 At the end of Year 1, the lease term is reduced by 1 year and the annual lease payment is reduced to \$10,000 for the remaining 4 years of the modified lease term. The estimated residual value of the equipment at the end of the modified lease term is \$33,000, of which \$30,000 is guaranteed by the unrelated third party, while the fair value of the equipment is \$56,000. The remaining economic life of the equipment is 8 years, and the present value of the remaining lease payments, discounted using the rate implicit in the modified lease of 8.857 percent, is \$32,499. Lessor concludes that the modified lease is not a sales-type lease because none of the criteria in paragraph 842-10-25-2 are met. However, the sum of the present value of the lease payments and the present value of the residual value of the underlying asset guaranteed by the third-party guarantor, discounted using the rate implicit in the modified lease of 8.857 percent, is \$53,864, which is substantially all of the fair value of the equipment, and collectibility of the lease payments is probable. As such, the modified lease is classified as a direct financing lease.

842-10-55-205 In accounting for the modification in accordance with paragraph 842-10-25-16(a), Lessor carries forward the balance of the net investment in the lease of \$59,133 immediately before the effective date of the modification as the opening balance of the net investment in the modified lease. To retain the same net investment in the lease even while the lease payments, the lease term, and the estimated residual value have all changed, Lessor adjusts the discount rate for the lease from the rate implicit in the modified lease of 8.857 percent to 6.95 percent. This discount rate is used to calculate interest income on the net investment in the lease throughout the remaining term of the modified lease and will result, at the end of the modified lease term, in a net investment balance that equals the estimated residual value of the underlying asset of \$33,000.

> > > > Case B—Direct Financing Lease to Sales-Type Lease

842-10-55-206 At the end of Year 1, the lease term is extended for two years. The lease payments remain \$11,000 annually, paid in arrears, for the remainder of the lease term. The estimated residual value is \$6,500, of which none is guaranteed. The rate implicit in the modified lease is 7.58 percent. At the effective date of the modification, the remaining economic life of the equipment is 8 years, and the fair value of the equipment is \$62,000. Because the modified lease term is now for the major part of the remaining economic life of the equipment, the modified lease is classified as a sales-type lease.

842-10-55-207 On the effective date of the modification, Lessor recognizes a net investment in the sales-type lease of \$62,000, which is equal to the fair value of the equipment at the effective date of the modification, and derecognizes the carrying amount of the net investment in the original direct financing lease of \$59,133. The difference of \$2,867 is the selling profit on the modified lease. After the effective date of the modification, Lessor accounts for the sales-type lease in the same manner as any other sales-type lease in accordance with Subtopic 842-30.

> > > > Case C—Direct Financing Lease to Operating Lease

842-10-55-208 At the end of Year 1, the lease term is reduced by 2 years, and the lease payments are reduced to \$9,000 per year for the remaining 3-year lease term. The estimated residual value is revised to \$33,000, of which only \$13,000 is guaranteed by an unrelated third party. The fair value of the equipment at the effective date of the modification is \$56,000. The modified lease does not transfer the title of the equipment to Lessee or grant Lessee an option to purchase the equipment. The modified lease is classified as an operating lease because it does not meet any of the criteria to be classified as a sales-type lease or as a direct financing lease.

842-10-55-209 Therefore, at the effective date of the modification, Lessor derecognizes the net investment in the lease, which has a carrying amount of \$59,133, and recognizes the equipment at that amount. Collectibility of the lease payments is probable; therefore, Lessor will recognize the \$27,000 ($\$9,000 \times 3$

years) in lease payments on a straight-line basis over the 3-year modified lease term, as well as depreciation on the rerecognized equipment.

> > Illustration of Lessee Accounting for Purchase Options

842-10-55-210 Examples 23 through 24 illustrate the evaluation of whether a lessee is reasonably certain to exercise an option to purchase the underlying asset.

> > > Example 23—Lessee Purchase Option

842-10-55-211 Lessee enters into a 5-year lease of equipment with annual lease payments of \$59,000, payable at the end of each year. There are no initial direct costs incurred by Lessee or lease incentives. At the end of Year 5, Lessee has an option to purchase the equipment for \$5,000. The expected residual value of the equipment at the end of the lease is \$75,000. Because the exercise price of the purchase option is significantly discounted from the expected fair value of the equipment at the time the purchase option becomes exercisable, Lessee concludes that it is reasonably certain to exercise the purchase option. The fair value of the equipment at the commencement date is \$250,000, and its economic life is 7 years. The discount rate for the lease, which is Lessee's incremental borrowing rate because the rate implicit in the lease is not available, is 6.5 percent.

842-10-55-212 Because the lease grants Lessee an option to purchase the underlying asset that it is reasonably certain to exercise, Lessee classifies the lease as a finance lease.

842-10-55-213 Lessee recognizes the lease liability at the commencement date at \$248,834 (the present value of 5 payments of \$59,000 + the present value of the \$5,000 payment for the purchase option, discounted at 6.5%). Because there are no initial direct costs, lease incentives, or other payments made to Lessor at or before the commencement date, Lessee recognizes the right-of-use asset at the same amount as the lease liability.

842-10-55-214 Lessee amortizes the right-of-use asset over the seven-year expected useful life of the equipment, rather than over the lease term of five years, because Lessee is reasonably certain to exercise the option to purchase the equipment. Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset is amortized on a straight-line basis.

842-10-55-215 During the first year of the lease, Lessee recognizes interest expense on the lease liability of \$16,174 ($6.5\% \times \$248,834$) and amortization of the right-of-use asset of \$35,548 ($\$248,834 \div 7$).

842-10-55-216 At the end of Year 1, the right-of-use asset is \$213,286 ($\$248,834 - \$35,548$), and the lease liability is \$206,008 ($\$248,834 + \$16,174 - \$59,000$).

842-10-55-217 At the end of Year 5, the carrying amount of the right-of-use asset is \$71,094 ($\$248,834 - [\$35,548 \times 5]$), and the remaining lease liability is \$5,000, which is the exercise price of the purchase option. Lessee exercises the purchase

option and settles the remaining lease liability. If the right-of-use asset was not previously presented together with property, plant, and equipment, Lessee reclassifies the right-of-use asset to property, plant, and equipment and applies Topic 360 to the asset beginning on the date the purchase option is exercised.

> > Example 24—Lessee Purchase Option

842-10-55-218 Lessee enters into a 5-year lease of specialized equipment with annual lease payments of \$65,000, payable in arrears. There are no initial direct costs or lease incentives. At the end of Year 5, Lessee has an option to purchase the equipment for \$90,000, which is the expected fair value of the equipment at that date. Lessor constructed the equipment specifically for the needs of Lessee. Furthermore, the specialized equipment is vital to Lessee's business; without this asset, Lessee would be required to halt operations while a new asset was built or customized. As such, Lessee concludes that it is reasonably certain to exercise the purchase option because the specialized nature, specifications of the asset, and its role in Lessee's operations create a significant economic incentive for Lessee to do so. The fair value of the equipment at the commencement date is \$440,000, and its economic life is 10 years. Lessee's incremental borrowing rate is 6.5 percent, which reflects the fixed rate at which Lessee could borrow an amount similar to that of the lease payments ($[\$65,000 \times 5 \text{ lease payments}] + \text{the } \$90,000 \text{ purchase option exercise price} = \$415,000$) in the same currency, for the same term, and with similar collateral as in the lease at the commencement date.

842-10-55-219 The lease grants Lessee an option to purchase the underlying asset that it is reasonably certain to exercise. In addition, the underlying asset is of such a specialized nature that it is expected to have no alternative use to Lessor at the end of the lease term. As such, Lessee classifies the lease as a finance lease.

842-10-55-220 Lessee recognizes the lease liability at the commencement date at \$335,808 (the present value of 5 payments of \$65,000 + the present value of the \$90,000 payment for the purchase option to be made at the end of Year 5, discounted at 6.5%). Because there are no initial direct costs, lease incentives, or other payments made to Lessor at or before the commencement date, Lessee recognizes the right-of-use asset at the same amount as the lease liability.

842-10-55-221 Lessee amortizes the right-of-use asset over the 10-year expected useful life of the equipment rather than over the lease term of 5 years, because Lessee is reasonably certain to exercise the option to purchase the equipment. Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset is amortized on a straight-line basis.

842-10-55-222 During the first year of the lease, Lessee recognizes interest expense on the lease liability of \$21,828 ($6.5\% \times \$335,808$) and amortization of the right-of-use asset of \$33,581 ($\$335,808 \div 10$).

842-10-55-223 At the end of Year 1, the right-of-use asset is \$302,227 ($\$335,808 - \$33,581$), and the lease liability is \$292,636 ($\$335,808 + \$21,828 - \$65,000$).

842-10-55-224 At the end of Year 5, the carrying amount of the right-of-use asset is \$167,903 ($\$335,808 - \$33,581 \times 5$), and the remaining lease liability is \$90,000, which is the amount of the purchase option. Lessee exercises the option to purchase the equipment and settles the remaining lease liability. If the right-of-use asset was not previously presented together with property, plant, and equipment, Lessee reclassifies the right-of-use asset to property, plant, and equipment and will apply Topic 360 to the equipment beginning on the date the purchase option is exercised.

> > Illustrations of Lessee Accounting for Variable Lease Payments

842-10-55-225 Example 25 illustrates how a lessee accounts for variable lease payments that depend on an index or a rate and variable lease payments that are linked to performance.

> > > Example 25—Variable Lease Payments That Depend on an Index or a Rate and Variable Lease Payments Linked to Performance

> > > > Case A—Variable Lease Payments That Depend on an Index or a Rate

842-10-55-226 Lessee enters into a 10-year lease of a building with annual lease payments of \$100,000, payable at the beginning of each year. The contract specifies that lease payments for each year will increase on the basis of the increase in the Consumer Price Index for the preceding 12 months. The Consumer Price Index at the commencement date is 125. This Example ignores any initial direct costs. The lease is classified as an operating lease.

842-10-55-227 The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 8 percent, which reflects the rate at which Lessee could borrow an amount equal to the lease payment in the same currency, over a similar term, and with similar collateral as in the lease.

842-10-55-228 At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at \$624,689 (the present value of 9 payments of \$100,000 discounted at the rate of 8 percent). The right-of-use asset is equal to the lease liability plus the prepaid rent (\$724,689).

842-10-55-229 Lessee prepares financial statements on an annual basis. Lessee determines the cost of the lease to be \$1 million (the total lease payments for the lease term). The annual lease expense to be recognized is \$100,000 ($\$1 \text{ million} \div 10 \text{ years}$).

842-10-55-230 At the end of the first year of the lease, the Consumer Price Index is 128. Lessee calculates the payment for the second year, adjusted to the Consumer Price Index, to be \$102,400 ($\$100,000 \times 128 \div 125$).

842-10-55-231 Because Lessee has not remeasured the lease liability for another reason, Lessee does not make an adjustment to the lease liability to reflect the Consumer Price Index at the end of the reporting period; that is, the lease liability continues to reflect annual lease payments of \$100,000 (8 remaining annual payments of \$100,000, discounted at the rate of 8 percent is \$574,664). However, the Year 2 payment amount of \$102,400 (the \$100,000 annual fixed payment + \$2,400 variable lease payment) will be recognized in profit or loss for Year 2 of the lease and classified as cash flow from operations in Lessee's statement of cash flows. In its quantitative disclosures, Lessee will include \$100,000 of the \$102,400 in its disclosure of operating lease cost and \$2,400 in its disclosure of variable lease cost.

> > > Case B—Variable Lease Payments Linked to Performance

842-10-55-232 Lessee enters into a 10-year lease of a building with annual lease payments of \$100,000, payable at the beginning of each year. The contract specifies that Lessee also is required to make variable lease payments each year of the lease, which are determined as 2 percent of Lessee's sales generated from the building.

842-10-55-233 At the commencement date, Lessee measures the lease liability and right-of-use asset at the same amounts as in Case A (paragraphs 842-10-55-226 through 55-231) because the 2 percent royalty that will be paid each year to Lessor under the lease is a variable lease payment, which means that payment is not included in the measurement of the lease liability (or the right-of-use asset) at any point during the lease.

842-10-55-234 During the first year of the lease, Lessee generates sales of \$1.2 million from the building and, therefore, recognizes total lease cost of \$124,000 (\$100,000 + [2% × \$1.2 million]). In its quantitative disclosures, Lessee will include \$100,000 of the \$124,000 in its disclosure of operating lease cost and \$24,000 in its disclosure of variable lease cost.

> > Illustration of Lessee Accounting for Termination Penalties

842-10-55-235 Example 26 illustrates how a lessee accounts for termination penalties.

> > > Example 26—Termination Penalties

842-10-55-236 Lessee enters into a 10-year lease of an asset, which it can terminate at the end of each year beginning at the end of Year 6. Lease payments are \$50,000 per year during the 10-year term, payable at the beginning of each year. If Lessee terminates the lease at the end of Year 6, Lessee must pay a penalty to Lessor of \$20,000. The termination penalty decreases by \$5,000 in each successive year.

842-10-55-237 At the commencement date, Lessee concludes that it is not reasonably certain it will continue to use the underlying asset after Year 6, having

considered both the significance of the termination penalty (in absolute terms and in relation to the remaining lease payments after the date the termination option becomes exercisable) and the other factors in paragraph 842-10-55-26.

842-10-55-238 Accordingly, Lessee determines that the lease term is six years. At the commencement date, Lessee measures the lease liability on the basis of lease payments of \$50,000 for 6 years plus the penalty of \$20,000 payable at the end of Year 6.

> > Illustration of Initial Direct Costs

842-10-55-239 Example 27 illustrates initial direct costs.

> > > Example 27—Initial Direct Costs

842-10-55-240 Lessee and Lessor enter into an operating lease. The following costs are incurred in connection with the lease:

Travel costs related to lease proposal	\$ 7,000
External legal fees	2,000
Allocation of employee costs for time negotiating lease terms and conditions	6,000
Commissions to brokers	10,000
Total costs incurred by Lessor	<u>\$ 45,000</u>
External legal fees	\$ 15,000
Allocation of employee costs for time negotiating lease terms and conditions	7,000
Payments made to existing tenant to obtain the lease	20,000
Total costs incurred by Lessee	<u>\$ 42,000</u>

842-10-55-241 Lessor capitalizes initial direct costs of \$10,000, which it recognizes ratably over the lease term, consistent with its recognition of lease income. The \$10,000 in broker commissions is an initial direct cost because that cost was incurred only as a direct result of obtaining the lease (that is, only as a direct result of the lease being executed). None of the other costs incurred by Lessor meet the definition of initial direct costs because they would have been incurred even if the lease had not been executed. For example, the employee salaries are paid regardless of whether the lease is obtained, and Lessor would be required to pay its attorneys for negotiating and drafting the lease even if Lessee did not execute the lease.

842-10-55-242 Lessee includes \$20,000 of initial direct costs in the initial measurement of the right-of-use asset. Lessee amortizes those costs ratably over

the lease term as part of its total lease cost. Throughout the lease term, any unamortized amounts from the original \$20,000 are included in the measurement of the right-of-use asset. The \$20,000 payment to the existing tenant is an initial direct cost because that cost is only incurred upon obtaining the lease; it would not have been owed if the lease had not been executed. None of the other costs incurred by Lessee meet the definition of initial direct costs because they would have been incurred even if the lease had not been executed (for example, the employee salaries are paid regardless of whether the lease is obtained, and Lessee would be required to pay its attorneys for negotiating and drafting the lease even if the lease was not executed).

> > Illustrations of Transition

> > > Illustration of Lessee Transition—Existing Capital Lease

842-10-55-243 Example 28 illustrates lessee accounting for the transition of existing capital leases.

> > > Example 28—Lessee Transition—Existing Capital Lease

842-10-55-244 The effective date of the guidance in this Topic for Lessee is January 1, 20X4. Lessee enters into a 7-year lease of an asset on January 1, 20X1, with annual lease payments of \$25,000 payable at the end of each year. The lease includes a residual value guarantee by Lessee, of \$8,190. Lessee's incremental borrowing rate on the date of commencement was 6 percent. Lessee accounts for the lease as a capital lease. At lease commencement, Lessee defers initial direct costs of \$2,800, which will be amortized over the lease term. On January 1, 20X2 (and before transition adjustments), Lessee has a lease liability of \$128,707, a lease asset of \$124,434, and unamortized initial direct costs of \$2,400.

842-10-55-245 January 1, 20X2 is the beginning of the earliest comparative period presented in the financial statements in which Lessee first applies the guidance in this Topic. Lessee has elected the package of practical expedients in paragraph 842-10-65-1(f). As such, Lessee accounts for the lease as a finance lease, without reassessing whether the contract contains a lease or whether classification of the lease would be different in accordance with this Topic. Lessee also does not reassess whether the unamortized initial direct costs on January 1, 20X2, would have met the definition of initial direct costs in this Topic at lease commencement.

842-10-55-246 On January 1, 20X2, Lessee recognizes a lease liability at the carrying amount of the capital lease obligation on December 31, 20X1, of \$128,707 and a right-of-use asset at the carrying amount of the capital lease asset of \$126,834 (which includes unamortized initial direct costs of \$2,400 that were included in the capital lease asset). Lessee subsequently measures the lease liability and the right-of-use asset in accordance with Subtopic 840-30 until the effective date.

842-10-55-247 Beginning on the effective date, Lessee applies the subsequent measurement guidance in Section 842-20-35, including the reassessment requirements, except for the requirement to reassess amounts probable of being owed under residual value guarantees. Such amounts will only be reassessed if there is a remeasurement of the lease liability for another reason, including as a result of a lease modification (that is, not accounted for as a separate contract).

> > > Illustration of Lessee Transition—Existing Operating Lease

842-10-55-248 Example 29 illustrates lessee accounting for the transition of existing operating leases.

> > > Example 29—Lessee Transition—Existing Operating Lease

842-10-55-249 The effective date of the guidance in this Topic for Lessee is January 1, 20X4. Lessee enters into a five-year lease of an asset on January 1, 20X1, with annual lease payments payable at the end of each year. Lessee accounts for the lease as an operating lease. At lease commencement, Lessee defers initial direct costs of \$500, which will be amortized over the lease term. On January 1, 20X2 (and before transition adjustments), Lessee has an accrued rent liability of \$1,200 for the lease, reflecting rent that was previously recognized as an expense but was not yet paid as of that date. Four lease payments (1 payment of \$31,000 followed by 3 payments of \$33,000) and unamortized initial direct costs of \$400 remain.

842-10-55-250 January 1, 20X2 is the beginning of the earliest comparative period presented in the financial statements in which Lessee first applies the guidance in this Topic. On January 1, 20X2, Lessee's incremental borrowing rate is 6 percent. Lessee has elected the package of practical expedients in paragraph 842-10-65-1(f). As such, Lessee accounts for the lease as an operating lease, without reassessing whether the contract contains a lease or whether classification of the lease would be different in accordance with this Topic. Lessee also does not reassess whether the unamortized initial direct costs on January 1, 20X2, would have met the definition of initial direct costs in this Topic at lease commencement.

842-10-55-251 On January 1, 20X2, Lessee measures the lease liability at \$112,462, which is the present value of 1 payment of \$31,000 and 3 payments of \$33,000 discounted using the rate of 6 percent. The right-of-use asset is equal to the lease liability before adjustment for accrued rent and unamortized initial direct costs, which were not reassessed because Lessee elected the practical expedients in paragraph 842-10-65-1(f).

842-10-55-252 On January 1, 20X2, Lessee recognizes a lease liability of \$112,462 and a right-of-use asset of \$111,662 (\$112,462 – \$1,200 + \$400).

842-10-55-253 From the transition date (January 1, 20X2) on, Lessee will continue to measure and recognize the lease liability at the present value of the sum of the remaining minimum rental payments (as that term was applied under Topic 840) and the right-of-use asset in accordance with this Topic.

842-10-55-254 Beginning on the effective date of January 1, 20X4, Lessee applies the subsequent measurement guidance in Section 842-20-35, including the reassessment requirements.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2016-02, *Leases* (Topic 842)

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-02, *Leases* (Topic 842):

- a. A **public business entity**, a **not-for-profit entity** that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Earlier application is permitted.
- b. All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Earlier application is permitted.
- c. In the financial statements in which an entity first applies the pending content that links to this paragraph, the entity shall recognize and measure **leases** within the scope of the pending content that links to this paragraph that exist at the beginning of the earliest comparative period presented, using the approach described in (i) through (ee).
- d. An entity shall adjust equity at the beginning of the earliest comparative period presented, and the other comparative amounts disclosed for each prior period presented in the financial statements, as if the pending content that links to this paragraph had always been applied, subject to the requirements in (h) through (dd).
- e. If a **lessee** elects not to apply the recognition and measurement requirements in the pending content that links to this paragraph to **short-term leases**, the lessee shall not apply the approach described in (k) through (s) to short-term leases.

See Examples 28 through 29 (paragraphs 842-10-55-243 through 55-254) for illustrations of the transition requirements.

Practical expedients

- f. An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a **lessor**), when applying the pending content that links to this paragraph to leases that commenced before the effective date:
1. An entity need not reassess whether any expired or existing **contracts** are or contain leases.
 2. An entity need not reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as **operating leases** in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as **finance leases**).
 3. An entity need not reassess **initial direct costs** for any existing leases.
- g. An entity also may elect a practical expedient, which must be applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor) to use hindsight in determining the **lease term** (that is, when considering lessee options to extend or terminate the lease and to purchase the **underlying asset**) and in assessing impairment of the entity's **right-of-use assets**. This practical expedient may be elected separately or in conjunction with the practical expedients in (f).

Amounts previously recognized in respect of business combinations

- h. If an entity has previously recognized an asset or a liability in accordance with Topic 805 on **business combinations** relating to favorable or unfavorable terms of an operating lease acquired as part of a business combination, the entity shall do all of the following:
1. Derecognize that asset and liability (except for those arising from operating leases for which the entity is a lessor).
 2. Adjust the carrying amount of the right-of-use asset by a corresponding amount if the entity is a lessee.
 3. Make a corresponding adjustment to equity at the beginning of the earliest comparative period presented if assets or liabilities arise from leases classified as **sales-type leases** or **direct financing leases** in accordance with Topic 840 for which the entity is a lessor.

Disclosure

- i. An entity shall provide the transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraph 250-10-50-1(b)(2).
- j. If an entity uses one or both of the practical expedients in (f) and (g), it shall disclose that fact.

Lessees**Leases previously classified as operating leases under Topic 840**

- k. A lessee should initially recognize a right-of-use asset and a **lease liability** at the later of the beginning of the earliest period presented in the financial statements and the **commencement date of the lease**.
- l. Unless, on or after the effective date, the lease is modified (and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8) or the lease liability is required to be remeasured in accordance with paragraph 842-20-35-4, a lessee shall measure the lease liability at the present value of the sum of the following, using a **discount rate for the lease** (which, for entities that are not public business entities, can be a risk-free rate determined in accordance with paragraph 842-20-30-3) established at the later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease:
 - 1. The remaining minimum rental payments (as defined under Topic 840).
 - 2. Any amounts **probable** of being owed by the lessee under a **residual value guarantee**.
- m. For each lease classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3, a lessee shall initially measure the right-of-use asset at the initial measurement of the lease liability adjusted for both of the following:
 - 1. The items in paragraph 842-20-35-3(b), as applicable.
 - 2. The carrying amount of any liability recognized in accordance with Topic 420 on exit or disposal cost obligations for the lease.
- n. For each lease classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3, a lessee shall subsequently measure the right-of-use asset throughout the remaining lease term in accordance with paragraph 842-20-35-3(b). If the initial measurement of the right-of-use asset in (m) is adjusted for the carrying amount of a liability recognized in accordance with Topic 420 on exit or disposal cost obligations for the lease, the lessee shall apply the recognition and subsequent measurement guidance in Sections 842-20-25 and 842-20-35, respectively, when the right-of-use asset has been impaired.
- o. For each lease classified as a finance lease in accordance with paragraph 842-10-25-2, a lessee shall measure the right-of-use asset as the applicable proportion of the lease liability at the commencement date, which can be imputed from the lease liability determined in accordance with (l). The applicable proportion is the remaining lease term at the beginning of the earliest comparative period presented relative to the total lease term. A lessee shall adjust the right-of-use asset recognized by the carrying amount of any prepaid or accrued **lease payments** and the

carrying amount of any liability recognized in accordance with Topic 420 for the lease.

- p. Any unamortized initial direct costs at the later of the beginning of the earliest period presented in the financial statements or the commencement date of the lease that do not meet the definition of initial direct costs in this Topic shall be written off as an adjustment to equity at the later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease.
- q. If a modification to the contractual terms and conditions occurs on or after the effective date, and the modification does not result in a separate contract in accordance with paragraph 842-10-25-8, or the lessee is required to remeasure the lease liability for any reason (see paragraphs 842-20-35-4 through 35-5), the lessee shall follow the requirements in this Topic from the **effective date of the modification** or the remeasurement date.

Leases previously classified as capital leases under Topic 840

- r. For each lease classified as a finance lease in accordance with this Topic, a lessee shall do all of the following:
 1. Recognize a right-of-use asset and a lease liability at the carrying amount of the lease asset and the capital lease obligation in accordance with Topic 840 at the later of the beginning of the earliest comparative period presented or the commencement date of the lease.
 2. Include any unamortized initial direct costs that meet the definition of initial direct costs in this Topic in the measurement of the right-of-use asset established in (r)(1).
 3. Write off, as an adjustment to equity, any unamortized initial direct costs at the later of the beginning of the earliest period presented in the financial statements or the commencement date of the lease that do not meet the definition of initial direct costs in this Topic and that are not included in the measurement of the capital lease asset under Topic 840 (unless the lessee elects the practical expedients described in (f)).
 4. Subsequently measure the right-of-use asset and the lease liability in accordance with Section 840-20-35 before the effective date.
 5. Apply the subsequent measurement guidance in paragraphs 842-20-35-4 through 35-5 and 842-20-35-8 after the effective date. However, when applying the pending content in paragraph 842-20-35-4, a lessee shall not remeasure the lease payments for amounts probable of being owed under residual value guarantees in accordance with paragraph 842-10-35-4(c)(3).
 6. Classify the assets and liabilities held under capital leases as right-of-use assets and lease liabilities arising from finance leases for the purposes of presentation and disclosure.

- s. For each lease classified as an operating lease in accordance with this Topic, a lessee shall do the following:
 - 1. Derecognize the carrying amount of any capital lease asset and capital lease obligation in accordance with Topic 840 at the later of the beginning of the earliest comparative period presented or the commencement date of the lease. Any difference between the carrying amount of the capital lease asset and the capital lease obligation shall be accounted for in the same manner as prepaid or accrued rent.
 - 2. Recognize a right-of-use asset and a lease liability in accordance with paragraph 842-20-35-3 if the lease commenced before the beginning of the earliest period presented in the financial statements.
 - 3. Recognize a right-of-use asset and a lease liability in accordance with paragraph 842-20-30-1 at the commencement date of the lease if the lease commenced after the beginning of the earliest period presented in the financial statements.
 - 4. Account for the operating lease in accordance with the guidance in Subtopic 842-20 after initial recognition in accordance with (r)(2) or (r)(3).
 - 5. Write off, as an adjustment to equity, any unamortized initial direct costs at the later of the beginning of the earliest period presented in the financial statements or the commencement date of the lease that do not meet the definition of initial direct costs in this Topic.
- t. If a modification to the contractual terms and conditions occurs on or after the effective date, and the modification does not result in a separate contract in accordance with paragraph 842-10-25-8, or the lessee is required to remeasure the lease liability in accordance with paragraph 842-20-35-4, the lessee shall subsequently account for the lease in accordance with the requirements in this Topic beginning on the effective date of the modification or the remeasurement date.

Build-to-suit lease arrangements

- u. A lessee shall apply a modified retrospective transition approach for leases accounted for as build-to-suit arrangements under Topic 840 that are existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements as follows:
 - 1. If an entity has recognized assets and liabilities solely as a result of a transaction's build-to-suit designation in accordance with Topic 840, the entity should derecognize those assets and liabilities at the later of the beginning of the earliest comparative period presented in the financial statements and the date that the lessee is determined to be the accounting owner of the asset in accordance with Topic 840. Any difference should be recorded as an adjustment to equity at that date. The lessee shall apply the lessee transition requirements in (k) through (s) to the lease.

2. If the construction period of the build-to-suit lease concluded before the beginning of the earliest comparative period presented in the financial statements and the transaction qualified as a sale and leaseback transaction in accordance with Subtopic 840-40 before the date of initial application, the entity shall follow the general lessee transition requirements for the lease.

Lessors

Leases previously classified as operating leases under Topic 840

- v. For each lease classified as an operating lease in accordance with this Topic, a lessor shall do all of the following:
 1. Continue to recognize the carrying amount of the underlying asset and any lease assets or liabilities at the later of the date of initial application and the commencement date as the same amounts recognized by the lessor immediately before that date in accordance with Topic 840.
 2. Account for previously recognized securitized receivables as secured borrowings in accordance with other Topics.
 3. Write off, as an adjustment to equity, any unamortized initial direct costs at the later of the beginning of the earliest period presented in the financial statements or the commencement date of the lease that do not meet the definition of initial direct costs in this Topic (unless the lessor elects the practical expedients described in (f)).
- w. For each lease classified as a direct financing or a sales-type lease in accordance with this Topic, the objective is to account for the lease, beginning on the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease, as if it had always been accounted for as a direct financing lease or a sales-type lease in accordance with this Topic. Consequently, a lessor shall do all of the following:
 1. Derecognize the carrying amount of the underlying asset at the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease.
 2. Recognize a **net investment in the lease** at the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease as if the lease had been accounted for as a direct financing lease or a sales-type lease in accordance with Subtopic 842-30 since lease commencement.
 3. Record any difference between the amounts in (w)(1) and (w)(2) as an adjustment to equity.
 4. Account for the lease in accordance with this Topic after the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease.

Leases previously classified as direct financing or sales-type leases under Topic 840

- x. For each lease classified as a direct financing lease or a sales-type lease in accordance with this Topic, do all of the following:
 1. Continue to recognize a net investment in the lease at the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease, at the carrying amount of the net investment at that date. This would include any unamortized initial direct costs capitalized as part of the lessor's net investment in the lease in accordance with Topic 840.
 2. Before the effective date, a lessor shall account for the lease in accordance with Topic 840.
 3. Beginning on the effective date, a lessor shall account for the lease in accordance with the recognition, subsequent measurement, presentation, and disclosure guidance in Subtopic 842-30.
 4. Beginning on the effective date, if a lessor modifies the lease (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8), it shall account for the modified lease in accordance with paragraph 842-10-25-16 if the modified lease is classified as a direct financing lease after the modification or paragraph 842-10-25-17 if the modified lease is classified as a sales-type lease after the modification. A lessor shall not remeasure the net investment in the lease on or after the effective date unless the lease is modified (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8).
- y. For each lease classified as an operating lease in accordance with this Topic, the objective is to account for the lease, beginning on the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease, as if it had always been accounted for as an operating lease in accordance with this Topic. Consequently, a lessor shall do all of the following:
 1. Recognize the underlying asset at what the carrying amount would have been had the lease been classified as an operating lease under Topic 840.
 2. Derecognize the carrying amount of the net investment in the lease.
 3. Record any difference between the amounts in (y)(1) and (y)(2) as an adjustment to equity.
 4. Subsequently account for the operating lease in accordance with this Topic and the underlying asset in accordance with other Topics.

Leases previously classified as leveraged leases under Topic 840

- z. For leases that were classified as **leveraged leases** in accordance with Topic 840, and for which the commencement date is before the effective

date, a lessor shall apply the requirements in Subtopic 842-50. If a leveraged lease is modified on or after the effective date, it shall be accounted for as a new lease as of the effective date of the modification in accordance with the guidance in Subtopics 842-10 and 842-30.

1. A lessor shall apply the pending content that links to this paragraph to a leveraged lease that meets the criteria in (z) that is acquired in a business combination or an **acquisition by a not-for-profit entity** on or after the effective date.

Sale and leaseback transactions before the beginning of the earliest comparative period presented

- aa. If a previous sale and leaseback transaction was accounted for as a sale and a leaseback in accordance with Topic 840, an entity shall not reassess the transaction to determine whether the transfer of the asset would have been a sale in accordance with paragraphs 842-40-25-1 through 25-3.
- bb. If a previous sale and leaseback transaction was accounted for as a failed sale and leaseback transaction in accordance with Topic 840 and remains a failed sale at the effective date, the entity shall reassess whether a sale would have occurred at any point on or after the beginning of the earliest period presented in the financial statements in accordance with paragraphs 842-40-25-1 through 25-3. The sale and leaseback transaction shall be accounted for on a modified retrospective basis from the date a sale is determined to have occurred, in accordance with the requirements in (cc) through (dd).
- cc. An entity shall account for the leaseback in accordance with the lessee and lessor transition requirements in (k) through (y).
- dd. If a previous sale and leaseback transaction was accounted for as a sale and capital leaseback in accordance with Topic 840, the transferor shall continue to recognize any deferred gain or loss that exists at the later of the beginning of the earliest comparative period presented in the financial statements or the date of the sale of the underlying asset as follows:
 1. If the underlying asset is land only, straight line over the remaining lease term.
 2. If the underlying asset is not land only and the leaseback is a finance lease, in proportion to the amortization of the right-of-use asset.
 3. If the underlying asset is not land only and the leaseback is an operating lease, in proportion to the recognition in profit or loss of the total lease cost.
- ee. If a previous sale and leaseback transaction was accounted for as a sale and operating leaseback in accordance with Topic 840, the transferor shall do the following:
 1. Recognize any deferred gain or loss not resulting from off-market terms (that is, where the consideration for the sale of the asset is not at **fair value** or the lease payments are not at market rates) as a

- cumulative-effect adjustment at the later of the date of initial application (to equity) or the date of sale (to earnings of the comparative period presented).
2. Recognize any deferred loss resulting from the consideration for the sale of the asset not being at fair value or the lease payments not being at market rates as an adjustment to the leaseback right-of-use asset at the date of initial application.
 3. Recognize any deferred gain resulting from the consideration for the sale of the asset not being at fair value or the lease payments not being at market rates as a financial liability at the date of initial application.

4. Add Subtopic 842-20, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Leases—Lessee

Overview and Background

General

842-20-05-1 This Subtopic addresses accounting by **lessees** for **leases** that have been classified as **finance leases** or **operating leases** in accordance with the requirements in Subtopic 842-10. Lessees shall follow the requirements in this Subtopic as well as those in Subtopic 842-10.

Scope and Scope Exceptions

General

842-20-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic.

Glossary

Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Direct Financing Lease

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b).

Discount Rate for the Lease

For a **lessee**, the discount rate for the **lease** is the **rate implicit in the lease** unless

that rate cannot be readily determined. In that case, the lessee is required to use its **incremental borrowing rate**.

For a **lessor**, the discount rate for the lease is the rate implicit in the lease.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Incremental Borrowing Rate

The rate of interest that a **lessee** would have to pay to borrow on a collateralized basis over a similar term an amount equal to the **lease payments** in a similar economic environment.

Initial Direct Costs

Incremental costs of a **lease** that would not have been incurred if the lease had not been obtained.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Liability

A **lessee's** obligation to make the **lease payments** arising from a **lease**, measured on a discounted basis.

Lease Modification

A change to the terms and conditions of a **contract** that results in a change in the scope of or the consideration for a **lease** (for example, a change to the terms and conditions of the contract that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term).

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Monetary Liability

An obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods and services.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any **lease** other than a **sales-type lease** or a **direct financing lease**.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Probable (second definition)

The future event or events are likely to occur.

Rate Implicit in the Lease

The rate of interest that, at a given date, causes the aggregate present value of (a) the **lease payments** and (b) the amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** to equal the sum of (1) the **fair value** of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and (2) any deferred **initial direct costs** of the lessor.

Related Parties

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Right-of-Use Asset

An asset that represents a **lessee's** right to use an **underlying asset** for the **lease term**.

Sales-Type Lease

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Short-Term Lease

A **lease** that, at the **commencement date**, has a **lease term** of 12 months or less and does not include an option to purchase the **underlying asset** that the **lessee** is reasonably certain to exercise.

Sublease

A transaction in which an **underlying asset** is re-leased by the **lessee** (or intermediate **lessor**) to a third party (the sublessee) and the original (or head) **lease** between the lessor and the lessee remains in effect.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Useful Life

The period over which an asset is expected to contribute directly or indirectly to future cash flows.

Variable Interest Entity

A **legal entity** subject to consolidation according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an **underlying asset** that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

Recognition

General

842-20-25-1 At the **commencement date**, a **lessee** shall recognize a **right-of-use asset** and a **lease liability**.

> Short-Term Leases

842-20-25-2 As an accounting policy, a **lessee** may elect not to apply the recognition requirements in this Subtopic to **short-term leases**. Instead, a lessee may recognize the **lease payments** in profit or loss on a straight-line basis over the **lease term** and **variable lease payments** in the period in which the obligation for those payments is incurred (consistent with paragraphs 842-20-55-1 through 55-2). The accounting policy election for short-term leases shall be made by class of **underlying asset** to which the right of use relates.

842-20-25-3 If the lease term or the assessment of a lessee option to purchase the underlying asset changes such that, after the change, the remaining lease term extends more than 12 months from the end of the previously determined lease term or the lessee is reasonably certain to exercise its option to purchase the underlying asset, the lease no longer meets the definition of a short-term lease and the lessee shall apply the remainder of the guidance in this Topic as if the date of the change in circumstances is the **commencement date**.

842-20-25-4 See Example 1 (paragraphs 842-20-55-13 through 55-16) for an illustration of the requirements on short-term leases.

> Finance Leases

842-20-25-5 After the **commencement date**, a **lessee** shall recognize in profit or loss, unless the costs are included in the carrying amount of another asset in accordance with other Topics:

- a. Amortization of the **right-of-use asset** and interest on the **lease liability**
- b. **Variable lease payments** not included in the lease liability in the period in which the obligation for those payments is incurred (see paragraphs 842-20-55-1 through 55-2)
- c. Any impairment of the right-of-use asset determined in accordance with paragraph 842-20-35-9.

> Operating Leases

842-20-25-6 After the **commencement date**, a **lessee** shall recognize all of the following in profit or loss, unless the costs are included in the carrying amount of another asset in accordance with other Topics:

- a. A single lease cost, calculated so that the remaining cost of the **lease** (as described in paragraph 842-20-25-8) is allocated over the remaining **lease term** on a straight-line basis unless another systematic and rational basis is more representative of the pattern in which benefits are expected to be derived from the right to use the **underlying asset** (see paragraph 842-20-55-3), unless the **right-of-use asset** has been impaired in accordance with paragraph 842-20-35-9, in which case the single lease cost is calculated in accordance with paragraph 842-20-25-7
- b. **Variable lease payments** not included in the **lease liability** in the period in which the obligation for those payments is incurred (see paragraphs 842-20-55-1 through 55-2)
- c. Any impairment of the right-of-use asset determined in accordance with paragraph 842-20-35-9.

842-20-25-7 After a right-of-use asset has been impaired in accordance with paragraph 842-20-35-9, the single lease cost described in paragraph 842-20-25-6(a) shall be calculated as the sum of the following:

- a. Amortization of the remaining balance of the right-of-use asset after the impairment on a straight-line basis, unless another systematic basis is more representative of the pattern in which the lessee expects to consume the remaining economic benefits from its right to use the underlying asset
- b. Accretion of the lease liability, determined for each remaining period during the lease term as the amount that produces a constant periodic discount rate on the remaining balance of the liability.

842-20-25-8 Throughout the lease term, the remaining cost of an **operating lease** for which the right-of-use asset has not been impaired consists of the following:

- a. The total **lease payments** (including those paid and those not yet paid), reflecting any adjustment to that total amount resulting from either a remeasurement in accordance with paragraphs 842-10-35-4 through 35-5 or a **lease modification**; plus
- b. The total **initial direct costs** attributable to the lease; minus
- c. The periodic lease cost recognized in prior periods.

Initial Measurement

General

842-20-30-1 At the **commencement date**, a **lessee** shall measure both of the following:

- a. The **lease liability** at the present value of the **lease payments** not yet paid, discounted using the **discount rate for the lease** at lease commencement (as described in paragraphs 842-20-30-2 through 30-4)
- b. The **right-of-use asset** as described in paragraph 842-20-30-5.

> Discount Rate for the Lease

842-20-30-2 The **discount rate for the lease** initially used to determine the present value of the **lease payments** for a **lessee** is calculated on the basis of information available at the **commencement date**.

842-20-30-3 A lessee should use the **rate implicit in the lease** whenever that rate is readily determinable. If the rate implicit in the lease is not readily determinable, a lessee uses its **incremental borrowing rate**. A lessee that is not a public business entity is permitted to use a risk-free discount rate for the lease, determined using a period comparable with that of the **lease term**, as an accounting policy election for all leases.

842-20-30-4 See Example 2 (paragraphs 842-20-55-17 through 55-20) for an illustration of the requirements on the discount rate.

> Initial Measurement of the Right-of-Use Asset

842-20-30-5 At the **commencement date**, the cost of the **right-of-use asset** shall consist of all of the following:

- a. The amount of the initial measurement of the **lease liability**
- b. Any **lease payments** made to the **lessor** at or before the commencement date, minus any lease incentives received
- c. Any **initial direct costs** incurred by the **lessee** (as described in paragraphs 842-10-30-9 through 30-10).

842-20-30-6 See Example 3 (paragraphs 842-20-55-21 through 55-39) for an illustration of the requirements on lessee measurement of the **lease term**.

Subsequent Measurement

General

842-20-35-1 After the **commencement date**, for a **finance lease**, a **lessee** shall measure both of the following:

- a. The **lease liability** by increasing the carrying amount to reflect interest on the lease liability and reducing the carrying amount to reflect the **lease payments** made during the period. The lessee shall determine the interest on the lease liability in each period during the **lease term** as the amount that produces a constant periodic discount rate on the remaining balance of the liability, taking into consideration the reassessment requirements in paragraphs 842-10-35-1 through 35-5.
- b. The **right-of-use asset** at cost less any accumulated amortization and any accumulated impairment losses, taking into consideration the reassessment requirements in paragraphs 842-10-35-1 through 35-5.

842-20-35-2 A lessee shall recognize amortization of the right-of-use asset and interest on the lease liability for a finance lease in accordance with paragraph 842-20-25-5.

842-20-35-3 After the commencement date, for an **operating lease**, a lessee shall measure both of the following:

- a. The lease liability at the present value of the lease payments not yet paid discounted using the **discount rate for the lease** established at the commencement date (unless the rate has been updated after the commencement date in accordance with paragraph 842-20-35-5, in which case that updated rate shall be used)
- b. The right-of-use asset at the amount of the lease liability, adjusted for the following, unless the right-of-use asset has been previously impaired, in which case the right-of-use asset is measured in accordance with paragraph 842-20-35-10 after the impairment:
 1. Prepaid or accrued lease payments
 2. The remaining balance of any lease incentives received, which is the amount of the gross lease incentives received net of amounts recognized previously as part of the single lease cost described in paragraph 842-20-25-6(a)
 3. Unamortized **initial direct costs**
 4. Impairment of the right-of-use asset.

> Remeasurement of the Lease Liability

842-20-35-4 After the **commencement date**, a **lessee** shall remeasure the **lease liability** to reflect changes to the **lease payments** as described in paragraphs 842-10-35-4 through 35-5. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the **right-of-use asset**. However, if the

carrying amount of the right-of-use asset is reduced to zero, a lessee shall recognize any remaining amount of the remeasurement in profit or loss.

842-20-35-5 If there is a remeasurement of the lease liability in accordance with paragraph 842-20-35-4, the lessee shall update the **discount rate for the lease** at the date of remeasurement on the basis of the remaining **lease term** and the remaining lease payments unless the remeasurement of the lease liability is the result of one of the following:

- a. A change in the lease term or the assessment of whether the lessee will exercise an option to purchase the **underlying asset** and the discount rate for the lease already reflects that the lessee has an option to extend or terminate the **lease** or to purchase the underlying asset.
- b. A change in amounts **probable** of being owed by the lessee under a **residual value guarantee** (see paragraph 842-10-35-4(c)(3)).
- c. A change in the lease payments resulting from the resolution of a contingency upon which some or all of the **variable lease payments** that will be paid over the remainder of the lease term are based (see paragraph 842-10-35-4(b)).

842-20-35-6 See Examples 3 and 4 (paragraphs 842-20-55-21 through 55-46) for an illustration of the requirements on lessee subsequent measurement.

> Amortization of the Right-of-Use Asset for a Finance Lease

842-20-35-7 A lessee shall amortize the **right-of-use asset** on a straight-line basis, unless another systematic basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. When the **lease liability** is remeasured and the right-of-use asset is adjusted in accordance with paragraph 842-20-35-4, amortization of the right-of-use asset shall be adjusted prospectively from the date of remeasurement.

842-20-35-8 A lessee shall amortize the right-of-use asset from the **commencement date** to the earlier of the end of the **useful life** of the right-of-use asset or the end of the **lease term**. However, if the **lease** transfers ownership of the **underlying asset** to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, the lessee shall amortize the right-of-use asset to the end of the useful life of the underlying asset.

> Impairment of a Right-of-Use Asset

842-20-35-9 A lessee shall determine whether a **right-of-use asset** is impaired and shall recognize any impairment loss in accordance with Section 360-10-35 on impairment or disposal of long-lived assets.

842-20-35-10 If a right-of-use asset is impaired in accordance with paragraph 842-20-35-9, after the impairment, it shall be measured at its carrying amount immediately after the impairment less any accumulated amortization. A lessee shall amortize, in accordance with paragraph 842-20-25-7 (for an **operating lease**)

or paragraph 842-20-35-7 (for a **finance lease**), the right-of-use asset from the date of the impairment to the earlier of the end of the **useful life** of the right-of-use asset or the end of the **lease term**.

842-20-35-11 See Example 5 (paragraphs 842-20-55-47 through 55-51) for an illustration of the requirements for impairment of a right-of-use asset.

> Amortization of Leasehold Improvements

842-20-35-12 Leasehold improvements shall be amortized over the shorter of the **useful life** of those leasehold improvements and the remaining **lease term**, unless the **lease** transfers ownership of the **underlying asset** to the **lessee** or the lessee is reasonably certain to exercise an option to purchase the underlying asset, in which case the lessee shall amortize the leasehold improvements to the end of their useful life.

842-20-35-13 Leasehold improvements acquired in a **business combination** or an **acquisition by a not-for-profit entity** shall be amortized over the shorter of the useful life of the assets and the remaining lease term at the date of acquisition.

> Subleases

842-20-35-14 If the nature of a **sublease** is such that the original **lessee** is not relieved of the primary obligation under the original **lease**, the original lessee (as sublessor) shall continue to account for the original lease in one of the following ways:

- a. If the sublease is classified as an **operating lease**, the original lessee shall continue to account for the original lease as it did before commencement of the sublease. If the lease cost for the term of the sublease exceeds the anticipated sublease income for that same period, the original lessee shall treat that circumstance as an indicator that the carrying amount of the **right-of-use asset** associated with the original lease may not be recoverable in accordance with paragraph 360-10-35-21.
- b. If the original lease is classified as a **finance lease** and the sublease is classified as a **sales-type lease** or a **direct financing lease**, the original lessee shall derecognize the original right-of-use asset in accordance with paragraph 842-30-40-1 and continue to account for the original **lease liability** as it did before commencement of the sublease. The original lessee shall evaluate its investment in the sublease for impairment in accordance with paragraph 842-30-35-3.
- c. If the original lease is classified as an operating lease and the sublease is classified as a sales-type lease or a direct financing lease, the original lessee shall derecognize the original right-of-use asset in accordance with paragraph 842-30-40-1 and, from the sublease **commencement date**, account for the original lease liability in accordance with paragraphs 842-20-35-1 through 35-2. The original lessee shall evaluate its

investment in the sublease for impairment in accordance with paragraph 842-30-35-3.

842-20-35-15 The original lessee (as sublessor) in a sublease shall use the **rate implicit in the lease** to determine the classification of the sublease and to measure the net investment in the sublease if the sublease is classified as a sales-type or a direct financing lease unless that rate cannot be readily determined. If the rate implicit in the lease cannot be readily determined, the original lessee may use the **discount rate for the lease** established for the original (or head) lease.

Derecognition

General

> Lease Termination

842-20-40-1 A termination of a **lease** before the expiration of the **lease term** shall be accounted for by the **lessee** by removing the **right-of-use asset** and the **lease liability**, with profit or loss recognized for the difference.

> > Purchase of the Underlying Asset

842-20-40-2 The termination of a **lease** that results from the purchase of an **underlying asset** by the **lessee** is not the type of termination of a lease contemplated by paragraph 842-20-40-1 but, rather, is an integral part of the purchase of the underlying asset. If the lessee purchases the underlying asset, any difference between the purchase price and the carrying amount of the lease liability immediately before the purchase shall be recorded by the lessee as an adjustment of the carrying amount of the asset. However, this paragraph does not apply to underlying assets acquired in a **business combination**, which are initially measured at **fair value** in accordance with paragraph 805-20-30-1.

> Subleases

842-20-40-3 If the nature of a **sublease** is such that the original **lessee** is relieved of the primary obligation under the original **lease**, the transaction shall be considered a termination of the original lease. Paragraph 842-20-35-14 addresses subleases in which the original lessee is not relieved of the primary obligation under the original lease. Any consideration paid or received upon termination that was not already included in the **lease payments** (for example, a termination payment that was not included in the lease payments based on the **lease term**) shall be included in the determination of profit or loss to be recognized in accordance with paragraph 842-20-40-1. If a sublease is a termination of the original lease and the original lessee is secondarily liable, the guarantee obligation shall be recognized by the lessee in accordance with paragraph 405-20-40-2.

Other Presentation Matters

General

> Statement of Financial Position

842-20-45-1 A **lessee** shall either present in the statement of financial position or disclose in the notes all of the following:

- a. **Finance lease right-of-use assets** and **operating lease** right-of-use assets separately from each other and from other assets
- b. Finance **lease liabilities** and operating lease liabilities separately from each other and from other liabilities.

Right-of-use assets and lease liabilities shall be subject to the same considerations as other nonfinancial assets and financial liabilities in classifying them as current and noncurrent in classified statements of financial position.

842-20-45-2 If a lessee does not present finance lease and operating lease right-of-use assets and lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those right-of-use assets and lease liabilities.

842-20-45-3 In the statement of financial position, a lessee is prohibited from presenting both of the following:

- a. Finance lease right-of-use assets in the same line item as operating lease right-of-use assets
- b. Finance lease liabilities in the same line item as operating lease liabilities.

> Statement of Comprehensive Income

842-20-45-4 In the statement of comprehensive income, a **lessee** shall present both of the following:

- a. For **finance leases**, the interest expense on the **lease liability** and amortization of the **right-of-use asset** are not required to be presented as separate line items and shall be presented in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets, respectively
- b. For **operating leases**, **lease** expense shall be included in the lessee's income from continuing operations.

> Statement of Cash Flows

842-20-45-5 In the statement of cash flows, a **lessee** shall classify all of the following:

- a. Repayments of the principal portion of the **lease liability** arising from **finance leases** within financing activities

- b. Interest on the lease liability arising from finance leases in accordance with the requirements relating to interest paid in Topic 230 on cash flows
- c. Payments arising from **operating leases** within operating activities, except to the extent that those payments represent costs to bring another asset to the condition and location necessary for its intended use, which should be classified within investing activities
- d. **Variable lease payments** and **short-term lease** payments not included in the lease liability within operating activities.

Disclosure

General

842-20-50-1 The objective of the disclosure requirements is to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from **leases**. To achieve that objective, a **lessee** shall disclose qualitative and quantitative information about all of the following:

- a. Its leases (as described in paragraphs 842-20-50-3(a) through (b) and 842-20-50-7 through 50-8)
- b. The significant judgments made in applying the requirements in this Topic to those leases (as described in paragraph 842-20-50-3(c))
- c. The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-20-50-4 and 842-20-50-6).

842-20-50-2 A lessee shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessee shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

842-20-50-3 A lessee shall disclose all of the following:

- a. Information about the nature of its leases, including:
 1. A general description of those leases.
 2. The basis and terms and conditions on which **variable lease payments** are determined.
 3. The existence and terms and conditions of options to extend or terminate the lease. A lessee should provide narrative disclosure about the options that are recognized as part of its **right-of-use assets** and **lease liabilities** and those that are not.
 4. The existence and terms and conditions of **residual value guarantees** provided by the lessee.
 5. The restrictions or covenants imposed by leases, for example, those relating to dividends or incurring additional financial obligations.

A lessee should identify the information relating to **subleases** included in the disclosures provided in (1) through (5), as applicable.

- b. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee, including the nature of any involvement with the construction or design of the **underlying asset**.
- c. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
 - 1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-27)
 - 2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraphs 842-10-15-28 through 15-32)
 - 3. The determination of the **discount rate for the lease** (as described in paragraphs 842-20-30-2 through 30-4).

842-20-50-4 For each period presented in the financial statements, a lessee shall disclose the following amounts relating to a lessee's total lease cost, which includes both amounts recognized in profit or loss during the period and any amounts capitalized as part of the cost of another asset in accordance with other Topics, and the cash flows arising from lease transactions:

- a. **Finance lease** cost, segregated between the amortization of the right-of-use assets and interest on the lease liabilities.
- b. **Operating lease** cost determined in accordance with paragraphs 842-20-25-6(a) and 842-20-25-7.
- c. **Short-term lease** cost, excluding expenses relating to leases with a **lease term** of one month or less, determined in accordance with paragraph 842-20-25-2.
- d. Variable lease cost determined in accordance with paragraphs 842-20-25-5(b) and 842-20-25-6(b).
- e. Sublease income, disclosed on a gross basis, separate from the finance or operating lease expense.
- f. Net gain or loss recognized from sale and leaseback transactions in accordance with paragraph 842-40-25-4.
- g. Amounts segregated between those for finance and operating leases for the following items:
 - 1. Cash paid for amounts included in the measurement of lease liabilities, segregated between operating and financing cash flows
 - 2. Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets
 - 3. Weighted-average remaining lease term
 - 4. Weighted-average discount rate.

842-20-50-5 See paragraphs 842-20-55-11 through 55-12 for implementation guidance on preparing the weighted-average remaining lease term and the weighted-average discount rate disclosures. See Example 6 (paragraphs 842-20-55-52 through 55-53) for an illustration of the lessee quantitative disclosure requirements in paragraph 842-20-50-4.

842-20-50-6 A lessee shall disclose a maturity analysis of its finance lease liabilities and its operating lease liabilities separately, showing the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessee shall disclose a reconciliation of the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recognized in the statement of financial position.

842-20-50-7 A lessee shall disclose lease transactions between related parties in accordance with paragraphs 850-10-50-1 through 50-6.

842-20-50-8 A lessee that accounts for short-term leases in accordance with paragraph 842-20-25-2 shall disclose that fact. If the short-term lease expense for the period does not reasonably reflect the lessee's short-term lease commitments, a lessee shall disclose that fact and the amount of its short-term lease commitments.

842-20-50-9 A lessee that elects the practical expedient on not separating lease components from nonlease components in paragraph 842-10-15-37 shall disclose its accounting policy election and which class or classes of underlying assets it has elected to apply the practical expedient.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Recognition of Costs from Variable Lease Payments

842-20-55-1 A lessee should recognize costs from **variable lease payments** (in annual periods as well as in interim periods) before the achievement of the specified target that triggers the variable lease payments, provided the achievement of that target is considered **probable**.

842-20-55-2 Variable lease costs recognized in accordance with paragraph 842-20-55-1 should be reversed at such time that it is probable that the specified target will not be met.

> > Pattern of Benefit from Use of the Underlying Asset

842-20-55-3 This Subtopic considers the right to control the use of the **underlying asset** as the equivalent of physical use. If the **lessee** controls the use of the underlying asset, recognition of **lease** cost in accordance with paragraph 842-20-25-6(a) or amortization of the **right-of-use asset** in accordance with paragraph 842-20-35-7 should not be affected by the extent to which the lessee uses the underlying asset.

> > Maintenance Deposits

842-20-55-4 Under certain **leases** (for example, certain equipment leases), a **lessee** is legally or contractually responsible for repair and maintenance of the **underlying asset** throughout the **lease term**. Additionally, certain lease agreements include provisions requiring the lessee to make deposits to the **lessor** to financially protect the lessor in the event the lessee does not properly maintain the underlying asset. Lease agreements often refer to these deposits as maintenance reserves or supplemental rent. However, the lessor is required to reimburse the deposits to the lessee on the completion of maintenance activities that the lessee is contractually required to perform under the lease agreement.

842-20-55-5 Under a typical arrangement, maintenance deposits are calculated on the basis of a performance measure, such as hours of use of the underlying asset, and are contractually required under the terms of the lease agreement to be used to reimburse the lessee for required maintenance of the underlying asset on the completion of that maintenance. The lessor is contractually required to reimburse the lessee for the maintenance costs paid by the lessee, to the extent of the amounts on deposit.

842-20-55-6 In some cases, the total cost of cumulative maintenance events over the term of the lease is less than the cumulative deposits, which results in excess amounts on deposit at the expiration of the lease. In those cases, some lease agreements provide that the lessor is entitled to retain such excess amounts, whereas other agreements specifically provide that, at the expiration of the lease agreement, such excess amounts are returned to the lessee (refundable maintenance deposit).

842-20-55-7 The guidance in paragraphs 842-20-55-8 through 55-9 does not apply to payments to a lessor that are not substantively and contractually related to maintenance of the leased asset. If at the **commencement date** a lessee determines that it is less than **probable** that the total amount of payments will be returned to the lessee as a reimbursement for maintenance activities, the lessee should consider that when determining the portion of each payment that is not addressed by the guidance in paragraphs 842-20-55-8 through 55-9.

842-20-55-8 Maintenance deposits paid by a lessee under an arrangement accounted for as a lease that are refunded only if the lessee performs specified maintenance activities should be accounted for as a deposit asset.

842-20-55-9 A lessee should evaluate whether it is probable that an amount on deposit recognized under paragraph 842-20-55-8 will be returned to reimburse the costs of the maintenance activities incurred by the lessee. When an amount on deposit is less than probable of being returned, it should be recognized in the same manner as variable lease expense. When the underlying maintenance is performed, the maintenance costs should be expensed or capitalized in accordance with the lessee's maintenance accounting policy.

> > **Leases Denominated in a Foreign Currency**

842-20-55-10 The **right-of-use asset** is a nonmonetary asset while the **lease liability** is a **monetary liability**. Therefore, in accordance with Subtopic 830-10 on foreign currency matters, when accounting for a **lease** that is denominated in a foreign currency, if remeasurement into the **lessee's** functional currency is required, the lease liability is remeasured using the current exchange rate, while the right-of-use asset is remeasured using the exchange rate as of the **commencement date**.

> > **Weighted-Average Remaining Lease Term and Weighted-Average Discount Rate Disclosures**

842-20-55-11 The **lessee** should calculate the weighted-average remaining **lease term** on the basis of the remaining lease term and the **lease liability** balance for each **lease** as of the reporting date.

842-20-55-12 The lessee should calculate the weighted-average discount rate on the basis of both of the following:

- a. The **discount rate for the lease** that was used to calculate the lease liability balance for each lease as of the reporting date.
- b. The remaining balance of the **lease payments** for each lease as of the reporting date.

> **Illustrations**

> > **Illustration of a Short-Term Lease**

842-20-55-13 Example 1 illustrates the assessment of whether a lease is a short-term lease.

> > > **Example 1—Short-Term Lease**

842-20-55-14 Lessee has made an accounting policy election not to recognize right-of-use assets and lease liabilities that arise from short-term leases for any class of underlying asset.

842-20-55-15 Lessee enters into a 12-month lease of a vehicle, with an option to extend for another 12 months. Lessee has considered all relevant factors and determined that it is not reasonably certain to exercise the option to extend. Because at lease commencement Lessee is not reasonably certain to exercise the option to extend, the lease term is 12 months.

842-20-55-16 The lease meets the definition of a short-term lease because the lease term is 12 months or less. Consequently, consistent with Lessee's accounting policy election, Lessee does not recognize the right-of-use asset and the lease liability arising from this lease.

> > Illustration of Discount Rate

842-20-55-17 Example 2 illustrates the determination of the discount rate for the lease.

> > > Example 2—Portfolio Approach to Establishing the Discount Rate for the Lease

842-20-55-18 Lessee, a public entity, is the parent of several consolidated subsidiaries. During the current period, 2 subsidiaries entered into a total of 400 individual leases of large computer servers, each with terms ranging between 4 and 5 years and annual payments ranging between \$60,000 and \$100,000, depending on the hardware capacity of the servers. In aggregate, total lease payments for these leases amount to \$30 million.

842-20-55-19 The individual lease contracts do not provide information about the rate implicit in the lease. Lessee is BBB credit rated and actively raises debt in the corporate bond market. Both subsidiaries are unrated and do not actively engage in treasury operations in their respective markets. On the basis of its credit rating and the collateral represented by the leased servers, Lessee's incremental borrowing rate on \$60,000 through \$100,000 (the range of lease payments on each of the 400 leases) would be approximately 4 percent. Lessee notes that 5-year zero-coupon U.S. Treasury instruments are currently yielding 1.7 percent (a risk-free rate). Because Lessee conducts its treasury operations centrally (that is, at the consolidated group level), it is reasonably assumed that consideration of the group credit standing factored into how each lease was priced.

842-20-55-20 Lessee may determine the discount rate for the lease for the 400 individual leases entered into on different dates throughout the current period by using a portfolio approach. That is, Lessee can apply a single discount rate to the portfolio of new leases. This is because during the period, the new leases are all of similar terms (four to five years), and Lessee's credit rating and the interest rate environment are stable. Because the pricing of the lease is influenced by the credit standing and profile of Lessee rather than the subsidiaries (that is, because Lessee conducts treasury operations for the consolidated group), Lessee concludes that its incremental borrowing rate of 4 percent is an appropriate discount rate for each of the 400 leases entered into by Lessee's 2 subsidiaries during the period. Because Lessee is a public entity, it is not permitted to use a risk-free discount rate.

> > Illustrations of Lessee Recognition, Measurement, and Reassessment of the Lease Term

842-20-55-21 Example 3 illustrates how a lessee would initially and subsequently measure right-of-use assets and lease liabilities and how a lessee would account for a change in the lease term.

> > > Example 3—Initial and Subsequent Measurement by a Lessee and Accounting for a Change in the Lease Term

> > > Case A—Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

842-20-55-22 Lessee enters into a 10-year lease of an asset, with an option to extend for an additional 5 years. Lease payments are \$50,000 per year during the initial term and \$55,000 per year during the optional period, all payable at the beginning of each year. Lessee incurs initial direct costs of \$15,000.

842-20-55-23 At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines the lease term to be 10 years.

842-20-55-24 The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5.87 percent, which reflects the fixed rate at which Lessee could borrow a similar amount in the same currency, for the same term, and with similar collateral as in the lease at the commencement date.

842-20-55-25 At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, and measures the lease liability at the present value of the remaining 9 payments of \$50,000, discounted at the rate of 5.87 percent, which is \$342,017. Lessee also measures a right-of-use asset of \$407,017 (the initial measurement of the lease liability plus the initial direct costs and the lease payment for the first year).

842-20-55-26 During the first year of the lease, Lessee recognizes lease expense depending on how the lease is classified. Paragraphs 842-20-55-27 through 55-30 illustrate the lease expense depending on whether the lease is classified as a finance lease or as an operating lease.

> > > > If the Lease Is Classified as a Finance Lease

842-20-55-27 Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset would be amortized on a straight-line basis over the 10-year lease term. The lease liability is increased to reflect the Year 1 interest on the lease liability in accordance with the interest method. As such, in Year 1 of the lease, Lessee recognizes the amortization expense of \$40,702 ($\$407,017 \div 10$) and the interest expense of \$20,076 ($5.87\% \times \$342,017$).

842-20-55-28 At the end of the first year of the lease, the carrying amount of Lessee's lease liability is \$362,093 ($\$342,017 + \$20,076$), and the carrying amount of the right-of-use asset is \$366,315 ($\$407,017 - \$40,702$).

> > > > If the Lease Is Classified as an Operating Lease

842-20-55-29 Lessee determines the cost of the lease to be \$515,000 (sum of the lease payments for the lease term and initial direct costs incurred by Lessee). The annual lease expense to be recognized is therefore \$51,500 ($\$515,000 \div 10$ years).

842-20-55-30 At the end of the first year of the lease, the carrying amount of Lessee's lease liability is \$362,093 ($\$342,017 + \$20,076$), and the carrying amount of the right-of-use asset is \$375,593 (the carrying amount of the lease liability plus the remaining initial direct costs, which equal \$13,500).

> > > Case B—Accounting for a Change in the Lease Term

842-20-55-31 At the end of Year 6 of the lease, Lessee makes significant leasehold improvements. Those improvements are expected to have significant economic value for Lessee at the end of the original lease term of 10 years. The improvements result in the underlying asset having greater utility to Lessee than alternative assets that could be leased for a similar amount and that are expected to have significant economic life beyond the original lease term. Consequently, construction of the leasehold improvements is deemed a significant event or significant change in circumstances that directly affects whether Lessee is reasonably certain to exercise the option to extend the lease and triggers a reassessment of the lease term. Upon reassessing the lease term, at the end of Year 6, Lessee concludes that it is reasonably certain to exercise the option to extend the lease for five years. Taking into consideration the extended remaining lease term, Lessee's incremental borrowing rate at the end of Year 6 is 7.83 percent. As a result of Lessee's remeasuring the remaining lease term to nine years, Lessee also would remeasure any variable lease payments that depend on an index or a rate; however, in this Example, there are no variable lease payments that depend on an index or a rate. In accordance with paragraph 842-10-25-1, Lessee reassesses the lease classification as a result of the change in the lease term. Assume for purposes of this Example that the reassessment does not change the classification of the lease from that determined at the commencement date.

842-20-55-32 At the end of Year 6, before accounting for the change in the lease term, the lease liability is \$183,973 (present value of 4 remaining payments of \$50,000, discounted at the rate of 5.87 percent). Lessee's right-of-use asset is \$162,807 if the lease is classified as a finance lease or \$189,973 if the lease is classified as an operating lease (the balance of the remeasured lease liability at the end of Year 6 plus the remaining initial direct costs of \$6,000).

842-20-55-33 Lessee remeasures the lease liability, which is now equal to the present value of 4 payments of \$50,000 followed by 5 payments of \$55,000, all discounted at the rate of 7.83 percent, which is \$355,189. Lessee increases the lease liability by \$171,216, representing the difference between the remeasured liability and its current carrying amount ($\$355,189 - \$183,973$). The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional rights.

842-20-55-34 Following the adjustment, the carrying amount of Lessee's right-of-use asset is \$334,023 if the lease is a finance lease (that is, $\$162,807 + \$171,216$) or \$361,189 if the lease is an operating lease (that is, $\$189,973 + \$171,216$).

842-20-55-35 Lessee then makes the \$50,000 lease payment for Year 7, reducing the lease liability to \$305,189 ($\$355,189 - \$50,000$), regardless of how the lease is classified.

842-20-55-36 Lessee recognizes lease expense in Year 7 as follows, depending on how the lease had been classified at the commencement date.

> > > > If the Lease Is Classified as a Finance Lease at the Commencement Date

842-20-55-37 Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset will be amortized on a straight-line basis over the lease term. The lease liability will be reduced in accordance with the interest method. As such, in Year 7 (the first year following the remeasurement), Lessee recognizes amortization expense of \$37,114 ($\$334,023 \div 9$) and interest expense of \$23,896 ($7.83\% \times \$305,189$).

> > > > If the Lease Is Classified as an Operating Lease at the Commencement Date

842-20-55-38 Lessee determines the remaining cost of the lease as the sum of the following:

- a. The total lease payments, as adjusted for the remeasurement, which is the sum of \$500,000 (10 payments of \$50,000 during the initial lease term) and \$275,000 (5 payments of \$55,000 during the term of the lease extension), plus
- b. The total initial direct costs attributable to the lease of \$15,000; minus
- c. The periodic lease cost recognized in prior periods of \$309,000.

842-20-55-39 The amount of the remaining cost of the lease is therefore \$481,000 ($\$775,000 + \$15,000 - \$309,000$). Consequently, Lessee determines that the annual expense to be recognized throughout the remainder of the lease term is \$53,444 ($\$481,000 \div$ the remaining lease term of 9 years).

> > Illustrations of Lessee Recognition and Measurement in an Operating Lease

842-20-55-40 Example 4 illustrates how a lessee would recognize lease cost in an operating lease and initially and subsequently measure right-of-use assets and lease liabilities for that lease.

> > > Example 4—Recognition and Initial and Subsequent Measurement by a Lessee in an Operating Lease

842-20-55-41 Lessee enters into a 10-year lease for 5,000 square feet of office space. The annual lease payment is \$10,000, paid in arrears, and increases 5 percent each year during the lease term. Lessee's incremental borrowing rate at lease commencement is 6 percent. Lessee classifies the lease as an operating

lease in accordance with paragraphs 842-10-25-2 through 25-3. Lessee incurs initial direct costs of \$5,000.

842-20-55-42 At the commencement date, Lessee receives a \$10,000 cash payment from Lessor that Lessee accounts for as a lease incentive. Lessee measures the lease liability at the present value of the 10 remaining lease payments (\$10,000 in Year 1, increasing by 5 percent each year thereafter), discounted at the rate of 6 percent, which is \$90,434. Lessee also measures a right-of-use asset of \$85,434 (the initial measurement of the lease liability + the initial direct costs of \$5,000 – the lease incentive of \$10,000).

842-20-55-43 During the first year of the lease, Lessee determines the remaining cost of the lease as the sum of the following:

- a. The total lease payments of \$115,779 (the sum of the 10 escalating payments to Lessor during the lease term of \$125,779 – the lease incentive paid to Lessee at the commencement date of \$10,000)
- b. The total initial direct costs attributable to the lease of \$5,000.

The amount of the remaining lease cost is therefore \$120,779 (\$115,779 + \$5,000). Consequently, Lessee determines that the single lease cost to be recognized every year throughout the lease term is \$12,078 (\$120,779 ÷ 10 years). This assumes that there are no remeasurements of the lease liability or modifications to the lease throughout the lease term.

842-20-55-44 At the end of Year 1, the carrying amount of the lease liability is \$85,860 (9 remaining lease payments, discounted at the rate of 6 percent), and the carrying amount of the right-of-use asset is the amount of the liability, adjusted for the following:

- a. Accrued lease payments of \$2,578 (the amount of payments to Lessor to be recognized as part of the single lease cost each year during the lease of \$12,578 [total payments to Lessor of \$125,779 ÷ 10 years] – the first year's lease payment of \$10,000)
- b. Unamortized initial direct costs of \$4,500 (gross initial direct costs of \$5,000 – amounts recognized previously as part of the single lease cost of \$500 [total initial direct costs of \$5,000 ÷ 10 years])
- c. The remaining balance of the lease incentive of \$9,000 (gross lease incentive of \$10,000 – amounts recognized previously as part of the single lease cost of \$1,000 [total lease incentives of \$10,000 ÷ 10 years]).

Therefore, at the end of Year 1, Lessee measures the right-of-use asset at the amount of \$78,782 (\$85,860 – \$2,578 + \$4,500 – \$9,000).

842-20-55-45 At the beginning of Year 2, Lessee determines the remaining cost of the lease to be \$108,701 (the total lease payments of \$115,779 + the total initial direct costs of \$5,000 – the single lease cost recognized in Year 1 of \$12,078). The single lease cost to be recognized in Year 2 is still \$12,078 (\$108,701 ÷ 9 years). For the purposes of the Example, only the first two years' determination of

the single lease cost are shown. However, the single lease cost will be determined in the same way as in Years 1 and 2 for the remainder of the lease and, in this Example, will continue to equal \$12,078 every period for the remainder of the lease term assuming that there are no remeasurements of the lease liability or modifications to the lease.

842-20-55-46 At the end of Year 2, the carrying amount of the lease liability is \$80,511, and the carrying amount of the right-of-use asset is \$71,855 (the carrying amount of the lease liability of \$80,511 – the accrued lease payments of \$4,656 + the unamortized initial direct costs of \$4,000 – the remaining balance of the lease incentive received of \$8,000). For the purposes of the Example, the subsequent measurement of the lease liability and the subsequent measurement of the right-of-use asset are shown only for the first two years. However, Lessee will continue to measure the lease liability and the right-of-use asset for this lease in the same manner throughout the remainder of the lease term.

> > Illustration of Impairment of a Right-of-Use Asset

842-20-55-47 Example 5 illustrates impairment of a right-of-use asset.

> > > Example 5—Impairment of a Right-of-Use Asset in an Operating Lease

842-20-55-48 Lessee enters into a 10-year lease of a nonspecialized asset. Lease payments are \$10,000 per year, payable in arrears. The lease does not transfer ownership of the underlying asset or grant Lessee an option to purchase the underlying asset. At lease commencement, the remaining economic life of the underlying asset is 50 years, and the fair value of the underlying asset is \$600,000. Lessee does not incur any initial direct costs as a result of the lease. Lessee's incremental borrowing rate is 7 percent, which reflects the fixed rate at which Lessee could borrow the amount of the lease payments in the same currency, for the same term, and with similar collateral as in the lease at commencement. The lease is classified as an operating lease.

842-20-55-49 At the commencement date, Lessee recognizes the lease liability of \$70,236 (the present value of the 10 lease payments of \$10,000, discounted at the rate of 7 percent). Lessee also recognizes a right-of-use asset of \$70,236 (the initial measurement of the lease liability). Lessee determines the cost of the lease to be \$100,000 (the total lease payments for the lease term). The annual lease expense to be recognized is therefore \$10,000 ($\$100,000 \div 10$ years).

842-20-55-50 At the end of Year 3, when the carrying amount of the lease liability and the right-of-use asset are both \$53,893, Lessee determines that the right-of-use asset is impaired in accordance with Section 360-10-35 and recognizes an impairment loss of \$35,000. The right-of-use asset is part of an asset group that Lessee tested for recoverability because of a significant adverse change in the business climate that affects Lessee's ability to derive benefit from the assets within the asset group. The portion of the total impairment loss for the asset group

allocated to the right-of-use asset in accordance with paragraph 360-10-35-28 is \$35,000. After the impairment charge, the carrying amount of the right-of-use asset at the end of Year 3 is \$18,893 (\$53,893 – \$35,000). Because of the impairment, the total expense recognized in Year 3 is \$45,000 (\$10,000 in lease expense + the \$35,000 impairment charge). Beginning in Year 4, and for the remainder of the lease term, the single lease cost recognized by Lessee in accordance with paragraphs 842-20-25-6(a) and 842-20-25-7 will equal the sum of the following:

- a. Amortization of the right-of-use asset remaining after the impairment (\$18,893 ÷ 7 years = \$2,699 per year)
- b. Accretion of the lease liability. For example, in Year 4, the accretion is \$3,773 (\$53,893 × 7%) and, in Year 5, the accretion is \$3,337 (\$47,665 × 7%).

842-20-55-51 Consequently, at the end of Year 4, the carrying amount of the lease liability is \$47,665 (that is, calculated as either the present value of the remaining lease payments, discounted at 7 percent, or the previous balance of \$53,893 – \$10,000 Year 4 lease payment + the \$3,773 accretion of the lease liability). The carrying amount of the right-of-use asset is \$16,194 (the previous balance of \$18,893 – \$2,699 amortization). Lessee measures the lease liability and the right-of-use asset in this manner throughout the remainder of the lease term.

> > Illustration of Lessee Quantitative Disclosure Requirements

842-20-55-52 Example 6 illustrates how a lessee may meet the quantitative disclosure requirements in paragraph 842-20-50-4.

> > Example 6—Lessee Quantitative Disclosure Requirements in Paragraph 842-20-50-4

842-20-55-53 The following Example illustrates how a lessee may meet the quantitative disclosure requirements in paragraph 842-20-50-4.

	Year Ending December 31,	
	20X2	20X1
Lease cost		
Finance lease cost:	\$XXX	\$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	<u>\$XXX</u>	<u>\$XXX</u>
Other information		
(Gains) and losses on sale and leaseback transactions, net	\$XXX	\$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	X.X years	X.X years
Weighted-average remaining lease term—operating leases	X.X years	X.X years
Weighted-average discount rate—finance leases	X.X%	X.X%
Weighted-average discount rate—operating	X.X%	X.X%

5. Add Subtopic 842-30, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Leases—Lessor

Overview and Background

General

842-30-05-1 This Subtopic addresses accounting by **lessors** for **leases** that have been classified as **sales-type leases**, **direct financing leases**, or **operating leases** in accordance with the requirements in Subtopic 842-10. Lessors should follow the requirements in this Subtopic as well as those in Subtopic 842-10.

Scope and Scope Exceptions

General

842-30-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 842-10-15.

Glossary

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Direct Financing Lease

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b).

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Initial Direct Costs

Incremental costs of a **lease** that would not have been incurred if the lease had not been obtained.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Receivable

A **lessor's** right to receive **lease payments** arising from a **sales-type lease** or a **direct financing lease** plus any amount that a lessor expects to derive from the underlying asset following the end of the **lease term** to the extent that it is guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Net Investment in the Lease

For a **sales-type lease**, the sum of the **lease receivable** and the **unguaranteed residual asset**.

For a **direct financing lease**, the sum of the **lease receivable** and the **unguaranteed residual asset**, net of any deferred selling profit.

Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any lease other than a **sales-type lease** or a **direct financing lease**.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Probable (second definition)

The future event or events are likely to occur.

Rate Implicit in the Lease

The rate of interest that, at a given date, causes the aggregate present value of (a) the **lease payments** and (b) the amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** to equal the sum of (1) the **fair value** of the underlying asset minus any related investment tax credit retained

and expected to be realized by the lessor and (2) any deferred **initial direct costs** of the lessor.

Related Parties

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Sales-Type Lease

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Selling Profit or Selling Loss

At the **commencement date**, selling profit or selling loss equals:

- a. The **fair value** of the **underlying asset** or the sum of (1) the **lease receivable** and (2) any **lease payments** prepaid by the lessee, if lower; minus
- b. The carrying amount of the underlying asset net of any **unguaranteed residual asset**; minus
- c. Any deferred **initial direct costs** of the lessor.

Sublease

A transaction in which an **underlying asset** is re-leased by the **lessee** (or intermediate **lessor**) to a third party (the sublessee) and the original (or head) **lease** between the lessor and the lessee remains in effect.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Unguaranteed Residual Asset

The amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** that is not guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Useful Life

The period over which an asset is expected to contribute directly or indirectly to future cash flows.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an **underlying asset** that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

Recognition

General

> Sales-Type Leases

842-30-25-1 At the **commencement date**, a **lessor** shall recognize each of the following and derecognize the **underlying asset** in accordance with paragraph 842-30-40-1:

- a. A **net investment in the lease**, measured in accordance with paragraph 842-30-30-1
- b. **Selling profit or selling loss** arising from the **lease**
- c. **Initial direct costs** as an expense if, at the commencement date, the **fair value** of the underlying asset is different from its carrying amount. If the fair value of the underlying asset equals its carrying amount, initial direct costs (see paragraphs 842-10-30-9 through 30-10) are deferred at the commencement date and included in the measurement of the net investment in the lease. The **rate implicit in the lease** is defined in such a way that those initial direct costs eligible for deferral are included

automatically in the net investment in the lease; there is no need to add them separately.

842-30-25-2 After the commencement date, a lessor shall recognize all of the following:

- a. Interest income on the net investment in the lease, measured in accordance with paragraph 842-30-35-1(a)
- b. **Variable lease payments** that are not included in the net investment in the lease as income in profit or loss in the period when the changes in facts and circumstances on which the variable lease payments are based occur
- c. Impairment of the net investment in the lease (as described in paragraph 842-30-35-3).

842-30-25-3 The guidance in paragraphs 842-30-25-1 through 25-2 notwithstanding, if collectibility of the **lease payments**, plus any amount necessary to satisfy a **residual value guarantee** provided by the **lessee**, is not **probable** at the commencement date, the lessor shall not derecognize the underlying asset but shall recognize lease payments received—including variable lease payments—as a deposit liability until the earlier of either of the following:

- a. Collectibility of the lease payments, plus any amount necessary to satisfy a residual value guarantee provided by the lessee, becomes probable. If collectibility is not probable at the commencement date, a lessor shall continue to assess collectibility to determine whether the lease payments and any amount necessary to satisfy a residual value guarantee are probable of collection.
- b. Either of the following events occurs:
 1. The **contract** has been terminated, and the lease payments received from the lessee are nonrefundable.
 2. The lessor has repossessed the underlying asset, it has no further obligation under the contract to the lessee, and the lease payments received from the lessee are nonrefundable.

842-30-25-4 When collectibility is not probable at the commencement date, at the date the criterion in paragraph 842-30-25-3(a) is met (that is, the date at which collectibility of the lease payments plus any amount necessary to satisfy a residual value guarantee provided by the lessee is assessed as probable), the lessor shall do all of the following:

- a. Derecognize the carrying amount of the underlying asset
- b. Derecognize the carrying amount of any deposit liability recognized in accordance with paragraph 842-30-25-3
- c. Recognize a net investment in the lease on the basis of the remaining lease payments and remaining **lease term**, using the rate implicit in the lease determined at the commencement date
- d. Recognize selling profit or selling loss calculated as:

1. The **lease receivable**; plus
2. The carrying amount of the deposit liability; minus
3. The carrying amount of the underlying asset, net of the **unguaranteed residual asset**.

842-30-25-5 When collectibility is not probable at the commencement date, at the date the criterion in paragraph 842-30-25-3(b) is met, the lessor shall derecognize the carrying amount of any deposit liability recognized in accordance with paragraph 842-30-25-3, with the corresponding amount recognized as lease income.

842-30-25-6 If collectibility is probable at the commencement date for a **sales-type lease** or for a **direct financing lease**, a lessor shall not reassess whether collectibility is probable. Subsequent changes in the credit risk of the lessee shall be accounted for in accordance with the impairment guidance applicable to the net investment in the lease in paragraph 842-30-35-3.

> Direct Financing Leases

842-30-25-7 At the **commencement date**, a **lessor** shall recognize both of the following and derecognize the **underlying asset** in accordance with paragraph 842-30-40-1:

- a. A **net investment in the lease**, measured in accordance with paragraph 842-30-30-2
- b. Selling loss arising from the lease, if applicable.

842-30-25-8 Selling profit and **initial direct costs** (see paragraphs 842-10-30-9 through 30-10) are deferred at the commencement date and included in the measurement of the net investment in the lease. The **rate implicit in the lease** is defined in such a way that initial direct costs deferred in accordance with this paragraph are included automatically in the net investment in the lease; there is no need to add them separately.

842-30-25-9 After the commencement date, a lessor shall recognize all of the following:

- a. Interest income on the net investment in the lease, measured in accordance with paragraph 842-30-35-1(a)
- b. **Variable lease payments** that are not included in the net investment in the lease as income in profit or loss in the period when the changes in facts and circumstances on which the variable lease payments are based occur
- c. Impairment of the net investment in the lease (as described in paragraph 842-30-35-3).

> Operating Leases

842-30-25-10 At the **commencement date**, a **lessor** shall defer **initial direct costs**.

842-30-25-11 After the commencement date, a lessor shall recognize all of the following:

- a. The **lease payments** as income in profit or loss over the **lease term** 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 use of the **underlying asset**, subject to paragraph 842-30-25-12
- b. **Variable lease payments** as income in profit or loss in the period in which the changes in facts and circumstances on which the variable lease payments are based occur
- c. Initial direct costs as an expense over the lease term on the same basis as lease income (as described in (a)).

842-30-25-12 If collectibility of the lease payments plus any amount necessary to satisfy a **residual value guarantee** (provided by the **lessee** or any other unrelated third party) is not **probable** at the commencement date, lease income shall be limited to the lesser of the income that would be recognized in accordance with paragraph 842-30-25-11(a) through (b) or the lease payments, including variable lease payments, that have been collected from the lessee.

842-30-25-13 If the assessment of collectibility changes after the commencement date, any difference between the lease income that would have been recognized in accordance with paragraph 842-30-25-11(a) through (b) and the lease payments, including variable lease payments, that have been collected from the lessee shall be recognized as a current-period adjustment to lease income.

842-30-25-14 See Example 1 (paragraphs 842-30-55-18 through 55-43) for an illustration of the requirements when collectibility is not probable.

Initial Measurement

General

> Sales-Type and Direct Financing Leases

842-30-30-1 At the **commencement date**, for a **sales-type lease**, a **lessor** shall measure the **net investment in the lease** to include both of the following:

- a. The **lease receivable**, which is measured at the present value, discounted using the **rate implicit in the lease**, of:
 1. The **lease payments** (as described in paragraph 842-10-30-5) not yet received by the lessor
 2. The amount the lessor expects to derive from the **underlying asset** following the end of the **lease term** that is guaranteed by the **lessee** or any other third party unrelated to the lessor
- b. The **unguaranteed residual asset** at the present value of the amount the lessor expects to derive from the underlying asset following the end

of the lease term that is not guaranteed by the lessee or any other third party unrelated to the lessor, discounted using the rate implicit in the lease.

842-30-30-2 At the commencement date, for a **direct financing lease**, a lessor shall measure the net investment in the lease to include the items in paragraph 842-30-30-1(a) through (b), reduced by the amount of any selling profit.

842-30-30-3 See Example 1 (paragraphs 842-30-55-18 through 55-43) for an illustration of the requirements for sales-type and direct financing leases.

> Operating Leases

842-30-30-4 A lessor shall continue to measure the **underlying asset** subject to an **operating lease** in accordance with other Topics.

Subsequent Measurement

General

> Sales-Type and Direct Financing Leases

842-30-35-1 After the **commencement date**, a lessor shall measure the **net investment in the lease** by doing both of the following:

- a. Increasing the carrying amount to reflect the interest income on the net investment in the lease. A lessor shall determine the interest income on the net investment in the lease in each period during the **lease term** as the amount that produces a constant periodic discount rate on the remaining balance of the net investment in the lease.
- b. Reducing the carrying amount to reflect the **lease payments** collected during the period.

842-30-35-2 After the commencement date, a lessor shall not remeasure the net investment in the lease unless the **lease** is modified and that modification is not accounted for as a separate **contract** in accordance with paragraph 842-10-25-8.

> > Impairment of the Net Investment in the Lease

842-30-35-3 A lessor shall determine impairment related to the **net investment in the lease** and shall recognize any impairment in accordance with Topic 310 on receivables (as described in paragraphs 310-10-35-16 through 35-30). When determining the loss allowance for a net investment in the lease, a lessor shall take into consideration the collateral relating to the net investment in the lease. The collateral relating to the net investment in the lease represents the cash flows that the lessor would expect to derive from the **underlying asset** during the remaining **lease term** (for example, from sale of the asset or release of the asset for the remainder of the lease term), which excludes the cash flows that the lessor would

expect to derive from the underlying asset following the end of the lease term (for example, cash flows from leasing the asset after the end of the lease term).

> > Sale of the Lease Receivable

842-30-35-4 If a **lessor** sells the **lease receivable** associated with a **sales-type lease** or a **direct financing lease** and retains an interest in the **unguaranteed residual asset**, the lessor shall not continue to accrete the unguaranteed residual asset to its estimated value over the remaining **lease term**. The lessor shall report any remaining unguaranteed residual asset thereafter at its carrying amount at the date of the sale of the lease receivable and apply Topic 360 on property, plant, and equipment to determine whether the unguaranteed residual asset is impaired.

> > Accounting for the Underlying Asset at the End of the Lease Term

842-30-35-5 At the end of the **lease term**, a **lessor** shall reclassify the **net investment in the lease** to the appropriate category of asset (for example, property, plant, and equipment) in accordance with other Topics, measured at the carrying amount of the net investment in the lease. The lessor shall account for the **underlying asset** that was the subject of a **lease** in accordance with other Topics.

> Operating Leases

842-30-35-6 A **lessor** shall continue to measure, including testing for impairment in accordance with Section 360-10-35 on impairment or disposal of long-lived assets, the **underlying asset** subject to an **operating lease** in accordance with other Topics.

> Subleases

842-30-35-7 If the original **lessee** enters into a **sublease** or the original **lease** agreement is sold or transferred by the original lessee to a third party, the original **lessor** shall continue to account for the lease as it did before.

Derecognition

General

> Sales-Type and Direct Financing Leases

842-30-40-1 At the **commencement date**, a **lessor** shall derecognize the carrying amount of the **underlying asset** (if previously recognized) unless the **lease** is a **sales-type lease** and collectibility of the **lease payments** is not **probable** (see paragraph 842-30-25-3).

> > Lease Termination

842-30-40-2 If a **sales-type lease** or a **direct financing lease** is terminated before the end of the **lease term**, a **lessor** shall do all of the following:

- a. Test the **net investment in the lease** for impairment in accordance with Topic 310 on receivables and recognize any impairment loss identified
- b. Reclassify the net investment in the lease to the appropriate category of asset in accordance with other Topics, measured at the sum of the carrying amounts of the **lease receivable** (less any amounts still expected to be received by the lessor) and the residual asset
- c. Account for the **underlying asset** that was the subject of the **lease** in accordance with other Topics.

> > Subleases

842-30-40-3 If the original **lease** agreement is replaced by a new agreement with a new **lessee**, the **lessor** shall account for the termination of the original lease as provided in paragraph 842-30-40-2 and shall classify and account for the new lease as a separate transaction.

842-30-40-4 For guidance on the acquisition of the residual value of an **underlying asset** by a third party, see paragraph 360-10-25-2.

Other Presentation Matters

General

> Sales-Type and Direct Financing Leases

> > Statement of Financial Position

842-30-45-1 A **lessor** shall present lease assets (that is, the aggregate of the lessor's net investment in **sales-type leases** and **direct financing leases**) separately from other assets in the statement of financial position.

842-30-45-2 **Lease** assets shall be subject to the same considerations as other assets in classification as current or noncurrent assets in a classified balance sheet.

> > Statement of Comprehensive Income

842-30-45-3 A **lessor** shall either present in the statement of comprehensive income or disclose in the notes income arising from **leases**. If a lessor does not separately present lease income in the statement of comprehensive income, the lessor shall disclose which line items include lease income in the statement of comprehensive income.

842-30-45-4 A lessor shall present any profit or loss on the lease recognized at the **commencement date** in a manner that best reflects the lessor's business model(s). Examples of presentation include the following:

- a. If a lessor uses leases as an alternative means of realizing value from the goods that it would otherwise sell, the lessor shall present revenue and cost of goods sold relating to its leasing activities in separate line items so that income and expenses from sold and leased items are presented consistently. Revenue recognized is the lesser of:
 1. The **fair value** of the **underlying asset** at the commencement date
 2. The sum of the **lease receivable** and any **lease payments** prepaid by the **lessee**.

Cost of goods sold is the carrying amount of the underlying asset at the commencement date minus the **unguaranteed residual asset**.
- b. If a lessor uses leases for the purposes of providing finance, the lessor shall present the profit or loss in a single line item.

> > Statement of Cash Flows

842-30-45-5 In the statement of cash flows, a **lessor** shall classify cash receipts from **leases** within operating activities.

> Operating Leases

> > Statement of Financial Position

842-30-45-6 A lessor shall present the **underlying asset** subject to an **operating lease** in accordance with other Topics.

> > Statement of Cash Flows

842-30-45-7 In the statement of cash flows, a **lessor** shall classify cash receipts from **leases** within operating activities.

Disclosure

General

842-30-50-1 The objective of the disclosure requirements is to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from **leases**. To achieve that objective, a **lessor** shall disclose qualitative and quantitative information about all of the following:

- a. Its leases (as described in paragraphs 842-30-50-3(a), 842-30-50-4, and 842-30-50-7)
- b. The significant judgments made in applying the requirements in this Topic to those leases (as described in paragraph 842-30-50-3(b))

- c. The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-30-50-5 through 50-6 and 842-30-50-8 through 50-13).

842-30-50-2 A lessor shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessor shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

842-30-50-3 A lessor shall disclose both of the following:

- a. Information about the nature of its leases, including:
 - 1. A general description of those leases
 - 2. The basis and terms and conditions on which **variable lease payments** are determined
 - 3. The existence and terms and conditions of options to extend or terminate the lease
 - 4. The existence and terms and conditions of options for a **lessee** to purchase the **underlying asset**.
- b. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
 - 1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-27)
 - 2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraphs 842-10-15-28 through 15-32)
 - 3. The determination of the amount the lessor expects to derive from the underlying asset following the end of the **lease term**.

842-30-50-4 A lessor shall disclose any lease transactions between related parties (see Topic 850 on related party disclosures).

842-30-50-5 A lessor shall disclose lease income recognized in each annual and interim reporting period, in a tabular format, to include the following:

- a. For **sales-type leases** and **direct financing leases**:
 - 1. Profit or loss recognized at the **commencement date** (disclosed on a gross basis or a net basis consistent with paragraph 842-30-45-4)
 - 2. Interest income either in aggregate or separated by components of the **net investment in the lease**.
- b. For **operating leases**, lease income relating to **lease payments**.
- c. Lease income relating to variable lease payments not included in the measurement of the **lease receivable**.

842-30-50-6 A lessor shall disclose in the notes the components of its aggregate net investment in sales-type and direct financing leases (that is, the carrying

amount of its lease receivables, its **unguaranteed residual assets**, and any deferred selling profit on direct financing leases).

842-30-50-7 A lessor shall disclose information about how it manages its risk associated with the residual value of its leased assets. In particular, a lessor should disclose all of the following:

- a. Its risk management strategy for residual assets
- b. The carrying amount of residual assets covered by **residual value guarantees** (excluding guarantees considered to be lease payments for the lessor, as described in paragraph 842-30-30-1(a)(2))
- c. Any other means by which the lessor reduces its residual asset risk (for example, buyback agreements or variable lease payments for use in excess of specified limits).

> Sales-Type and Direct Financing Leases

842-30-50-8 In addition to the disclosures required by paragraphs 842-30-50-3 through 50-7, a **lessor** also shall provide the disclosures in paragraphs 842-30-50-9 through 50-10 for **sales-type leases** and **direct financing leases**.

842-30-50-9 A lessor shall explain significant changes in the balance of its **unguaranteed residual assets** and deferred selling profit on direct financing leases.

842-30-50-10 A lessor shall disclose a maturity analysis of its **lease receivables**, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall disclose a reconciliation of the undiscounted cash flows to the lease receivables recognized in the statement of financial position (or disclosed separately in the notes).

> Operating Leases

842-30-50-11 In addition to the disclosures required by paragraphs 842-30-50-3 through 50-7, a **lessor** also shall provide the disclosures in paragraphs 842-30-50-12 through 50-13 for **operating leases**.

842-30-50-12 A lessor shall disclose a maturity analysis of **lease payments**, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall present that maturity analysis separately from the maturity analysis required by paragraph 842-30-50-10 for **sales-type leases** and **direct financing leases**.

842-30-50-13 A lessor shall provide disclosures required by Topic 360 on property, plant, and equipment separately for **underlying assets** under operating leases from owned assets.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Sales of Equipment with Guaranteed Minimum Resale Amount

842-30-55-1 This implementation guidance addresses the application of the provisions of this Subtopic in the following circumstances. A manufacturer sells equipment with an expected **useful life** of several years to end users (purchasers) utilizing various sales incentive programs. Under one such sales incentive program, the manufacturer contractually guarantees that the purchaser will receive a minimum resale amount at the time the equipment is disposed of, contingent on certain requirements.

842-30-55-2 The manufacturer provides the guarantee by agreeing to do either of the following:

- a. Reacquire the equipment at a guaranteed price at specified time periods as a means to facilitate its resale
- b. Pay the purchaser for the deficiency, if any, between the sales proceeds received for the equipment and the guaranteed minimum resale value.

There may be dealer involvement in these types of transactions, but the minimum resale guarantee is the responsibility of the manufacturer.

842-30-55-3 A sales incentive program in which an entity (for example, a manufacturer) contractually guarantees that it has either a right or an obligation to reacquire the equipment at a guaranteed price (or prices) at a specified time (or specified time periods) as a means to facilitate its resale should be evaluated in accordance with the guidance on satisfaction of performance obligations in paragraph 606-10-25-30 and the guidance on repurchase agreements in paragraphs 606-10-55-66 through 55-78. If that evaluation results in a **lease**, the manufacturer should account for the transaction as a lease using the principles of lease accounting in Subtopic 842-10 and in this Subtopic.

842-30-55-4 A sales incentive program in which an entity (for example, a manufacturer) contractually guarantees that it will pay a purchaser for the deficiency, if any, between the sales proceeds received for the equipment and the guaranteed minimum resale value should be accounted for in accordance with Topic 460 on guarantees and Topic 606 on revenue from **contracts** with customers.

842-30-55-5 The **lease payments** used as part of the determination of whether the transaction should be classified as an **operating lease**, a **direct financing lease**, or a **sales-type lease** generally will be the difference between the proceeds upon the equipment's initial transfer and the amount of the **residual value guarantee** to the purchaser as of the first exercise date of the guarantee.

842-30-55-6 If the transaction qualifies as an operating lease, the net proceeds upon the equipment's initial transfer should be recorded as a liability in the manufacturer's balance sheet.

842-30-55-7 The liability is then subsequently reduced on a pro rata basis over the period to the first exercise date of the guarantee to the amount of the guaranteed residual value at that date with corresponding credits to revenue in the manufacturer's income statement. Any further reduction in the guaranteed residual value resulting from the purchaser's decision to continue to use the equipment should be recognized in a similar manner.

842-30-55-8 The equipment should be included in the manufacturer's balance sheet and depreciated following the manufacturer's normal depreciation policy.

842-30-55-9 The Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 on property, plant, and equipment provide guidance on the accounting for any potential impairment of the equipment.

842-30-55-10 At the time the purchaser elects to exercise the residual value guarantee by selling the equipment to another party, the liability should be reduced by the amount, if any, paid to the purchaser. The remaining undepreciated carrying amount of the equipment and any remaining liability should be removed from the balance sheet and included in the determination of income of the period of the equipment's sale.

842-30-55-11 Alternatively, if the purchaser exercises the residual value guarantee by selling the equipment to the manufacturer at the guaranteed price, the liability should be reduced by the amount paid to the purchaser. Any remaining liability should be included in the determination of income of the period of the exercise of the guarantee.

842-30-55-12 The accounting for a guaranteed minimum resale value is not in the scope of Topic 815 on derivatives and hedging. In the transaction described, the embedded guarantee feature is not an embedded derivative instrument that must be accounted for separately from the lease because it does not meet the criterion in paragraph 815-15-25-1(c).

842-30-55-13 Specifically, if freestanding, the guarantee feature would be excluded from the scope of paragraph 815-10-15-59(b) because of both of the following conditions:

- a. It is not exchange traded.
- b. The underlying on which settlement is based is the price of a nonfinancial asset of one of the parties, and that asset is not readily convertible to cash. It is assumed that the equipment is not readily convertible to cash, as that phrase is used in Topic 815.

842-30-55-14 Paragraph 815-10-15-59(b)(2) states that the related exception applies only if the nonfinancial asset related to the underlying is owned by the party

that would not benefit under the contract from an increase in the price or value of the nonfinancial asset. (In some circumstances, the exclusion in paragraph 815-10-15-63 also would apply.)

842-30-55-15 Lastly, Topic 460 on guarantees does not affect the guarantor's accounting for the guarantee because that Topic does not apply to a guarantee for which the underlying is related to an asset of the guarantor. Because the manufacturer continues to recognize the residual value of the equipment guaranteed by the manufacturer as an asset (included in the seller-lessor's **net investment in the lease**) if recording a sales-type lease, that guarantee does not meet the characteristics in paragraph 460-10-15-4 and is, therefore, not subject to the guidance in Topic 460. Additionally, if the lease is classified as an operating lease, the manufacturer does not remove the asset from its books, and its guarantee would be a market value guarantee of its own asset. A market value guarantee of the guarantor's own asset is not within the scope of Topic 460, and the guidance in paragraphs 842-10-55-32 through 55-33 for an operating lease is not affected. As a result, the guarantor's accounting for the guarantee is unaffected by Topic 460.

> > **Guarantee Payments Received**

842-30-55-16 Indemnification payments related to tax effects other than the investment tax credit should be reflected by the **lessor** in income consistent with the classification of the **lease**. That is, the payments should be accounted for as an adjustment of the lessor's **net investment in the lease** if the lease is a **sales-type lease** or a **direct financing lease** or recognized ratably over the **lease term** if the lease is an **operating lease**.

> > **Pattern of Benefit from Use of the Underlying Asset**

842-30-55-17 This Subtopic considers the right to control the use of the **underlying asset** as the equivalent of physical use. If the **lessee** controls the use of the underlying asset, recognition of **lease** income in accordance with paragraph 842-30-25-11(a) should not be affected by the extent to which the lessee uses the underlying asset.

> **Illustrations**

> > **Illustration of Lessor Accounting**

842-30-55-18 Example 1 illustrates how a lessor would account for sales-type leases and direct financing leases.

> > > **Example 1—Lessor Accounting Example**

> > > > **Case A—Lessor Accounting—Sales-Type Lease**

842-30-55-19 Lessor enters into a 6-year lease of equipment with Lessee, receiving annual lease payments of \$9,500, payable at the end of each year. Lessee provides a residual value guarantee of \$13,000. Lessor concludes that it

is probable it will collect the lease payments and any amount necessary to satisfy the residual value guarantee provided by Lessee. The equipment has a 9-year estimated remaining economic life, a carrying amount of \$54,000, and a fair value of \$62,000 at the commencement date. Lessor expects the residual value of the equipment to be \$20,000 at the end of the 6-year lease term. The lease does not transfer ownership of the underlying asset to Lessee or contain an option for Lessee to purchase the underlying asset. Lessor incurs \$2,000 in initial direct costs in connection with obtaining the lease, and no amounts are prepaid by Lessee to Lessor. The rate implicit in the lease is 5.4839 percent.

842-30-55-20 Lessor classifies the lease as a sales-type lease because the sum of the present value of the lease payments and the present value of the residual value guaranteed by the lessee amounts to substantially all of the fair value of the equipment. None of the other criteria to be classified as a sales-type lease are met.

842-30-55-21 Lessor measures the net investment in the lease at \$62,000 at lease commencement, which is equal to the fair value of the equipment. The net investment in the lease consists of the lease receivable (which includes the 6 annual payments of \$9,500 and the residual value guarantee of \$13,000, both discounted at the rate implicit in the lease, which equals \$56,920) and the present value of the unguaranteed residual value (the present value of the difference between the expected residual value of \$20,000 and the residual value guarantee of \$13,000, which equals \$5,080). Lessor calculates the selling profit on the lease as \$8,000, which is the difference between the lease receivable (\$56,920) and the carrying amount of the equipment net of the unguaranteed residual asset (\$54,000 – \$5,080 = \$48,920). The initial direct costs do not factor into the calculation of the selling profit in this Example because they are not eligible for deferral on the basis of the guidance in paragraph 842-30-25-1(c) (that is, because the fair value of the underlying asset is different from its carrying amount at the commencement date).

842-30-55-22 At the commencement date, Lessor derecognizes the equipment (carrying amount of \$54,000) and recognizes the net investment in the lease of \$62,000 and the selling profit of \$8,000. Lessor also pays and recognizes the initial direct costs of \$2,000 as an expense.

842-30-55-23 At the end of Year 1, Lessor recognizes the receipt of a lease payment of \$9,500 and interest on the net investment in the lease (the beginning balance of the net investment in the lease of \$62,000 × the rate implicit in the lease of 5.4839% = \$3,400), resulting in a balance in the net investment of the lease of \$55,900. For disclosure purposes, Lessor also calculates the separate components of the net investment in the lease: the lease receivable and the unguaranteed residual asset. The lease receivable equals \$50,541 (the beginning balance of the lease receivable of \$56,920 – the annual lease payment received of \$9,500 + the amount of interest income on the lease receivable during Year 1 of \$3,121, which is \$56,920 × 5.4839%). The unguaranteed residual asset equals \$5,360 (the beginning balance of the unguaranteed residual asset of \$5,081 + the

interest income on the unguaranteed residual asset during Year 1 of \$279, which is $\$5,081 \times 5.4839\%$).

842-30-55-24 At the end of Year 6, Lessor reclassifies the net investment in the lease, then equal to the estimated residual value of the underlying asset of \$20,000, as equipment.

> > > Case B—Lessor Accounting—Sales-Type Lease—Collectibility of the Lease Payments Is Not Probable

842-30-55-25 Assume the same facts and circumstances as in Case A (paragraphs 842-30-55-19 through 55-24), except that it is not probable Lessor will collect the lease payments and any amount necessary to satisfy the residual value guarantee provided by Lessee. In reaching this conclusion, the entity observes that Lessee's ability and intention to pay may be in doubt because of the following factors:

- a. Lessee intends to make the lease payments primarily from income derived from its business in which the equipment will be used (which is a business facing significant risks because of high competition in the industry and Lessee's limited experience)
- b. Lessee has limited credit history and no significant other income or assets with which to make the payments if the business is not successful.

842-30-55-26 In accordance with paragraph 842-30-25-3, Lessor does not derecognize the equipment and does not recognize a net investment in the lease or any selling profit or selling loss. However, consistent with Case A, Lessor pays and recognizes the initial direct costs of \$2,000 as an expense at the commencement date.

842-30-55-27 At the end of Year 1, Lessor reassesses whether it is probable it will collect the lease payments and any amount necessary to satisfy the residual value guarantee provided by Lessee and concludes that it is not probable. In addition, neither of the events in paragraph 842-30-25-3(b) has occurred. The contract has not been terminated and Lessor has not repossessed the equipment because Lessee is fulfilling the terms of the contract. Consequently, Lessor accounts for the \$9,500 Year 1 lease payment as a deposit liability in accordance with paragraph 842-30-25-3. Lessor recognizes depreciation expense on the equipment of \$7,714 ($\$54,000 \text{ carrying value} \div 7\text{-year useful life}$).

842-30-55-28 Lessor's accounting in Years 2 and 3 is the same as in Year 1. At the end of Year 4, Lessee makes the fourth \$9,500 annual lease payment such that the deposit liability equals \$38,000. Lessor concludes that collectibility of the lease payments and any amount necessary to satisfy the residual value guarantee provided by Lessee is now probable on the basis of Lessee's payment history under the contract and the fact that Lessee has been successfully operating its business for four years. Lessor does not reassess the classification of the lease as a sales-type lease.

842-30-55-29 Consequently, at the end of Year 4, Lessor derecognizes the equipment, which has a carrying amount of \$23,143, and recognizes a net investment in the lease of \$35,519. The net investment in the lease consists of the lease receivable (the sum of the 2 remaining annual payments of \$9,500 and the residual value guarantee of \$13,000, discounted at the rate implicit in the lease of 5.4839 percent determined at the commencement date, which equals \$29,228) and the unguaranteed residual asset (the present value of the difference between the expected residual value of \$20,000 and the residual value guarantee of \$13,000, which equals \$6,291). Lessor recognizes selling profit of \$50,376, the difference between (a) the sum of the lease receivable and the carrying amount of the deposit liability (\$29,228 lease receivable + \$38,000 in lease payments already made = \$67,228) and (b) the carrying amount of the equipment, net of the unguaranteed residual asset (\$23,143 – \$6,291 = \$16,852).

842-30-55-30 After the end of Year 4, Lessor accounts for the remaining two years of the lease in the same manner as any other sales-type lease. Consistent with Case A, at the end of Year 6, Lessor reclassifies the net investment in the lease, then equal to the estimated residual value of the underlying asset of \$20,000, as equipment.

> > > Case C—Lessor Accounting—Direct Financing Lease

842-30-55-31 Assume the same facts and circumstances as in Case A (paragraphs 842-30-55-19 through 55-24), except that the \$13,000 residual value guarantee is provided by a third party, not by Lessee. Collectibility of the lease payments and any amount necessary to satisfy the third party residual value guarantee is probable.

842-30-55-32 None of the criteria in paragraph 842-10-25-2 to be classified as a sales-type lease are met. Lessor classifies the lease as a direct financing lease because the sum of the present value of the lease payments and the present value of the residual value guaranteed by the third party amounts to substantially all of the fair value of the equipment. In accordance with paragraph 842-10-25-4, the discount rate used to determine the present value of the lease payments and the guaranteed residual value (5.4839 percent) assumes that no initial direct costs will be deferred because, at the commencement date, the fair value of the equipment is different from its carrying amount.

842-30-55-33 At the commencement date, Lessor derecognizes the equipment and recognizes a net investment in the lease of \$56,000, which is equal to the carrying amount of the underlying asset of \$54,000 plus the initial direct costs of \$2,000 that are included in the measurement of the net investment in the lease in accordance with paragraph 842-30-25-8 (that is, because the lease is classified as a direct financing lease). The net investment in the lease includes a lease receivable of \$58,669 (the present value of the 6 annual lease payments of \$9,500 and the third-party residual value guarantee of \$13,000, discounted at the rate implicit in the lease of 4.646 percent), an unguaranteed residual asset of \$5,331 (the present value of the difference between the estimated residual value of

\$20,000 and the third-party residual value guarantee of \$13,000, discounted at 4.646 percent), and deferred selling profit of \$8,000.

842-30-55-34 Lessor calculates the deferred selling profit of \$8,000 in this Example as follows:

- a. The lease receivable (\$58,669); minus
- b. The carrying amount of the equipment (\$54,000), net of the unguaranteed residual asset (\$5,331), which equals \$48,669; minus
- c. The initial direct costs included in the measurement of the net investment in the lease (\$2,000).

842-30-55-35 At the end of Year 1, Lessor recognizes the receipt of the lease payment of \$9,500 and interest on the net investment in the lease of \$4,624 (the beginning balance of the net investment in the lease of \$56,000 $\times$ the discount rate that, at the commencement date, would have resulted in the sum of the lease receivable and the unguaranteed residual asset equaling \$56,000, which is 8.258 percent), resulting in a balance in the net investment of the lease of \$51,124.

842-30-55-36 Also at the end of Year 1, Lessor calculates, for disclosure purposes, the separate components of the net investment in the lease: the lease receivable, the unguaranteed residual asset, and the deferred selling profit. The lease receivable equals \$51,895 (the beginning balance of the lease receivable of \$58,669 – the annual lease payment received of \$9,500 + the amount of interest income on the lease receivable during Year 1 of \$2,726, which is \$58,669 $\times$ 4.646%). The unguaranteed residual asset equals \$5,578 (the beginning balance of the unguaranteed residual asset of \$5,331 + the interest income on the unguaranteed residual asset during Year 1 of \$247, which is \$5,331 $\times$ 4.646%). The deferred selling profit equals \$6,349 (the initial deferred selling profit of \$8,000 – \$1,651 recognized during Year 1 [the \$1,651 is the difference between the interest income recognized on the net investment in the lease during Year 1 of \$4,624 calculated in paragraph 842-30-55-35 and the sum of the interest income earned on the lease receivable and the unguaranteed residual asset during Year 1]).

842-30-55-37 At the end of Year 2, Lessor recognizes the receipt of the lease payment of \$9,500 and interest on the net investment in the lease (the beginning of Year 2 balance of the net investment in the lease of \$51,124 $\times$ 8.258%, which is \$4,222), resulting in a carrying amount of the net investment in the lease of \$45,846.

842-30-55-38 Also at the end of Year 2, Lessor calculates the separate components of the net investment in the lease. The lease receivable equals \$44,806 (the beginning of Year 2 balance of \$51,895 – the annual lease payment received of \$9,500 + the interest income earned on the lease receivable during Year 2 of \$2,411, which is \$51,895 $\times$ 4.646%). The unguaranteed residual asset equals \$5,837 (the beginning of Year 2 balance of the unguaranteed residual asset of \$5,578 + the interest income earned on the unguaranteed residual asset during

Year 2 of \$259, which is $\$5,578 \times 4.646\%$). The deferred selling profit equals \$4,797 (the beginning of Year 2 balance of deferred selling profit of \$6,349 – \$1,552 recognized during Year 2 [the \$1,552 is the difference between the interest income recognized on the net investment in the lease during Year 2 of \$4,222 and the sum of the interest income earned on the lease receivable and the unguaranteed residual asset during Year 2]).

842-30-55-39 At the end of Year 6, Lessor reclassifies the net investment in the lease, then equal to the estimated residual value of the underlying asset of \$20,000, as equipment.

> > > **Case D—Lessor Accounting—Collectibility Is Not Probable**

842-30-55-40 Assume the same facts and circumstances as Case C (paragraphs 842-30-55-31 through 55-39), except that collectibility of the lease payments and any amount necessary to satisfy the residual value guarantee provided by the third party is not probable and the lease payments escalate every year over the lease term. Specifically, the lease payment due at the end of Year 1 is \$7,000, and subsequent payments increase by \$1,000 every year for the remainder of the lease term. Because it is not probable that Lessor will collect the lease payments and any amount necessary to satisfy the residual value guarantee provided by the third party in accordance with paragraph 842-10-25-3, Lessor classifies the lease as an operating lease.

842-30-55-41 Lessor continues to measure the equipment in accordance with Topic 360 on property, plant, and equipment.

842-30-55-42 Because collectibility of the lease payments is not probable, Lessor recognizes lease income only when Lessee makes the lease payments, and in the amount of those lease payments. Therefore, Lessor only recognizes lease income of \$7,000 at the point in time Lessee makes the end of Year 1 payment for that amount.

842-30-55-43 At the end of Year 2, Lessor concludes that collectibility of the remaining lease payments and any amount necessary to satisfy the residual value guarantee provided by the third party is probable; therefore, Lessor recognizes lease income of \$12,000. The amount of \$12,000 is the difference between lease income that would have been recognized through the end of Year 2 ($\$57,000$ in total lease payments $\div$ 6 years = $\$9,500$ per year $\times$ 2 years = $\$19,000$) and the \$7,000 in lease income previously recognized. Collectibility of the remaining lease payments remains probable throughout the remainder of the lease term; therefore, Lessor continues to recognize lease income of \$9,500 each year.

6. Add Subtopic 842-40, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Leases—Sale and Leaseback Transactions

Overview and Background

General

842-40-05-1 This Subtopic addresses accounting for sale and leaseback transactions when a **lease** has been accounted for in accordance with Subtopic 842-10 and either Subtopic 842-20 or Subtopic 842-30.

Scope and Scope Exceptions

General

842-40-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 842-10-15.

842-40-15-2 If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer **contract** and the **lease** in accordance with Sections 842-40-25, 842-40-30, and 842-40-50.

842-40-15-3 See paragraphs 842-40-55-1 through 55-21 for implementation guidance on the scope of this Subtopic. See Example 3 (paragraphs 842-40-55-39 through 55-44) for an illustration of the scope of this Subtopic.

Glossary

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Direct Financing Lease

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b).

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information,

including information that might be obtained through due diligence efforts that are usual and customary

- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any lease other than a **sales-type lease** or a **direct financing lease**.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Related Parties

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Sales-Type Lease

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Sublease

A transaction in which an **underlying asset** is re-leased by the **lessee** (or intermediate **lessor**) to a third party (the sublessee) and the original (or head) **lease** between the lessor and the lessee remains in effect.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Recognition

General

> Determining Whether the Transfer of the Asset Is a Sale

842-40-25-1 An entity shall apply the following requirements in Topic 606 on revenue from **contracts** with customers when determining whether the transfer of an asset shall be accounted for as a sale of the asset.

- a. Paragraphs 606-10-25-1 through 25-8 on the existence of a contract
- b. Paragraph 606-10-25-30 on when an entity satisfies a performance obligation by transferring control of an asset.

842-40-25-2 The existence of a leaseback (that is, a seller-lessee's right to use the **underlying asset** for a period of time) does not, in isolation, prevent the buyer-lessor from obtaining control of the asset. However, the buyer-lessor is not considered to have obtained control of the asset in accordance with the guidance on when an entity satisfies a performance obligation by transferring control of an asset in Topic 606 if the leaseback would be classified as a **finance lease** or a **sales-type lease**.

842-40-25-3 An option for the seller-lessee to repurchase the asset would preclude accounting for the transfer of the asset as a sale of the asset unless both of the following criteria are met:

- a. The exercise price of the option is the **fair value** of the asset at the time the option is exercised.
- b. There are alternative assets, substantially the same as the transferred asset, readily available in the marketplace.

> Transfer of the Asset Is a Sale

842-40-25-4 If the transfer of the asset is a sale in accordance with paragraphs 842-40-25-1 through 25-3, both of the following apply:

- a. The seller-lessee shall:
 1. Recognize the transaction price for the sale at the point in time the buyer-lessor obtains control of the asset in accordance with paragraph 606-10-25-30 in accordance with the guidance on determining the transaction price in paragraphs 606-10-32-2 through 32-27
 2. Derecognize the carrying amount of the **underlying asset**
 3. Account for the **lease** in accordance with Subtopic 842-20.
- b. The buyer-lessor shall account for the purchase in accordance with other Topics and for the lease in accordance with Subtopic 842-30.

> Transfer of the Asset Is Not a Sale

842-40-25-5 If the transfer of the asset is not a sale in accordance with paragraphs 842-40-25-1 through 25-3, both of the following apply:

- a. The seller-lessee shall not derecognize the transferred asset and shall account for any amounts received as a financial liability in accordance with other Topics.
- b. The buyer-lessor shall not recognize the transferred asset and shall account for the amounts paid as a receivable in accordance with other Topics.

Initial Measurement

General

> Transfer of the Asset Is a Sale

842-40-30-1 An entity shall determine whether a sale and leaseback transaction is at **fair value** on the basis of the difference between either of the following, whichever is more readily determinable:

- a. The sale price of the asset and the fair value of the asset
- b. The present value of the **lease payments** and the present value of market rental payments.

842-40-30-2 If the sale and leaseback transaction is not at fair value, the entity shall adjust the sale price of the asset on the same basis the entity used to determine that the transaction was not at fair value in accordance with paragraph 842-40-30-1. The entity shall account for both of the following:

- a. Any increase to the sale price of the asset as a prepayment of rent
- b. Any reduction of the sale price of the asset as additional financing provided by the buyer-lessor to the seller-lessee. The seller-lessee and

the buyer-lessor shall account for the additional financing in accordance with other Topics.

842-40-30-3 A sale and leaseback transaction is not off market solely because the sale price or the lease payments include a variable component. In determining whether the sale and leaseback transaction is at fair value, the entity should consider those variable payments it reasonably expects to be entitled to (or to make) on the basis of all of the information (historical, current, and forecast) that is reasonably available to the entity. For a seller-lessee, this would include estimating any variable consideration to which it expects to be entitled in accordance with paragraphs 606-10-32-5 through 32-9.

842-40-30-4 If the transaction is a related party **lease**, an entity shall not make the adjustments required in paragraph 842-40-30-2, but shall provide the required disclosures as discussed in paragraphs 842-20-50-7 and 842-30-50-4.

842-40-30-5 See Examples 1 and 2 (paragraphs 842-40-55-22 through 55-38) for illustrations of the requirements for a sale and leaseback transaction.

> Transfer of the Asset Is Not a Sale

842-40-30-6 The guidance in paragraph 842-40-25-5 notwithstanding, the seller-lessee shall adjust the interest rate on its financial liability as necessary to ensure that both of the following apply:

- a. Interest on the financial liability is not greater than the principal payments on the financial liability over the shorter of the **lease term** and the term of the financing. The term of the financing may be shorter than the lease term because the transfer of an asset that does not qualify as a sale initially may qualify as a sale at a point in time before the end of the lease term.
- b. The carrying amount of the asset does not exceed the carrying amount of the financial liability at the earlier of the end of the lease term or the date at which control of the asset will transfer to the buyer-lessor (for example, the date at which a repurchase option expires if that date is earlier than the end of the lease term).

Disclosure

General

842-40-50-1 If a seller-lessee or a buyer-lessor enters into a sale and leaseback transaction that is accounted for in accordance with paragraphs 842-40-25-4 and 842-40-30-1 through 30-3, it shall provide the disclosures required in paragraphs 842-20-50-1 through 50-9 for a seller-lessee or paragraphs 842-30-50-1 through 50-13 for a buyer-lessor.

842-40-50-2 In addition to the disclosures required by paragraphs 842-20-50-1 through 50-9, a seller-lessee that enters into a sale and leaseback transaction shall disclose both of the following:

- a. The main terms and conditions of that transaction
- b. Any gains or losses arising from the transaction separately from gains or losses on disposal of other assets.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Control of the Underlying Asset before the Commencement Date

842-40-55-1 A **lessee** may obtain legal title to the **underlying asset** before that legal title is transferred to the **lessor** and the asset is leased to the lessee. If the lessee controls the underlying asset (that is, it can direct its use and obtain substantially all of its remaining benefits) before the asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for in accordance with this Subtopic.

842-40-55-2 If the lessee obtains legal title, but does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. For example, this may be the case if a manufacturer, a lessor, and a lessee negotiate a transaction for the purchase of an asset from the manufacturer by the lessor, which in turn is leased to the lessee. For tax or other reasons, the lessee might obtain legal title to the underlying asset momentarily before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the asset but does not control the asset before it is transferred to the lessor, the transaction is accounted for as a purchase of the asset by the lessor and a **lease** between the lessor and the lessee.

> > Costs of the Lessee Relating to the Construction or Design of an Underlying Asset

842-40-55-3 An entity may negotiate a **lease** before the **underlying asset** is available for use by the **lessee**. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the **contract**, a lessee may be required to make payments relating to the construction or design of the asset.

842-40-55-4 If a lessee incurs costs relating to the construction or design of an underlying asset before the **commencement date**, the lessee should account for those costs in accordance with other Topics, for example, Topic 330 on inventory or Topic 360 on property, plant, and equipment. Costs relating to the construction

or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use the underlying asset are **lease payments**, regardless of the timing of those payments or the form of those payments (for example, a lessee might contribute construction materials for the asset under construction).

842-40-55-5 If the lessee controls the underlying asset being constructed before the commencement date, the transaction is accounted for in accordance with this Subtopic. Any one (or more) of the following would demonstrate that the lessee controls an underlying asset that is under construction before the commencement date:

- a. The lessee has the right to obtain the partially constructed underlying asset at any point during the construction period (for example, by making a payment to the **lessor**).
- b. The lessor has an enforceable right to payment for its performance to date, and the asset does not have an alternative use (see paragraph 842-10-55-7) to the owner-lessor. In evaluating whether the asset has an alternative use to the owner-lessor, an entity should consider the characteristics of the asset that will ultimately be leased.
- c. The lessee legally owns either:
 1. Both the land and the property improvements (for example, a building) that are under construction
 2. The non-real-estate asset (for example, a ship or an airplane) that is under construction.
- d. The lessee controls the land that property improvements will be constructed upon (this includes where the lessee enters into a transaction to transfer the land to the lessor, but the transfer does not qualify as a sale in accordance with paragraphs 842-40-25-1 through 25-3) and does not enter into a lease of the land before the beginning of construction that, together with renewal options, permits the lessor or another unrelated third party to lease the land for substantially all of the economic life of the property improvements.
- e. The lessee is leasing the land that property improvements will be constructed upon, the term of which, together with lessee renewal options, is for substantially all of the economic life of the property improvements, and does not enter into a **sublease** of the land before the beginning of construction that, together with renewal options, permits the lessor or another unrelated third party to sublease the land for substantially all of the economic life of the property improvements.

The list of circumstances above in which a lessee controls an underlying asset that is under construction before the commencement date is not all inclusive. There may be other circumstances that individually or in combination demonstrate that a lessee controls an underlying asset that is under construction before the commencement date.

842-40-55-6 See Example 3 (paragraphs 842-40-55-39 through 55-44) for an illustration of the scope of this Subtopic.

> > Lessee Indemnification for Environmental Contamination

842-40-55-7 A provision that requires **lessee** indemnifications for preexisting environmental contamination does not, on its own, mean that the lessee controlled the **underlying asset** before the **lease** commenced regardless of the likelihood of loss resulting from the indemnity. Consequently, the presence of such a provision does not mean the transaction is in the scope of this Subtopic.

> > Sale Subject to a Preexisting Lease

842-40-55-8 An entity owns an interest in an **underlying asset** and also is a **lessee** under an **operating lease** for all or a portion of the underlying asset. Acquisition of an ownership interest in the underlying asset and consummation of the **lease** occurred at or near the same time. This owner-lessee relationship can occur, for example, when the entity has an investment in a partnership that owns the underlying asset (or a larger asset of which the underlying asset is a distinct portion). The entity subsequently sells its interest or the partnership sells the underlying asset to an independent third party, and the entity continues to lease the underlying asset under the preexisting operating lease.

842-40-55-9 A transaction should be subject to the guidance in this Subtopic if the scope or price of the preexisting lease is modified in connection with the sale. If the scope or the price of the preexisting lease is not modified in conjunction with the sale, the sale should be accounted for in accordance with other Topics.

842-40-55-10 A lease between parties under common control should not be considered a preexisting lease. Accordingly, the guidance in this Subtopic should be applied to transactions that include nonfinancial assets within its scope, except if Topic 980 on regulated operations applies. That is, if one of the parties under common control is a regulated entity with a lease that has been approved by the appropriate regulatory agency, that lease should be considered a preexisting lease.

> > Transfer of Tax Benefits

842-40-55-11 A U.S. entity purchases an asset and enters into a **contract** with a foreign investor that provides that foreign investor with an ownership right in, but not necessarily title to, the asset. That ownership right enables the foreign investor to claim certain benefits of ownership of the asset for tax purposes in the foreign tax jurisdiction.

842-40-55-12 The U.S. entity also enters into a contract in the form of a leaseback for the ownership right with the foreign investor. The contract contains a purchase option for the U.S. entity to acquire the foreign investor's ownership right in the asset at the end of the **lease term**.

842-40-55-13 The foreign investor pays the U.S. entity an amount of cash on the basis of an appraised value of the asset. The U.S. entity immediately transfers a portion of that cash to a third party, and that third party assumes the U.S. entity's obligation to make the future **lease payments**, including the purchase option payment. The cash retained by the U.S. entity is consideration for the tax benefits to be obtained by the foreign investor in the foreign tax jurisdiction. The U.S. entity may agree to indemnify the foreign investor against certain future events that would reduce the availability of tax benefits to the foreign investor. The U.S. entity also may agree to indemnify the third-party trustee against certain future events.

842-40-55-14 The result of the transaction is that both the U.S. entity and the foreign investor have a tax basis in the same depreciable asset.

842-40-55-15 An entity should determine whether the transfer of the ownership right is a sale based on the guidance in paragraphs 842-40-25-1 through 25-3. Consistent with paragraphs 842-40-25-2 through 25-3, if the leaseback for the ownership right is a **finance lease** or if the U.S. entity has an option to repurchase the ownership right at any exercise price other than the **fair value** of that right on the exercise date, there is no sale. If the transfer of the ownership right is not a sale, consistent with the guidance in paragraph 842-40-25-5, the entity should account for the cash received from the foreign investor as a financial liability in accordance with other Topics.

842-40-55-16 If the transfer of the ownership right is a sale, income recognition for the cash received should be determined on the basis of individual facts and circumstances. Immediate income recognition is not appropriate if there is more than a remote possibility of loss of the cash consideration received because of indemnification or other contingencies.

842-40-55-17 The total consideration received by the U.S. entity is compensation for both the tax benefits and the indemnification of the foreign investor or other third-party trustee. The recognition of a liability for the indemnification agreement at inception in accordance with the guidance in Topic 460 on guarantees would reduce the amount of income related to the tax benefits that the seller-lessee would recognize immediately when the possibility of loss is remote.

> > **Sale-Leaseback-Sublease Transactions**

842-40-55-18 An entity enters into a sale and leaseback of an asset that meets either of the following criteria:

- a. The asset is subject to an **operating lease**.
- b. The asset is subleased or intended to be subleased by the seller-lessee to another party under an operating lease.

842-40-55-19 A sale-leaseback-sublease transaction is within the scope of this Subtopic. The existence of the **sublease** (that is, the operating lease in paragraph 842-40-55-18(a) or (b)) does not, in isolation, prevent the buyer-lessor from

obtaining control of the asset in accordance with paragraphs 842-40-25-1 through 25-3, nor does it prevent the seller-lessee from controlling the asset before its transfer to the buyer-lessor (that is, the seller-lessee is subject to the same requirements for determining whether the transfer of the asset is a sale as it would be without the sublease). All facts and circumstances should be considered in determining whether the buyer-lessor obtains control of the **underlying asset** from the seller-lessee in a sale-leaseback-sublease transaction.

> > **Seller-Lessee Guarantee of the Residual Value**

842-40-55-20 The seller-lessee may guarantee to the **lessor** that the residual value will be a stipulated amount at the end of the **lease term**. If the transfer of the asset is a sale in accordance with paragraphs 842-40-25-1 through 25-3, the seller-lessee **residual value guarantee** should be accounted for in the same manner as any other residual value guarantee provided by a **lessee**.

842-40-55-21 The residual value guarantee does not, on its own, preclude accounting for the transaction as a sale and leaseback, but should be considered in evaluating whether control of the asset has transferred to the buyer-lessor in accordance with paragraph 606-10-25-30. For example, a significant residual value guarantee by the seller-lessee may affect an entity's consideration of the transfer of control indicator in paragraph 606-10-25-30(d).

> **Illustrations**

> > **Illustration of Sale and Leaseback Transaction**

842-40-55-22 Examples 1 and 2 illustrate the accounting for sale and leaseback transactions.

> > > **Example 1—Sale and Leaseback Transaction**

842-40-55-23 An entity (Seller) sells a piece of land to an unrelated entity (Buyer) for cash of \$2 million. Immediately before the transaction, the land has a carrying amount of \$1 million. At the same time, Seller enters into a contract with Buyer for the right to use the land for 10 years (the leaseback), with annual payments of \$120,000 payable in arrears. This Example ignores any initial direct costs associated with the transaction. The terms and conditions of the transaction are such that Buyer obtains substantially all the remaining benefits of the land on the basis of the combination of the cash flows it will receive from Seller during the leaseback and the benefits that will be derived from the land at the end of the lease term. In determining that a sale occurs at commencement of the leaseback, Seller considers that, at that date, all of the following apply:

- a. Seller has a present right to payment of the sales price of \$2 million.
- b. Buyer obtains legal title to the land.
- c. Buyer has the significant risks and rewards of ownership of the land because, for example, Buyer has the ability to sell the land if the property

value increases and also must absorb any losses, realized or unrealized, if the property value declines.

842-40-55-24 The observable fair value of the land at the date of sale is \$1.4 million. Because the fair value of the land is observable, both Seller and Buyer utilize that benchmark in evaluating whether the sale is at market term. Because the sale is not at fair value (that is, the sales price is significantly in excess of the fair value of the land), both Seller and Buyer adjust for the off-market terms in accounting for the transaction. Seller recognizes a gain of \$400,000 (\$1.4 million – \$1 million) on the sale of the land. The amount of the excess sale price of \$600,000 (\$2 million – \$1.4 million) is recognized as additional financing from Buyer to Seller (that is, Seller is receiving the additional benefit of financing from Buyer). Seller's incremental borrowing rate is 6 percent. The leaseback is classified as an operating lease.

842-40-55-25 At the commencement date, Seller derecognizes the land with a carrying amount of \$1 million. Seller recognizes the cash received of \$2 million, a financial liability for the additional financing obtained from Buyer of \$600,000, and a gain on sale of the land of \$400,000. Seller also recognizes a lease liability for the leaseback at the present value of the portion of the 10 contractual leaseback payments attributable to the lease of \$38,479 (\$120,000 contractual lease payment – \$81,521 of that lease payment that is attributable to the additional Buyer financing), discounted at the rate of 6 percent, which is \$283,210, and a corresponding right-of-use asset of \$283,210. The amount of \$81,521 is the amount of each \$120,000 annual payment that must be attributed to repayment of the principal of the financial liability for that financial liability to reduce to zero by the end of the lease term.

842-40-55-26 After initial recognition and measurement, at each period of the lease term, Seller will do both of the following:

- a. Decrease the financing obligation for the amount of each lease payment allocated to that obligation (that is, \$81,521) and increase the carrying amount of the obligation for interest accrued using Seller's incremental borrowing rate of 6 percent. For example, at the end of Year 1, the balance of the financial obligation is \$554,479 (\$600,000 – \$81,521 + \$36,000).
- b. Recognize the interest expense on the financing obligation (for example, \$36,000 in Year 1) and \$38,479 in operating lease expense.

842-40-55-27 At the end of the lease term, the financing obligation and the lease liability equal \$0.

842-40-55-28 Also, at the commencement date, Buyer recognizes the land at a cost of \$1.4 million and a financial asset for the additional financing provided to Seller of \$600,000. Because the lease is an operating lease, at the date of sale Buyer does not do any accounting for the lease.

842-40-55-29 In accounting for the additional financing to Seller, Buyer uses 6 percent as the applicable discount rate, which it determined in accordance with paragraphs 835-30-25-12 through 25-13. Therefore, Buyer will allocate \$81,521 of each lease payment to Buyer's financial asset and allocate the remaining \$38,479 to lease income. After initial recognition and measurement at each period of the lease term, Buyer will do both of the following:

- a. Decrease the financial asset for the amount of each lease payment received that is allocated to that obligation (that is, \$81,521) and increase the carrying amount of the obligation for interest accrued on the financial asset using Seller's incremental borrowing rate of 6 percent. Consistent with Seller's accounting, at the end of Year 1, the carrying amount of the financial asset is \$554,479 (\$600,000 – \$81,521 + \$36,000).
- b. Recognize the interest income on the financing obligation (for example, \$33,269 in Year 2) and \$38,479 in operating lease income.

842-40-55-30 At the end of the lease term, the carrying amount of the financial asset is \$0, and Buyer continues to recognize the land.

> > > Example 2—Accounting for a Failed Sale and Leaseback Transaction

842-40-55-31 An entity (Seller) sells an asset to an unrelated entity (Buyer) for cash of \$2 million. Immediately before the transaction, the asset has a carrying amount of \$1.8 million and has a remaining useful life of 21 years. At the same time, Seller enters into a contract with Buyer for the right to use the asset for 8 years with annual payments of \$200,000 payable at the end of each year and no renewal options. Seller's incremental borrowing rate at the date of the transaction is 4 percent. The contract includes an option to repurchase the asset at the end of Year 5 for \$800,000.

842-40-55-32 The exercise price of the repurchase option is fixed and, therefore, is not the fair value of the asset on the exercise date of the option. Consequently, the repurchase option precludes accounting for the transfer of the asset as a sale. Absent the repurchase option, there are no other factors that would preclude accounting for the transfer of the asset as a sale.

842-40-55-33 Therefore, at the commencement date, Seller accounts for the proceeds of \$2 million as a financial liability and continues to account for the asset. Buyer accounts for the payment of \$2 million as a financial asset and does not recognize the transferred asset. Seller accounts for its financing obligation, and Buyer accounts for its financial asset in accordance with other Topics, except that, in accordance with paragraph 842-40-30-6, Seller imputes an interest rate (4.23 percent) to ensure that interest on the financial liability is not greater than the principal payments on the financial liability over the shorter of the lease term and the term of the financing and that the carrying amount of the asset will not exceed the financial liability at the point in time the repurchase option expires (that is, at the point in time Buyer will obtain control of the asset in accordance with the guidance on satisfying performance obligations in Topic 606). Paragraph 842-40-

30-6 does not apply to the buyer-lessor; therefore, Buyer recognizes interest income on its financial asset on the basis of the imputed interest rate determined in accordance with paragraphs 835-30-25-12 through 25-13, which in this case Buyer determines to be 4 percent.

842-40-55-34 During Year 1, Seller recognizes interest expense of \$84,600 ($4.23\% \times \$2 \text{ million}$) and recognizes the payment of \$200,000 as a reduction of the financial liability. Seller also recognizes depreciation expense of \$85,714 ($\$1.8 \text{ million} \div 21 \text{ years}$). Buyer recognizes interest income of \$80,000 ($4\% \times \$2 \text{ million}$) and recognizes the payment of \$200,000 as a reduction of its financial asset.

842-40-55-35 At the end of Year 1, the carrying amount of Seller's financial liability is \$1,884,600 ($\$2 \text{ million} + \$84,600 - \$200,000$), and the carrying amount of the underlying asset is \$1,714,286 ($\$1.8 \text{ million} - \$85,714$). The carrying amount of Buyer's financial asset is \$1,880,000 ($\$2 \text{ million} + \$80,000 - \$200,000$).

842-40-55-36 At the end of Year 5, the option to repurchase the asset expires, unexercised by Seller. The repurchase option was the only feature of the arrangement that precluded accounting for the transfer of the asset as a sale. Therefore, upon expiration of the repurchase option, Seller recognizes the sale of the asset by derecognizing the carrying amount of the financial liability of \$1,372,077, derecognizing the carrying amount of the underlying asset of \$1,371,429, and recognizing a gain of \$648. Buyer recognizes the purchase of the asset by derecognizing the carrying amount of its financial asset of \$1,350,041 and recognizes the transferred asset at that same amount. The date of sale also is the commencement date of the leaseback for accounting purposes. The lease term is 3 years (8 year contractual leaseback term – 5 years already passed at the commencement date). Therefore, Seller recognizes a lease liability at the present value of the 3 remaining contractual leaseback payments of \$200,000, discounted at Seller's incremental borrowing rate at the contractually stated commencement date of 4 percent, which is \$555,018, and a corresponding right-of-use asset of \$555,018. Seller uses the incremental borrowing rate as of the contractual commencement date because that rate more closely reflects the interest rate that would have been considered by Buyer in pricing the lease.

842-40-55-37 The lease is classified as an operating lease by both Seller and Buyer. Consequently, in Year 6 and each year thereafter, Seller recognizes a single lease cost of \$200,000, while Buyer recognizes lease income of \$200,000 and depreciation expense of \$84,378 on the underlying asset ($\$1,350,041 \div 16 \text{ years remaining useful life}$).

842-40-55-38 At the end of Year 6 and at each reporting date thereafter, Seller calculates the lease liability at the present value of the remaining lease payments of \$200,000, discounted at Seller's incremental borrowing rate of 4 percent. Because Seller does not incur any initial direct costs and there are no prepaid or accrued lease payments, Seller measures the right-of-use asset at an amount equal to the lease liability at each reporting date for the remainder of the lease term.

> > Illustration of Guidance on Application of Costs of the Lessee Relating to the Construction or Design of an Underlying Asset

842-40-55-39 Example 3 illustrates the guidance on determining whether a lessee controls an underlying asset that is under construction before the commencement date.

> > > Example 3—Lessee Control over an Asset under Construction

842-40-55-40 Lessee and Lessor enter into a contract whereby Lessor will construct (whether itself or using subcontractors) a building to Lessee's specifications and lease that building to Lessee for a period of 20 years once construction is completed for an annual lease payment of \$1,000,000, increasing by 5 percent per year, plus a percentage of any overruns above the budgeted cost to construct the building. The building is expected to have an economic life of 50 years once it is constructed. Lessee does not legally own the building and does not have a right under the contract to obtain the building while it is under construction (for example, a right to purchase the construction in process from Lessor). In addition, while the building is being developed to Lessee's specifications, those specifications are not so specialized that the asset does not have an alternative use to Lessor.

> > > > Case A—Lessee Does Not Control the Asset under Construction

842-40-55-41 Assume Lessee controls (that is, Lessee is the owner for accounting purposes) the land upon which the building will be constructed and, as part of the contract, Lessee agrees to lease the underlying land to Lessor for an initial period of 25 years. Lessor also is granted a series of six 5-year renewal options for the land lease.

842-40-55-42 None of the circumstances in paragraph 842-40-55-5 exist. Even though Lessee owns the land (whether legally or for accounting purposes only) upon which the building will be constructed, Lessor legally owns the property improvements and has rights to use the underlying land for at least substantially all of the economic life of the building. Lessee does not own the building and does not have a right under the contract to obtain the building (for example, a right to purchase the building from Lessor). In addition, the building has an alternative use to Lessor. Therefore, Lessee does not control the building under construction. Consequently, the arrangement is not within the scope of this Subtopic. Lessee and Lessor will account for the lease of the building in accordance with Subtopics 842-20 and 842-30, respectively. If Lessee incurs costs related to the construction or design of the building (for example, architectural services in developing the specifications of the building), it will account for those costs as lease payments unless the costs are for goods or services provided to Lessee, in which case Lessee will account for those costs in accordance with other Topics.

> > > **Case B—Lessee Controls the Asset under Construction**

842-40-55-43 Assume Lessee leases, rather than owns, the land upon which the building will be constructed. Lessee has a 20-year lease of the underlying land and five 10-year renewal options. Therefore, Lessee's lease of the underlying land, together with the renewal options, is for at least substantially all of the economic life of the building under construction. Lessee enters into a sublease with Lessor for the right to use the underlying land for 20 years that commences upon completion of the building. The sublease has a single 10-year renewal option available to Lessor.

842-40-55-44 Lessee controls the building during the construction period and, therefore, the arrangement is within the scope of this Subtopic. Lessee and Lessor will apply the guidance in this Subtopic to determine whether this arrangement qualifies as a sale and a leaseback or whether this arrangement is, instead, a financing arrangement. Lessee controls the building during the construction period because, in accordance with paragraph 842-40-55-5(e), Lessee controls the use of the land upon which the building will be constructed for a period that is at least substantially all of the economic life of the building and the sublease entered into with Lessor does not both (a) grant Lessor the right to use the land before the beginning of construction and (b) permit Lessor to use the land for substantially all the economic life of the building (that is, the sublease, including Lessor renewal options, only is for 30 years as compared with the 50-year economic life of the building).

7. Add Subtopic 842-50, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Leases—Leveraged Lease Arrangements

Overview and Background

General

842-50-05-1 This Subtopic addresses accounting for **leases** that meet the definition of a **leveraged lease**.

Scope and Scope Exceptions

General

842-50-15-1 This Subtopic addresses accounting for **leases** that meet the criteria in transition paragraph 842-10-65-1(z). If a **lessee** exercises an option to extend a lease that meets the criteria in transition paragraph 842-10-65-1(z) that it was not

previously reasonably assured of exercising, the exercise of that option shall be considered a **lease modification** as described in paragraph 842-10-65-1(z).

Glossary

Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Delayed Equity Investment

In **leveraged lease** transactions that have been structured with terms such that the **lessee's** rent payments begin one to two years after **lease inception**, equity contributions the **lessor** agrees to make (in the lease agreement or a separate binding **contract**) that are used to service the nonrecourse debt during this brief period. The total amount of the lessor's contributions is specifically limited by the agreements.

Estimated Residual Value

The estimated fair value of the leased property at the end of the **lease term**.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Inception

The date of the lease agreement or commitment, if earlier. For purposes of this definition, a commitment shall be in writing, signed by the parties in interest to the transaction, and shall specifically set forth the principal provisions of the transaction. If any of the principal provisions are yet to be negotiated, such a preliminary agreement or commitment does not qualify for purposes of this definition.

Lease Modification

A change to the terms and conditions of a **contract** that results in a change in the scope of or the consideration for a **lease** (for example, a change to the terms and conditions of the contract that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term).

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Leveraged Lease

From the perspective of a **lessor**, a **lease** that was classified as a leveraged lease in accordance with the leases guidance in effect before the effective date and for which the **commencement date** is before the effective date.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Minimum Lease Payments

Minimum lease payments comprise the payments that the lessee is obligated to make or can be required to make in connection with the leased property, excluding both of the following:

- a. Contingent rentals
- b. Any guarantee by the lessee of the lessor's debt and the lessee's obligation to pay (apart from the rental payments) executory costs such as insurance, maintenance, and taxes in connection with the leased property.

If the lease contains a bargain purchase option, only the minimum rental payments over the lease term and the payment called for by the bargain purchase option are required to be included in the minimum lease payments. Otherwise, minimum lease payments include all of the following:

- a. The minimum rental payments called for by the lease over the lease term.
- b. Any guarantee of the residual value at the expiration of the lease term, whether or not payment of the guarantee constitutes a purchase of the leased property or of rental payments beyond the lease term by the lessee (including a third party related to the lessee) or a third party unrelated to either the lessee or the lessor, provided the third party is financially capable of discharging the obligations that may arise from the guarantee. If the lessor has the right to require the lessee to purchase the property at termination of the lease for a certain or determinable amount, that amount is required to be considered a lessee guarantee of the residual value. If the lessee agrees to make up any deficiency below a stated amount in the lessor's realization of the residual value, the residual value guarantee to be included in the minimum lease payments is required to be the stated amount, rather than an estimate of the deficiency to be made up.
- c. Any payment that the lessee must make or can be required to make upon failure to renew or extend the lease at the expiration of the lease term, whether or not the payment would constitute a purchase of the leased property. Note that the definition of lease term includes all periods, if any, for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at lease inception, to be reasonably assured. If the lease term has been extended because of that provision, the related penalty is not included in minimum lease payments.
- d. Payments made before the beginning of the lease term. The lessee is required to use the same interest rate to accrete payments to be made before the beginning of the lease term that it uses to discount lease payments to be made during the lease term.
- e. Fees that are paid by the lessee to the owners of the special-purpose entity for structuring the lease transaction. Such fees are required to be

included as part of minimum lease payments (but not included in the fair value of the leased property).

Lease payments that depend on a factor directly related to the future use of the leased property, such as machine hours of use or sales volume during the lease term, are contingent rentals and, accordingly, are excluded from minimum lease payments in their entirety. However, lease payments that depend on an existing index or rate, such as the Consumer Price Index or the prime interest rate, are required to be included in minimum lease payments based on the index or rate existing at lease inception; any increases or decreases in lease payments that result from subsequent changes in the index or rate are contingent rentals and, thus, affect the determination of income as accruable.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Related Parties

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity

- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Variable Interest Entity

A **legal entity** subject to consolidation according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.

Recognition

General

842-50-25-1 A **lessor** shall record its investment in a **leveraged lease**. The net of the balances of the following accounts as measured in accordance with this Subtopic shall represent the lessor's initial and continuing investment in leveraged leases:

- a. Rentals receivable
- b. Investment-tax-credit receivable
- c. **Estimated residual value** of the leased asset
- d. Unearned and deferred income.

> Leveraged Lease Acquired in a Business Combination or an Acquisition by a Not-for-Profit Entity

842-50-25-2 In a business combination or an **acquisition by a not-for-profit entity**, the acquiring entity shall retain the classification of the acquired entity's investment as a **lessor** in a **leveraged lease** at the date of the combination. The net investment of the acquired leveraged lease shall be disaggregated into its component parts, namely net rentals receivable, **estimated residual value**, and unearned income including discount to adjust other components to present value.

Initial Measurement

General

842-50-30-1 A **lessor** shall initially measure its investment in a **leveraged lease** net of the nonrecourse debt (as discussed in paragraph 842-50-25-1). The net of the balances of the following accounts shall represent the initial and continuing investment in leveraged leases:

- a. Rentals receivable, net of that portion of the rental applicable to principal and interest on the nonrecourse debt.
- b. A receivable for the amount of the investment tax credit to be realized on the transaction.
- c. The **estimated residual value** of the leased asset. The estimated residual value shall not exceed the amount estimated at **lease inception** except if the **lease** agreement includes a provision to escalate **minimum lease payments** either for increases in construction or acquisition cost of the leased property or for increases in some other measure of cost or value (such as general price levels) during the construction or preacquisition period. In that case, the effect of any increases that have occurred shall be considered in the determination of the estimated residual value of the **underlying asset** at lease inception.
- d. Unearned and deferred income consisting of both of the following:
 1. The estimated pretax lease income (or loss), after deducting initial direct costs, remaining to be allocated to income over the **lease term**.
 2. The investment tax credit remaining to be allocated to income over the lease term.

> Leveraged Lease Acquired in a Business Combination or an Acquisition by a Not-for-Profit Entity

842-50-30-2 In a business combination or an **acquisition by a not-for-profit entity**, the acquiring entity shall assign an amount to the acquired net investment in the **leveraged lease** in accordance with the general guidance in Topic 805 on business combinations, based on the remaining future cash flows and giving appropriate recognition to the estimated future tax effects of those cash flows.

Subsequent Measurement

General

> Leveraged Lease Acquired in a Business Combination or an Acquisition by a Not-for-Profit Entity

842-50-35-1 In a business combination or an **acquisition by a not-for-profit entity**, the acquiring entity shall subsequently account for its acquired investment as a **lessor** in a **leveraged lease** in accordance with the guidance in this Subtopic as it would for any other leveraged lease.

> Income Recognition on a Leveraged Lease

842-50-35-2 The investment in **leveraged leases** minus deferred taxes arising from differences between pretax accounting income and taxable income shall represent the **lessor's** net investment in leveraged leases for purposes of computing periodic net income from the leveraged lease. Given the original investment and using the projected cash receipts and disbursements over the term of the **lease**, the rate of return on the net investment in the years in which it is positive shall be computed. The rate is that rate that, when applied to the net investment in the years in which the net investment is positive, will distribute the net income to those years and is distinct from the interest rate implicit in the lease. In each year, whether positive or not, the difference between the net cash flow and the amount of income recognized, if any, shall serve to increase or reduce the net investment balance. The use of the term **years** is not intended to preclude application of the accounting prescribed in this paragraph to shorter accounting periods.

842-50-35-3 The net income (or loss) that a lessor recognizes on a leveraged lease shall be composed of the following three elements:

- a. Pretax lease income (or loss)
- b. Investment tax credit
- c. Tax effect of pretax lease income (or loss).

842-50-35-4 The pretax lease income (or loss) and investment tax credit elements shall be allocated in proportionate amounts from the unearned and deferred income included in the lessor's net investment (as described in paragraph 842-50-30-1(d)). The tax effect of the pretax lease income (or loss) recognized shall be reflected in tax expense for the year. The tax effect of the difference between pretax accounting income (or loss) and taxable income (or loss) for the year shall be charged or credited to deferred taxes.

842-50-35-5 If, at any time during the **lease term** the application of the method prescribed in this Subtopic would result in a loss being allocated to future years, that loss shall be recognized immediately. This situation might arise in circumstances in which one of the important assumptions affecting net income is revised (see paragraphs 842-50-35-6 through 35-15).

> > Changes in Assumptions

842-50-35-6 Any **estimated residual value** and all other important assumptions affecting estimated total net income from the **leveraged lease** shall be reviewed at least annually. The rate of return and the allocation of income to positive investment years shall be recalculated from **lease inception** following the method

described in paragraphs 842-50-35-2 through 35-4 and using the revised assumption if, during the **lease term**, any of the following conditions occur:

- a. The estimate of the residual value is determined to be excessive, and the decline in the residual value is judged to be other than temporary.
- b. The revision of another important assumption changes the estimated total net income from the **lease**.
- c. The projected timing of the income tax cash flows is revised.

842-50-35-7 The **lessor** shall update all assumptions used to calculate total and periodic income if the lessor is performing a recalculation of the leveraged lease. That recalculation shall include actual cash flows up to the date of the recalculation and projected cash flows following the date of recalculation.

842-50-35-8 The accounts constituting the net investment balance shall be adjusted to conform to the recalculated balances, and the change in the net investment shall be recognized as a gain or loss in the year in which the assumption is changed. The gain or loss shall be recognized as follows:

- a. The pretax gain or loss shall be included in income from continuing operations before income taxes in the same line item in which leveraged lease income is recognized.
- b. The tax effect of the gain or loss shall be included in the income tax line item.
- c. An upward adjustment of the estimated residual value (including any guaranteed portion) shall not be made.

842-50-35-9 The projected timing of income tax cash flows generated by the leveraged lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The income effect of a change in the income tax rate shall be recognized in the first accounting period ending on or after the date on which the legislation effecting a rate change becomes law.

842-50-35-10 A revision of the projected timing of the income tax cash flows applies only to changes or projected changes in the timing of income taxes that are directly related to the leveraged lease transaction. For example, a change in timing or projected timing of the tax benefits generated by a leveraged lease as a result of any of the following circumstances would require a recalculation because that change in timing is directly related to that lease:

- a. An interpretation of the tax law
- b. A change in the lessor's assessment of the likelihood of prevailing in a challenge by the taxing authority
- c. A change in the lessor's expectations about settlement with the taxing authority.

842-50-35-11 In contrast, as discussed in paragraph 842-50-35-20, a change in timing of income taxes solely as a result of an alternative minimum tax credit or

insufficient taxable income of the lessor would not require a recalculation of a leveraged lease because that change in timing is not directly related to that lease. A recalculation would not be required unless there is an indication that the previous assumptions about total after-tax net income from the leveraged lease were no longer valid.

842-50-35-12 Tax positions shall be reflected in the lessor's initial calculation or subsequent recalculation on the recognition, measurement, and derecognition criteria in paragraphs 740-10-25-6, 740-10-30-7, and 740-10-40-2. The determination of when a tax position no longer meets those criteria is a matter of individual facts and circumstances evaluated in light of all available evidence.

842-50-35-13 If the lessor expects to enter into a settlement of a tax position relating to a leveraged lease with a taxing authority, the cash flows following the date of recalculation shall include projected cash flows between the date of the recalculation and the date of any projected settlement and a projected settlement amount at the date of the projected settlement.

842-50-35-14 The recalculation of income from the leveraged lease shall not include interest or penalties in the cash flows from the leveraged lease.

842-50-35-15 Advance payments and deposits made with a taxing authority shall not be considered an actual cash flow of the leveraged lease; rather, those payments and deposits shall be included in the projected settlement amount.

> Effect of Alternative Minimum Tax

842-50-35-16 An entity shall include assumptions about the effect of the alternative minimum tax, considering its consolidated tax position, in **leveraged lease** computations.

842-50-35-17 Any difference between alternative minimum tax depreciation and the tax depreciation assumed in the leveraged lease or between income recognition for financial reporting purposes and alternative minimum tax income could, depending on the **lessor's** overall tax situation, result in alternative minimum tax or the utilization of alternative minimum tax credits.

842-50-35-18 If alternative minimum tax is paid or an alternative minimum tax credit is utilized, the total cash flows from the leveraged lease could be changed and the lessor's net investment in the leveraged lease and income recognition would be affected.

842-50-35-19 If a change to the tax assumptions changes total estimated after-tax net income, the rate of return on the leveraged lease shall be recalculated from inception, the accounts constituting the lessor's net investment shall be adjusted, and a gain or loss shall be recognized in the year in which the assumption is changed.

842-50-35-20 However, an entity whose tax position frequently varies between alternative minimum tax and regular tax shall not be required to recalculate the

rate of return on the leveraged lease each year unless there is an indication that the original assumptions regarding total after-tax net income from the **lease** are no longer valid. In that circumstance, the entity shall be required to revise the leveraged lease computations in any period in which total net income from the leveraged lease changes because of the effect of the alternative minimum tax on cash flows for the lease.

> Transfer of Minimum Rental Payments

842-50-35-21 If a **lessor** sells substantially all of the minimum rental payments associated with a **leveraged lease** and retains an interest in the residual value of the leased asset, the lessor shall not recognize increases in the value of the **lease** residual to its estimated value over the remaining **lease term**. The lessor shall report any remaining interest thereafter at its carrying amount at the date of the sale of the **lease payments**. If it is determined subsequently that the **fair value** of the residual value of the leased asset has declined below the carrying amount of the interest retained and that decline is other than temporary, the asset shall be written down to fair value, and the amount of the write-down shall be recognized as a loss. That fair value becomes the asset's new carrying amount, and the asset shall not be increased for any subsequent increase in its fair value before its sale or disposition.

Other Presentation Matters

General

842-50-45-1 For purposes of presenting the investment in a **leveraged lease** in the **lessor's** balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment). In the income statement or the notes to that statement, separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period.

> Income Taxes and Leveraged Leases

842-50-45-2 Integration of the results of income tax accounting for **leveraged leases** with the other results of accounting for income taxes under Topic 740 on income taxes is required if deferred tax credits related to leveraged leases are the only source (see paragraph 740-10-30-18) for recognition of a tax benefit for deductible temporary differences and carryforwards not related to leveraged leases. A valuation allowance is not necessary if deductible temporary differences and carryforwards will offset taxable amounts from future recovery of the net investment in the leveraged lease. However, to the extent that the amount of deferred tax credits for a leveraged lease as determined in accordance with this Subtopic differs from the amount of the deferred tax liability related to the

leveraged lease that would otherwise result from applying the guidance in Topic 740, that difference is preserved and is not a source of taxable income for recognition of the tax benefit of deductible temporary differences and operating loss or tax credit carryforwards.

842-50-45-3 This Subtopic requires that the tax effect of any difference between the assigned value and the tax basis of a leveraged lease at the date of a business combination or an **acquisition by a not-for-profit entity** shall not be accounted for as a deferred tax credit. Any tax effects included in unearned and deferred income as required by this Subtopic shall not be offset by the deferred tax consequences of other temporary differences or by the tax benefit of operating loss or tax credit carryforwards. However, deferred tax credits that arise after the date of a combination shall be accounted for in the same manner as for leveraged leases that were not acquired in a combination.

Disclosure

General

842-50-50-1 If leveraged leasing is a significant part of the **lessor's** business activities in terms of revenue, net income, or assets, the components of the net investment balance in **leveraged leases** as set forth in paragraph 842-50-25-1 shall be disclosed in the notes to financial statements.

842-50-50-2 For guidance on disclosures about financing receivables, which include receivables relating to a lessor's rights to payments from leveraged leases, see the guidance beginning in paragraphs 310-10-50-5A, 310-10-50-27, and 310-10-50-31.

842-50-50-3 If accounting for the effect on leveraged leases of the change in tax rates results in a significant variation from the customary relationship between income tax expense and pretax accounting income and the reason for that variation is not otherwise apparent, the lessor shall disclose the reason for that variation.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Leveraged Lease Involving an Existing Asset of a Regulated Entity

842-50-55-1 Although the carrying amount of an asset acquired previously may not differ significantly from its **fair value**, it is unlikely that the two will be the same. However, regulated utilities have argued that the carrying amounts of certain of

their assets always equal the fair value based on the utility's ability to recover that cost in conjunction with a franchise to sell a related service in a specified area. That argument is not valid when considering the value of the asset to a third-party purchaser that does not own that franchise.

> > **Delayed Equity Investment**

842-50-55-2 A **delayed equity investment** frequently obligates the **lessor** to make up the shortfall between rent and debt service in the first several years of the transaction. The type of recourse debt resulting from the delayed equity investment does not contradict the notion of nonrecourse and, therefore, does not preclude **leveraged lease** accounting as long as other requirements of leveraged lease accounting are met. The lessor's related obligation should be recorded as a liability at present value at **lease inception**.

842-50-55-3 Recognition of the liability would increase the lessor's net investment on which the lessor bases its pattern of income recognition. While the increase to the net investment results in an increase in income, it may be offset by the accrual of interest on the liability.

> > **Income Taxes Related to Leveraged Leases**

842-50-55-4 The accounting for income taxes related to **leveraged leases** set forth in this Subtopic is not consistent with the guidance in Topic 740 on income taxes.

842-50-55-5 The integration of the results of accounting for income taxes related to leveraged leases with the other results of accounting for income taxes as required by Topic 740 is an issue if all of the following exist:

- a. The accounting for a leveraged lease requires recognition of deferred tax credits.
- b. The guidance in Topic 740 limits the recognition of a tax benefit for deductible temporary differences and carryforwards not related to the leveraged lease.
- c. Unrecognized tax benefits in this paragraph could offset taxable amounts that result from future recovery of the net investment in the leveraged lease.

> **Illustrations**

> > **Example 1: Lessor's Accounting for a Leveraged Lease**

842-50-55-6 This Example illustrates a lessor's accounting for a leveraged lease in accordance with the guidance in this Subtopic. It also illustrates one way of meeting the disclosure requirements in paragraphs 842-50-45-1 and 842-50-50-1 as applied to a leveraged lease. The Example does not encompass all circumstances that may arise about leveraged leases; rather, the Example is based on a single instance of a leveraged lease. The elements of accounting and reporting illustrated for this Example of a leveraged lease are as follows:

- a. Cash flow analysis by years (see paragraph 842-50-55-8)
- b. Allocation of annual cash flow to investment and income (see paragraph 842-50-55-9)
- c. Journal entries for lessor's initial investment and first year of operation (see paragraph 842-50-55-10)
- d. Financial statements including notes at end of second year (see paragraph 842-50-55-11)
- e. Accounting for a revision in the estimated residual value of the leased asset assumed to occur in the eleventh year of the lease (from \$200,000 to \$120,000):
 1. Revised allocation of annual cash flow to investment and income (see paragraph 842-50-55-12)
 2. Balances in investment accounts at beginning of the eleventh year before revised estimate (see paragraph 842-50-55-13)
 3. Journal entries (see paragraph 842-50-55-14)
 4. Adjustment of investment accounts (see paragraph 842-50-55-15).

842-50-55-7 This Example has the following terms and assumptions.

Cost of leased asset (equipment)	\$1,000,000
Lease term	15 years, dating from January 1, 1976
Lease rental payments	\$90,000 per year (payable last day of each year)
Residual value	\$200,000 estimated to be realized 1 year after lease termination; in the eleventh year of the lease the estimate is reduced to \$120,000
Financing:	
Equity investment by lessor	\$490,000
Long-term nonrecourse debt	\$600,000, bearing interest at 9% and repayable in annual installments (on last day of each year) of \$74,435.30
Depreciation allowable to lessor for income tax purposes	7-year asset depreciation range life using double-declining-balance method for the first 2 years (with the half-year convention election applied in the first year) and sum-of-years digits method for remaining life, depreciated to \$100,000 salvage value
Lessor's income tax rate (federal and state)	50.4% (assumed to continue in existence throughout the term of the lease)
Investment tax credit	10% of equipment cost or \$100,000 (realized by the lessor on last day of first year of lease)
Initial direct costs	For simplicity, initial direct costs have not been included in the illustration

842-50-55-8 Cash flow analysis by years follows.

	1	2	3	4	5	6	7	8	9
	Gross Lease Rentals and Residual Value	Depreciation (for Income Tax Purposes)	Loan Interest Payments	Taxable Income (Loss) (Col. 1- 2- 3)	Income Tax Credits (Charges) (Col. 4 x 50.4%)	Loan Principal Payments	Investment Tax Credit Realized	Annual Cash Flow (Col. 1- 3 + 5 - 6 + 7)	Cumulative Cash Flow
Initial Investment	-	-	-	-	-	-	-	\$(400,000)	\$ (400,000)
1	\$ 90,000	\$ 142,857	\$ 54,000	\$(106,857)	\$ 53,856	\$ 20,435	\$ 100,000	169,421	(230,579)
2	90,000	244,898	52,161	(207,059)	104,358	22,274	-	119,923	(110,656)
3	90,000	187,075	50,156	(147,231)	74,204	24,279	-	89,769	(20,887)
4	90,000	153,061	47,971	(111,032)	55,960	26,464	-	71,525	50,638
5	90,000	119,048	45,589	(74,637)	37,617	28,846	-	53,182	103,820
6	90,000	53,061	42,993	(6,054)	3,051	31,442	-	18,616	122,436
7	90,000	-	40,163	49,837	(25,118)	34,272	-	(9,553)	112,883
8	90,000	-	37,079	52,921	(26,672)	37,357	-	(11,108)	101,775
9	90,000	-	33,717	56,283	(28,367)	40,719	-	(12,803)	88,972
10	90,000	-	30,052	59,948	(30,214)	44,383	-	(14,649)	74,323
11	90,000	-	26,058	63,942	(32,227)	48,378	-	(16,663)	57,660
12	90,000	-	21,704	68,296	(34,421)	52,732	-	(18,857)	38,803
13	90,000	-	16,957	73,043	(36,813)	57,478	-	(21,248)	17,555
14	90,000	-	11,785	78,215	(39,420)	62,651	-	(23,856)	(6,301)
15	90,000	-	6,145	83,855	(42,263)	68,290	-	(26,698)	(92,999)
16	200,000	100,000	-	100,000	(50,400)	-	-	149,600	116,601
Totals	\$1,550,000	\$1,000,000	\$516,530	\$ 33,470	\$ (16,869)	\$600,000	\$ 100,000	\$ 100,000	\$ 100,000

842-50-55-9 Allocation of annual cash flow to investment and income follows.

	1	2	3	4	5	6	7
	Lessor's Net Investment at Beginning of Year	Total (from Col. 8 of Paragraph 842-50-55-8)	Allocated to Investment	Allocated to Income ^(b)	Pretax Income	Tax Effect of Pretax Income	Investment Tax Credit
Year							
1	\$ 400,000	\$ 169,421	\$ 134,833	\$ 34,588	\$ 9,929	\$ (5,004)	\$ 29,663
2	265,167	119,923	96,994	22,929	6,582	(3,317)	19,664
3	168,173	89,769	75,227	14,542	4,174	(2,104)	12,472
4	92,946	71,525	63,488	8,037	2,307	(1,163)	6,893
5	29,458	53,182	50,635	2,547	731	(368)	2,184
6	(21,177)	18,616	18,616	-	-	-	-
7	(39,793)	(9,553)	(9,553)	-	-	-	-
8	(30,240)	(11,108)	(11,108)	-	-	-	-
9	(19,132)	(12,803)	(12,803)	-	-	-	-
10	(6,329)	(14,649)	(14,649)	-	-	-	-
11	8,320	(16,663)	(17,382)	719	206	(104)	617
12	25,702	(18,857)	(21,079)	2,222	637	(321)	1,906
13	46,781	(21,248)	(25,293)	4,045	1,161	(585)	3,469
14	72,074	(23,856)	(30,088)	6,232	1,789	(902)	5,345
15	102,162	(26,698)	(35,532)	8,834	2,536	(1,278)	7,576
16	137,694	149,600	137,694	11,906	3,418	(1,723)	10,211
Totals		\$ 516,601	\$ 400,000	\$ 116,601	\$ 33,470	\$ (16,869)	\$ 100,000

(a) Lease income is recognized as 8.647% of the unrecovered investment at the beginning of each year in which the net investment is positive. The rate is that rate which, if applied to the net investment in the years in which the net investment is positive, will distribute the net income (net cash flow) to those years.

(b) Each component is allocated among the years of positive net investment in proportion to the allocation of net income in column 4.

842-50-55-10 Illustrative journal entries for the year ending December 31, 1975, follow.

Lessor's Initial Investment	Debit	Credit
Rentals receivable (table in paragraph 842-50-55-8, total of column 1 minus residual value, minus totals of columns 3 and 6)	\$ 233,470	
Investment tax credit receivable (table in paragraph 842-50-55-8, column 7)	100,000	
Estimated residual value (paragraph 842-50-55-7)	200,000	
Unearned and deferred income (table in paragraph 842-50-55-9, totals of columns 5 and 7)		\$133,470
Cash		400,000
Record lessor's initial investment		
First Year of Operation		
<i>Journal Entry 1</i>		
Cash	15,565	
Rentals receivable (table in paragraph 842-50-55-8, column 1 minus columns 3 and 6)		15,565
Collection of first year's net rental		
<i>Journal Entry 2</i>		
Cash ^(a)	100,000	
Investment tax credit receivable (table in paragraph 842-50-55-8, column 7)		100,000
Receipt of investment tax credit		
<i>Journal Entry 3</i>		
Unearned and deferred income		9,929
Income from leveraged leases (table in paragraph 842-50-55-9, column 5)		9,929
Recognition of first year's portion of pretax income allocated in the same proportion as the allocation of total income		
$(34,588 \div 116,601) \times 33,470 = 9,929$		
<i>Journal Entry 4</i>		
Unearned and deferred income	29,663	
Investment tax credit recognized (table in paragraph 842-50-55-9, column 7)		29,663
Recognition of first year's portion of investment tax credit allocated in the same proportion as the allocation of total income		
$(34,588 \div 116,601) \times 100,000 = 29,663$		
<i>Journal Entry 5</i>		
Cash (table in paragraph 842-50-55-8, column 5) ^(a)	53,856	
Income tax expense (table in paragraph 842-50-55-9, column 6)	5,004	
Deferred taxes		58,860
To record receipt of first year's tax credit from lease operation, to charge income tax expense for tax effect of pretax accounting income, and to recognize as deferred taxes the tax effect of the difference between pretax accounting income and the tax loss for the year, calculated as follows:		
Tax loss (table in paragraph 842-50-55-8, column 4)	\$ (106,857)	
Pretax accounting income	9,929	
Difference	<u>\$ (116,786)</u>	
Deferred taxes $(\$116,786 \times 50.4\%)$		<u>\$ 58,860</u>

(a) Receipts of the investment tax credit and other tax benefits are shown as cash receipts for simplicity only. Those receipts probably would not be in the form of immediate cash inflow. Instead, they likely would be in the form of reduced payments of taxes on other income of the lessor or on the combined income of the lessor and other entities whose operations are joined with the lessor's operations in a consolidated tax return.

842-50-55-11 The following are illustrative partial financial statements including notes.

BALANCE SHEET					
ASSETS			LIABILITIES		
December 31,			December 31,		
	1976	1975		1976	1975
Investment in leveraged leases	\$334,708	\$324,027	Deferred taxes arising from leveraged leases	\$166,535	\$ 58,860

INCOME STATEMENT			
(Ignoring all income and expense items other than those relating to leveraged leasing)			
	1976	1975	
Income from leveraged leases	\$ 6,582	\$ 9,929	
Income before taxes and investment tax credit	6,582	9,929	
Less: Income tax expense ^(a)	(3,317)	(5,004)	
	3,265	4,925	
Investment tax credit recognized ^(a)	19,664	29,663	
Net income	\$ 22,929	\$ 34,588	

(a) These two items may be netted for purposes of presentation in the income statement, provided that the separate amounts are disclosed in a note to financial statements.

The following are notes to the illustrative financial statements included in this Example.

Investment in Leveraged Leases

Entity is the lessor in a leveraged lease agreement entered into in 1975 under which mining equipment having an estimated economic life of 18 years was leased for a term of 15 years. Entity's equity investment represented 40 percent of the purchase price; the remaining 60 percent was furnished by third-party financing in the form of long-term debt that provides for no recourse against Entity and is secured by a first lien on the property. At the end of the lease term, the equipment is turned back to Entity. The residual value at that time is estimated to be 20 percent of cost. For federal income tax purposes, Entity receives the investment tax credit and has the benefit of tax deductions for depreciation on the entire leased asset and for interest on the long-term debt. During the early years of the lease, those deductions exceed the lease rental income, and substantial excess deductions are available to be applied against Entity's other income. In the later years of the lease, rental income will exceed the deductions and taxes will be payable. Deferred taxes are provided to reflect this reversal. Entity's net investment in leveraged leases is composed of the following elements.

	December 31,	
	1976	1975
Rentals receivable (net of principal and interest on the nonrecourse debt)	\$ 202,340	\$ 217,905
Estimated residual value of leased assets	200,000	200,000
Less: Unearned and deferred income	(67,632)	(93,878)
Investment in leveraged leases	334,708	324,027
Less: Deferred taxes arising from leveraged leases	(166,535)	(58,860)
Net investment in leveraged leases	<u>\$ 168,173</u>	<u>\$ 265,167</u>

842-50-55-12 Allocation of annual cash flow to investment and income follows, revised to include new residual value estimate.

	1	2	3	4	5	6	7
		Annual Cash Flow		Components of Income			
Year	Lessor's Net Investment at Beginning of Year	Total	Allocated to Investment	Allocated to Income ^(a)	Pretax Loss	Tax Effect of Pretax Loss	Investment Tax Credit
1	\$ 400,000	\$ 169,421	\$ 142,458	\$ 16,963	\$ (16,904)	\$ 8,220	\$ 35,052
2	257,542	119,923	102,533	17,390	(10,501)	5,293	22,568
3	154,979	89,189	79,323	9,866	(6,319)	3,184	13,581
4	75,656	71,525	67,423	5,100	(3,085)	1,555	6,630
5	9,231	56,182	52,560	622	(377)	190	809
6	(43,329)	18,616	18,616	-	-	-	-
7	(61,945)	(9,553)	(9,553)	-	-	-	-
8	(52,392)	(11,108)	(11,108)	-	-	-	-
9	(41,284)	(12,803)	(12,803)	-	-	-	-
10	(28,481)	(14,649)	(14,649)	-	-	-	-
11	(13,832)	(16,663)	(16,663)	-	-	-	-
12	2,831	(18,857)	(19,048)	191	(115)	58	248
13	21,879	(21,248)	(22,723)	1,475	(892)	450	1,917
14	44,602	(23,856)	(26,862)	3,006	(1,819)	916	3,909
15	71,464	(26,698)	(31,515)	4,817	(2,914)	1,469	6,262
16	102,979	109,920	102,979	6,941	(4,199)	2,116	9,024
Totals		<u>\$ 476,921</u>	<u>\$ 400,000</u>	<u>\$ 76,921</u>	<u>\$ (46,530)</u>	<u>\$ 23,451</u>	<u>\$ 100,000</u>

(a) The revised allocation rate is 6.741%.

842-50-55-13 Balances in investment accounts before revised estimate of residual value follow.

	1	2	3	4	5	6	7
				Unearned and Deferred Income			
	Rentals Receivable ^(a)	Estimated Residual Value	Investment Tax Credit Receivable	Pretax Income (Loss) ^(b)	Investment Tax Credit ^(c)	Deferred Taxes ^(d)	Net Investment (Col. 1+2+3) less (Col. 4 + 5 + 6)
Initial investment	\$ 233,470	\$200,000	\$ 100,000	\$ 33,470	\$ 100,000	\$ -	\$ 400,000
Changes in year of operation							
1	(15,565)	-	(100,000)	(9,929)	(29,663)	58,860	(134,833)
2	(15,565)	-	-	(6,582)	(19,664)	107,675	(96,994)
3	(15,565)	-	-	(4,174)	(12,472)	76,308	(75,227)
4	(15,565)	-	-	(2,307)	(6,893)	57,123	(63,488)
5	(15,565)	-	-	(731)	(2,184)	37,985	(50,635)
6	(15,565)	-	-	-	-	3,051	(18,616)
7	(15,565)	-	-	-	-	(25,118)	9,553
8	(15,564)	-	-	-	-	(26,672)	11,108
9	(15,564)	-	-	-	-	(28,367)	12,863
10	(15,565)	-	-	-	-	(30,211)	14,649
Balances, beginning of eleventh year	\$ 77,822	\$200,000	\$ -	\$ 9,747	\$ 29,124	\$230,631	\$ 8,320

(a) Table in paragraph 842-50-55-8, column 1, excluding residual value, minus columns 3 and 6.

(b) Table in paragraph 842-50-55-9, column 5.

(c) Table in paragraph 842-50-55-9, column 7.

(d) 50.4% of difference between taxable income (loss) in column 4 of the table in paragraph 842-50-55-8 and pretax accounting income (loss) in column 5 of the table in paragraph 842-50-55-9.

842-50-55-14 Illustrative journal entries involving a reduction in residual value follow.

	<u>Debit</u>	<u>Credit</u>
<i>Journal Entry 1</i>		
Pretax income (or loss)	\$ 60,314	
Unearned and deferred income	27,450	
Pretax income (loss):		
Balance at end of tenth year	\$ 9,747 ^(a)	
Revised balance	(9,939) ^(b)	
Adjustment	(19,686)	
Deferred investment tax credit:		
Balance at end of tenth year	29,124 ^(c)	
Revised balance	21,360 ^(d)	
Adjustment	(7,764)	
Investment tax credit recognized		\$ 7,764
Estimated residual value		80,000
To record:		
a. The cumulative effect on pretax income and the effect on future income resulting from the decrease in estimated residual value:		
Reduction in estimated residual value		\$80,000
Less portion attributable to future years (unearned and deferred income)		(19,686)
Cumulative effect (charged against current income)		<u>\$60,314</u>
b. The cumulative and future effect of the change in allocation of the investment tax credit resulting from the reduction in estimated residual value:		
<i>Journal Entry 2</i>		
Deferred taxes	30,398	
Income tax expense		30,398
To recognize deferred taxes for the difference between pretax accounting income (or loss) and taxable income (or loss) for the effect of the reduction in estimated residual value:		
Pretax accounting loss per Journal Entry 1	\$(60,314)	
Tax income (or loss)	-	
Difference	<u>\$(60,314)</u>	
Deferred taxes (\$60,314 x 50.4%)	<u>\$(30,398)</u>	

(a) Table in paragraph 842-50-55-13, column 4.

(b) Table in paragraph 842-50-55-12, total of column 5 minus amounts applicable to the first 10 years.

(c) Table in paragraph 842-50-55-13, column 5.

(d) Table in paragraph 842-50-55-12, total of column 7 minus amounts applicable to the first 10 years.

842-50-55-15 Adjustment of investment accounts for revised estimates of residual value follows.

	1	2	Unearned and Deferred Income		5	6
	Rentals Receivable	Estimated Residual Value	Pretax Income (Loss)	Investment Tax Credit	Deferred Taxes	Net Investment (Col. 1 + 2) less (Col. 3 + 4 + 5)
Balances, beginning of eleventh year (table in paragraph 842-50-55-13)	\$ 77,822	\$200,000	\$ 9,747	\$ 29,124	\$230,631	\$ 8,320
Adjustment of estimated residual value and unearned and deferred income (table in paragraph 842-50-55-14, Journal Entry 1)	-	(80,000)	(19,686)	(7,764)	-	(52,550)
Adjustment of deferred taxes for the cumulative effect on pretax accounting income (table in paragraph 842-50-55-14, Journal Entry 2)	-	-	-	-	(30,398)	30,398
Adjusted balances, beginning of eleventh year	\$ 77,822	\$120,000	\$(9,939)	\$ 21,360	\$200,233	\$ 13,832

(a) Table in paragraph 842-50-55-12, column 1.

> > Example 2: Income Taxes Related to a Leveraged Lease

842-50-55-16 This Example illustrates integration of the results of a lessor's income tax accounting for leveraged leases (in accordance with the guidance in this Subtopic) with the other results of accounting for income taxes as required by Topic 740.

842-50-55-17 At the end of Year 1 (the current year), an entity has two temporary differences.

842-50-55-18 The first temporary difference is for a leveraged lease that was entered into in a prior year. During Year 1, the enacted tax rate for Year 2 and thereafter changes from 40 percent to 35 percent.

842-50-55-19 After adjusting for the change in estimated total net income from the lease as a result of the change in tax rates, the components of the investment in the leveraged lease at the end of Year 1 are as follows.

Net rentals receivable plus residual value minus unearned pretax income		\$ 150,000
Reduced by:		
Deferred investment tax credit	\$9,000	
Deferred tax credits	<u>39,000</u>	<u>48,000</u>
Net investment in leveraged lease for financial reporting		<u>\$ 102,000</u>

842-50-55-20 The second temporary difference is a \$120,000 estimated liability for warranty expense that will result in a tax deduction in Year 5 when the liability is expected to be paid. Absent consideration of the deferred tax credits attributable to the leveraged lease, the weight of available evidence indicates that a valuation allowance is needed for the entire amount of the deferred tax asset related to that \$120,000 deductible temporary difference.

842-50-55-21 The tax basis of the investment in the leveraged lease at the end of Year 1 is \$41,000. The amount of the deferred tax liability for that leveraged lease that would otherwise result from the application of guidance in Topic 740 on income taxes is determined as follows.

Net rentals receivable plus residual value minus unearned pretax income	\$ 150,000
Temporary difference for deferred investment tax credit	<u>9,000</u>
	141,000
Tax basis of leveraged lease	<u>41,000</u>
Temporary difference	<u>\$ 100,000</u>
Deferred tax liability (35 percent)	<u>\$ 35,000</u>

842-50-55-22 Loss carryback (to Year 2) and loss carryforward (to Year 20) of the \$120,000 tax deduction for warranty expense in Year 5 would offset the \$100,000 of taxable amounts resulting from future recovery of the net investment in the leveraged lease over the remainder of the lease term.

842-50-55-23 At the end of Year 1, the entity recognizes a \$42,000 (\$120,000 at 35 percent) deferred tax asset and a related \$7,000 valuation allowance. The effect is to recognize a \$35,000 net deferred tax benefit for the reduction in deferred tax credits attributable to the leveraged lease. Deferred tax credits attributable to the leveraged lease determined under the guidance in this Subtopic are \$39,000.

However, the deferred tax liability determined is only \$35,000. The \$4,000 difference is not available for offsetting.

> > Example 3: Effect of Advance Payments and Deposits on Recalculation of a Leveraged Lease

842-50-55-24 This Example illustrates how (in accordance with the guidance in paragraph 842-50-35-13 and other paragraphs) a lessor would include advance payments and deposits in a recalculation of a leveraged lease resulting from a determination by the lessor that it would enter into a settlement of a tax position arising from a leveraged lease.

842-50-55-25 This Example assumes that the lessor has concluded that the position originally taken on the tax return would meet the more-likely-than-not threshold in Subtopic 740-10 on income taxes. It also assumes that the lessor would conclude that the estimate of \$50 for the projected lease-in, lease-out settlement is consistent with the measurement guidance in that Subtopic.

842-50-55-26 A lessor makes an advance payment of \$25 on July 1, 2007, \$10 of which is estimated to be associated with issues arising from a lease-in, lease-out transaction. On July 1, 2007, the lessor changes its assumption about the timing of the tax cash flows and projects a settlement with the Internal Revenue Service on September 1, 2009. The projected settlement would result in a payment to the taxing authority of \$125 of which \$50 is associated with the lease-in, lease-out transaction. On July 1, 2007, when the lessor recalculates the leveraged lease, the lessor would include a \$50 cash flow on September 1, 2009, as a projected outflow in the leveraged lease recalculation.

> > Example 4: Leveraged Lease Acquired in a Business Combination or an Acquisition by a Not-for-Profit Entity

842-50-55-27 This Example illustrates one way that a lessor's investment in a leveraged lease might be valued by the acquiring entity in a business combination or an acquisition by a not-for-profit entity and the subsequent accounting for the investment in accordance with the guidance in this Subtopic. The elements of accounting and reporting illustrated for this Example are as follows:

- a. Acquiring entity's cash flow analysis by years (see paragraph 842-50-55-29)
- b. Acquiring entity's valuation of investment in the leveraged lease (see paragraph 842-50-55-30)
- c. Acquiring entity's allocation of annual cash flow to investment and income (see paragraph 842-50-55-31)
- d. Journal entry for recording allocation of purchase price to net investment in the leveraged lease (see paragraph 842-50-55-32)
- e. Journal entries for the year ending December 31, 1984 (Year 10 of the lease) (see paragraph 842-50-55-33).

842-50-55-28 This Example has the following terms and assumptions.

Cost of leased asset (equipment)	\$1,000,000
Lease term	15 years, dating from January 1, 1975
Lease rental payments	\$90,000 per year (payable last day of each year)
Residual value	\$200,000 estimated to be realized 1 year after lease termination
Financing:	
Equity investment by lessor	\$400,000
Long-term nonrecourse debt	\$600,000, bearing interest at 9% and repayable in annual installments (on last day of each year) of \$74,435.30
Depreciation allowable to lessor for income tax purposes	7-year asset depreciation range life using double-declining-balance method for the first 2 years (with the half-year convention election applied in the first year) and sum-of-years digits method for remaining life, depreciated to \$100,000 salvage value
Lessor's income tax rate (federal and state)	50.4% (assumed to continue in existence throughout the term of the lease)
Investment tax credit	10% of equipment cost or \$100,000 (realized by the lessor on last day of first year of lease)
Initial direct costs	For simplicity, initial direct costs have not been included in the illustration
Date of business combination	January 1, 1982
Tax status of business combination	Nontaxable transaction
Appropriate interest rate for valuing net-of-tax return on investment	4½%

842-50-55-29 Acquiring entity's cash flow analysis by years follows.

	1	2	3	4	5	6	7
Year	Gross Lease Rentals and Residual Value	Depreciation (for Income Tax Purposes)	Loan Interest Payments	Taxable Income (Col. 1 – 2 – 3)	Income Tax (Charges) (Col. 4 x 50.4%)	Loan Principal Payments	Annual Cash Flow (Col. 1 – 3 + 5 – 6)
8	\$ 90,000	-	\$ 37,079	\$ 52,921	\$ (26,672)	\$ 37,357	\$ (11,108)
9	90,000	-	33,717	56,283	(28,367)	40,719	(12,803)
10	90,000	-	30,052	59,948	(30,214)	44,383	(14,649)
11	90,000	-	26,058	63,942	(32,227)	48,378	(16,663)
12	90,000	-	21,704	68,296	(34,421)	52,732	(18,857)
13	90,000	-	16,957	73,043	(36,813)	57,478	(21,248)
14	90,000	-	11,785	78,215	(39,420)	62,651	(23,856)
15	90,000	-	6,145	83,855	(42,263)	68,290	(26,698)
16	200,000	\$ 100,000	-	100,000	(50,400)	-	149,600
Totals	\$ 920,000	\$ 100,000	\$183,497	\$ 636,503	\$ (320,797)	\$411,988	\$ 3,718

842-50-55-30 Acquiring entity's valuation of investment in the leveraged lease follows.

Cash Flow	Present Value at 4½% Net-of-Tax Rate
1. Rentals receivable (net of principal and interest on the nonrecourse debt) (\$15,564.70 at the end of each year for 8 years)	\$ 102,663
2. Estimated residual value (\$200,000 realizable at the end of 9 years)	134,581
3. Future tax payments (various amounts payable over 9 years—see the table in paragraph 842-50-55-29)	(253,489)
Net present value	<u>\$ (16,245)</u>

842-50-55-31 Acquiring entity's allocation of annual cash flow to investment and income follows (see footnote (a)).

1	2	3	4	5	6
	Annual Cash Flow			Components of Income ^(a)	
Year	Net Investment at Beginning of Year	Total from Col. 7 of the Table in Paragraph 842-50-55-29	Allocated to Investment	Allocated to Income ^(a)	Pretax Income
8	\$ (16,245)	\$ (11,108)	\$ (11,108)	-	-
9	(5,137)	(2,893)	(2,893)	-	-
10	7,666	(14,649)	(14,973)	\$ 324	\$ 5,530
11	22,639	16,365	(17,621)	958	16,353
12	40,260	(18,857)	(20,561)	1,704	29,087
13	60,127	(21,248)	(23,822)	2,574	43,937
14	84,643	(23,856)	(27,439)	3,583	61,160
15	112,082	(26,698)	(31,443)	4,745	80,995
16	143,525	149,600	143,525	6,075	103,698
Totals		<u>\$ 3,718</u>	<u>\$ (16,245)</u>	<u>\$ 19,963</u>	<u>\$ 340,760</u>
					<u>\$ (320,797)</u>

(a) Lease income is recognized as 4.233% of the unrecovered investment at the beginning of each year in which the net investment is positive. The rate is that rate which, if applied to the net investment in the years in which the net investment is positive, will distribute the net income (net cash flow) to those years.

(b) Each component is allocated among the years of positive net investment in proportion to the allocation of net income in column 4. Journal Entry 2 in the table in paragraph 842-50-55-33 includes an example of this computation.

842-50-55-32 Illustrative journal entry for recording allocation of purchase price to net investment in the leveraged lease follows.

Rentals receivable (table in paragraph 842-50-55-29, total of column 1 minus residual value, minus totals of columns 3 and 6)	\$ 124,515
Estimated residual value (paragraph 842-50-55-28)	200,000
Purchase price allocation clearing account (paragraph 842-50-55-30, present value)	16,245
Unearned and deferred income (paragraph 842-50-55-30, present value, minus total of rentals receivable and estimated residual value)	<u>\$ 340,760</u>

842-50-55-33 Illustrative journal entries for year ending December 31, 19Y4, follows.

**Third Year of Operation after the Business Combination
(Year 10 of the Lease)**

Journal Entry 1

Cash	\$15,565	
Rentals receivable (table in paragraph 842-50-55-29, column 1 minus columns 3 and 6)		\$15,565
Collection of year's net rental		

Journal Entry 2

Unearned and deferred income	\$ 5,530	
Income from leveraged leases (table in paragraph 842-50-55-31, column 5)		\$ 5,530

Recognition of pretax income for the year allocated in the same proportion as the allocation of total income computed as follows:

$$([\$324 \div \$19,963] \times \$340,760 = \$5,530)$$

Journal Entry 3

Deferred taxes (table in paragraph 842-50-55-29, column 5, minus table in paragraph 842-50-55-31, column 6)	\$25,008	
Income tax expense (table in paragraph 842-50-55-31, column 6)	5,206	
Cash (table in paragraph 842-50-55-29, column 5)		\$30,214
To record payment of tax for the year		

Section B—Conforming Amendments Related to Leases: Amendments to the *FASB Accounting Standards Codification*[®]

Amendments to Master Glossary

8. Supersede the following Master Glossary terms, with a link to transition paragraph 842-10-65-1.

- Active Use of the Property
- Bargain Purchase Option
- Bargain Renewal Option
- Capital Lease
- Construction Period Lease Payments
- Contingent Rentals
- Fair Value of Leased Property
- Heat Supply (or Burn-Up) Contracts
- Indirectly Related to the Leased Property
- Minor
- Noncancelable Lease Term
- Normal Leaseback
- Original Lessee
- Profit or Loss on Sale
- Property Improvements or Integral Equipment
- Sale-Leaseback Accounting
- Substantially All
- Wrap Lease Transaction

9. Amend the following Master Glossary terms, with a link to transition paragraph 842-10-65-1, as follows:

Delayed Equity Investment

In {add glossary link} leveraged lease {add glossary link} transactions that have been structured with terms such that the {add glossary link} lessee's {add glossary link} rent payments begin one to two years after {add glossary link} lease inception {add glossary link}, equity contributions the {add glossary link} lessor {add glossary link} agrees to make (in the lease agreement or a separate binding {add glossary link} contract {add glossary link}) that are used

to service the nonrecourse debt during this brief period. The total amount of the lessor's contributions is specifically limited by the agreements.

Direct Financing ~~Lease~~Leases

From the perspective of a {add glossary link}lessor{add glossary link}, a {add glossary link}lease{add glossary link} that meets ~~all~~none of the ~~conditions~~criteria in paragraph ~~842-10-25-2~~ but meets the criteria in paragraph ~~842-10-25-3(b)~~840-10-25-43(b).

~~Estimated~~Economic Life

~~The estimated remaining~~ Either the period during which the property over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more usersusers, with normal repairs and maintenance, for the purpose for which it was intended at lease inception, without limitation by the lease term.

Incremental Borrowing Rate

The rate of interest that that, at lease inception, thea {add glossary link}lessee{add glossary link} would have incurred to pay to borrow on a collateralized basis over a similar term an amount equal to the funds necessary to purchase the lease payments in a similar economic environment leased asset. This definition does not prescribe the lessee's use of a secured borrowing rate as its incremental borrowing rate if that rate is determinable, reasonable, and consistent with the financing that would have been used in the particular circumstances.

Interest Cost

Interest cost includes interest recognized on obligations having explicit interest rates, interest imputed on certain types of payables in accordance with Subtopic 835-30, and interest related to a capital lease~~finance lease~~ determined in accordance with Topic 842~~Subtopic 840-30~~. With respect to obligations having explicit interest rates, interest cost includes amounts resulting from periodic amortization of discount or premium and issue costs on debt.

Lease

~~An agreement conveying~~A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) (land and/or depreciable assets) usually for a stated period of time in exchange for consideration.

Lease Term

~~The fixed noncancelable lease term~~ plus all of the following, except as noted in the following paragraph: The noncancellable period for which a lessee has the right to use an underlying asset, together with all of the following:

- a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option~~All periods, if any, covered by **bargain renewal options**.~~
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option~~All periods, if any, for which failure to renew the lease imposes a **penalty** on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured~~
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**~~All periods, if any, covered by ordinary renewal options during which any of the following conditions exist:~~
 1. ~~A guarantee by the lessee of the lessor's debt directly or **indirectly related to the leased property** is expected to be in effect.~~
 2. ~~A loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding.~~
- d. ~~All periods, if any, covered by ordinary renewal options preceding the date as of which a **bargain purchase option** is exercisable~~
- e. ~~All periods, if any, representing renewals or extensions of the lease at the lessor's option.~~

~~The lease term shall not be assumed to extend beyond the date a bargain purchase option becomes exercisable.~~

Leveraged Lease

From the perspective of a ~~{add glossary link}~~lessor~~{add glossary link}~~, a ~~{add glossary link}~~lease~~{add glossary link}~~ that meets all of the conditions in paragraph 840-10-25-43(c)~~was classified as a leveraged lease in accordance with the leases guidance in effect before the effective date and for which the **commencement date** is before the effective date.~~

~~From the perspective of a lessor, a lease that meets conditions in paragraph 840-10-25-43(c).~~

Minimum Lease Payments

~~The guidance beginning in paragraph 840-10-25-4 defines what constitutes minimum lease payments under the minimum lease payments criterion in paragraph 840-10-25-1(d) from the perspective of a lessee and a lessor. Minimum lease payments comprise the payments that the lessee is obligated to make or can be required to make in connection with the leased property, excluding both of the following:~~

- a. Contingent rentals
- b. Any guarantee by the lessee of the lessor's debt and the lessee's obligation to pay (apart from the rental payments) executory costs such as insurance, maintenance, and taxes in connection with the leased property.

If the lease contains a bargain purchase option, only the minimum rental payments over the lease term and the payment called for by the bargain purchase option are required to be included in the minimum lease payments. Otherwise, minimum lease payments include all of the following:

- a. The minimum rental payments called for by the lease over the lease term.
- b. Any guarantee of the residual value at the expiration of the lease term, whether or not payment of the guarantee constitutes a purchase of the leased property or of rental payments beyond the lease term by the lessee (including a third party related to the lessee) or a third party unrelated to either the lessee or the lessor, provided the third party is financially capable of discharging the obligations that may arise from the guarantee. If the lessor has the right to require the lessee to purchase the property at termination of the lease for a certain or determinable amount, that amount is required to be considered a lessee guarantee of the residual value. If the lessee agrees to make up any deficiency below a stated amount in the lessor's realization of the residual value, the residual value guarantee to be included in the minimum lease payments is required to be the stated amount, rather than an estimate of the deficiency to be made up.
- c. Any payment that the lessee must make or can be required to make upon failure to renew or extend the lease at the expiration of the lease term, whether or not the payment would constitute a purchase of the leased property. Note that the definition of lease term includes all periods, if any, for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at lease inception, to be reasonably assured. If the lease term has been extended because of that provision, the related penalty is not included in minimum lease payments.
- d. Payments made before the beginning of the lease term. The lessee is required to use the same interest rate to accrete payments to be made before the beginning of the lease term that it uses to discount lease payments to be made during the lease term.
- e. Fees that are paid by the lessee to the owners of the special-purpose entity for structuring the lease transaction. Such fees are required to be included as part of minimum lease payments (but not included in the fair value of the leased property).

Lease payments that depend on a factor directly related to the future use of the leased property, such as machine hours of use or sales volume during the lease term, are contingent rentals and, accordingly, are excluded from minimum lease payments in their entirety. However, lease payments that depend on an existing index or rate, such as the Consumer Price Index or the prime interest rate, are required to be included in minimum lease payments based on the index or rate existing at lease inception; any increases or decreases in lease payments that result from subsequent changes in the index or rate are contingent rentals and, thus, affect the determination of income as accruable.

Operating Lease

From the perspective of a {add glossary link}lessee{add glossary link}, any {add glossary link}lease{add glossary link} other than a capital leasefinance lease.

From the perspective of a {add glossary link}lessor{add glossary link}, ~~any~~ lease that meets the conditions in paragraph 840-10-25-43(d) other than a sales-type lease or a direct financing lease.

Penalty

Any requirement that is imposed or can be imposed on the {add glossary link}lessee{add glossary link} by the {add glossary link}lease{add glossary link} agreement or by factors outside the lease agreement to do any of the following:

- a. Disburse cash
- b. Incur or assume a liability
- c. Perform services
- d. Surrender or transfer an asset or rights to an asset or otherwise forego an economic benefit, or suffer an economic detriment. Factors to consider in determining whether an economic detriment may be incurred include, but are not limited to, all of the following:
 1. The uniqueness of purpose or location of the property underlying asset
 2. The availability of a comparable replacement property asset
 3. The relative importance or significance of the property underlying asset to the continuation of the lessee's line of business or service to its customers
 4. The existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the leased property underlying asset
 5. Adverse tax consequences
 6. The ability or willingness of the lessee to bear the cost associated with relocation or replacement of the leased property underlying asset at market rental rates or to tolerate other parties using the leased property underlying asset.

~~Interest Rate Implicit in the Lease~~

The ~~discount rate of interest that, at a given date, that causes the aggregate present value at the beginning of the lease term of (a) the minimum {add glossary link}lease payments{add glossary link} and (b) the amount that a lessor expects to derive from the underlying asset following the end of the lease term (as described in paragraph 840-10-25-4), excluding that portion of the payments representing executory costs to be paid by the lessor, together with any profit thereon and the unguaranteed residual value, accruing to the benefit of the lessor to be equal to the sum of (1) the {add glossary link}fair value{add glossary link} of the underlying asset leased property to the lessor at lease inception, minus any~~

~~related investment tax credit retained by the lessor and expected to be realized by him; the lessor and (2) any deferred **initial direct costs** of the lessor. If the lessor is not entitled to any excess of the amount realized on disposition of the property over a guaranteed amount, no unguaranteed residual value would accrue to its benefit.~~

Sales-Type Lease

From the perspective of a {add glossary link}lessor{add glossary link}, a {add glossary link}lease{add glossary link} that meets ~~either one or more~~ of the ~~conditions~~criteria in paragraph 840-10-25-43(a)842-10-25-2.

Sublease

A transaction in which an underlying asset ~~a leased property~~ is re-leased by the original {add glossary link}lessee{add glossary link} (or intermediate **lessor**) to a third party, party (the sublessee) and the original (or head) {add glossary link}lease{add glossary link} agreement between the lessor and the lessee two original parties remains in effect.

10. Add the following new Master Glossary terms, with a link to transition paragraph 842-10-65-1, as follows:

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Consideration in the Contract

See paragraph 842-10-15-35 for what constitutes the consideration in the **contract** for **lessees** and paragraph 842-10-15-39 for what constitutes consideration in the contract for **lessors**.

Discount Rate for the Lease

For a **lessee**, the discount rate for the **lease** is the **rate implicit in the lease** unless that rate cannot be readily determined. In that case, the lessee is required to use its **incremental borrowing rate**.

For a **lessor**, the discount rate for the lease is the rate implicit in the lease.

Effective Date of the Modification

The date that a **lease modification** is approved by both the **lessee** and the **lessor**.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Initial Direct Costs

Incremental costs of a **lease** that would not have been incurred if the lease had not been obtained.

Lease Liability

A **lessee's** obligation to make the **lease payments** arising from a **lease**, measured on a discounted basis.

Lease Modification

A change to the terms and conditions of a **contract** that results in a change in the scope of or the consideration for a **lease** (for example, a change to the terms and conditions of the contract that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term).

Lease Payments

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

Lease Receivable

A **lessor's** right to receive **lease payments** arising from a **sales-type lease** or a **direct financing lease** plus any amount that a lessor expects to derive from the underlying asset following the end of the **lease term** to the extent that it is guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Net Investment in the Lease

For a **sales-type lease**, the sum of the **lease receivable** and the **unguaranteed residual asset**.

For a **direct financing lease**, the sum of the lease receivable and the unguaranteed residual asset, net of any deferred selling profit.

Period of Use

The total period of time that an asset is used to fulfill a **contract** with a customer (including the sum of any nonconsecutive periods of time).

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Right-of-Use Asset

An asset that represents a **lessee's** right to use an **underlying asset** for the **lease term**.

Selling Profit or Selling Loss

At the **commencement date**, selling profit or selling loss equals:

- a. The **fair value** of the **underlying asset** or the sum of (1) the **lease receivable** and (2) any **lease payments** prepaid by the lessee, if lower; minus
- b. The carrying amount of the underlying asset, net of any **unguaranteed residual asset**; minus
- c. Any deferred **initial direct costs** of the lessor.

Short-Term Lease

A **lease** that, at the **commencement date**, has a **lease term** of 12 months or less and does not include an option to purchase the **underlying asset** that the **lessee** is reasonably certain to exercise.

Standalone Price

The price at which a customer would purchase a component of a **contract** separately.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Unguaranteed Residual Asset

The amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** that is not guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an **underlying asset** that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

11. Add the following Master Glossary term to Subtopic 954-470 as follows:

Advance Refunding

A transaction involving the issuance of new debt to replace existing debt with the proceeds from the new debt placed in trust or otherwise restricted to retire the existing debt at a determinable future date or dates.

Amendments to Subtopic 205-40

12. Amend paragraph 205-40-55-3(b), with a link to transition paragraph 842-10-65-1, as follows:

Presentation of Financial Statements—Going Concern

Implementation Guidance and Illustrations

> > Examples of Adverse Conditions and Events

205-40-55-3 The following are examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern. The examples are not all-inclusive. Below each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is **probable** that the plan will be effectively implemented within one year after the date that the financial statements are issued.

- b. Plans to borrow money or restructure debt:
 1. Availability and terms of new debt financing, or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback-sale and leaseback of assets
 2. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
 3. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral

Amendments to Subtopic 210-20

13. Amend paragraph 210-20-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Balance Sheet—Offsetting

Scope and Scope Exceptions

> Other Considerations

210-20-15-3 The general principle of a **right of setoff** involves only two parties, and exceptions to that general principle shall be limited to practices specifically permitted by the Subtopics listed in this paragraph. Various accounting Subtopics specify accounting treatments in circumstances that result in offsetting or in a presentation in a statement of financial position that is similar to the effect of offsetting. The guidance in this Subtopic does not modify the accounting treatment in the particular circumstances prescribed by any of the following Subtopics:

- a. Paragraphs 840-30-35-32 through 35-52 Subtopic 842-50 (**{add glossary link}** leveraged leases **{add glossary link}**)
- b. Subtopic 715-80 (accounting for pension plan assets and liabilities)
- c. Subtopic 715-60 (accounting for plan assets and liabilities)
- d. Subtopic 740-10 (net tax asset or liability amounts reported)
- dd. Paragraphs 815-10-45-1 through 45-7 (derivative instruments with the right to reclaim cash collateral or the obligation to return cash collateral)
- e. Subtopics 940-320 (trade date accounting for trading portfolio positions) and 910-405 (advances received on construction contracts)
- f. Paragraph 942-305-45-1 (reciprocal balances with other banks).

14. Amend paragraph 210-20-60-4, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

210-20-60-4 For guidance on **{add glossary link}** leveraged leases **{add glossary link}**, see Section 842-50-35 paragraphs 840-30-35-32 through 35-52.

Amendments to Subtopic 230-10

15. Amend paragraph 230-10-50-4, with a link to transition paragraph 842-10-65-1, as follows:

Statement of Cash Flows—Overall

Disclosure

> Noncash Investing and Financing Activities

230-10-50-4 Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; obtaining a right-of-use asset in exchange for a lease liability; ~~an asset by entering into a capital lease~~; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

16. Amend paragraphs 230-10-55-10 through 55-11, 230-10-55-13, 230-10-55-15, and 230-10-55-19 through 55-20, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Direct and Indirect Method for a Manufacturing Entity

230-10-55-10 The following is a statement of cash flows for the year ended December 31, 19X1, for Entity A, a U.S. corporation engaged principally in manufacturing activities. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 230-10-45-25.

Entity A		
Consolidated Statement of Cash Flows		
For the Year Ended December 31, 19X1		
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities:		
Cash received from customers	\$ 13,850	
Cash paid to suppliers and employees	(12,000)	
Dividend received from affiliate	20	
Interest received	55	
Interest paid (net of amount capitalized)	(220)	
Income taxes paid	(325)	
Insurance proceeds received	15	
Cash paid to settle lawsuit for patent infringement	(30)	
Net cash provided by operating activities		\$ 1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(1,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under finance lease obligation	(25)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		<u>\$ 1,665</u>
Reconciliation of net income to net cash provided by operating activities:		
Net income		\$ 760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	\$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Entity B:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		<u>\$ 1,365</u>

230-10-55-11 The supplemental schedule of noncash **investing** and **financing activities** is as follows.

Entity A purchased all of the capital stock of Entity B for \$950. In conjunction with the acquisition, liabilities were assumed as follows.

Fair value of assets acquired	\$ 1,580
Cash paid for the capital stock	<u>(950)</u>
Liabilities assumed	<u>\$ 630</u>

A ~~finance~~ capital lease obligation of \$850 was incurred when Entity A entered into a lease for new equipment.

Additional common stock was issued upon the conversion of \$500 of long-term debt.

230-10-55-12 The disclosure of accounting policy is as follows.

For purposes of the statement of cash flows, the entity considers all highly liquid debt instruments purchased with a maturity of three months or less to be **cash equivalents**.

230-10-55-13 The following is Entity A's statement of cash flows for the year ended December 31, 19X1, prepared using the indirect method, as described in paragraph 230-10-45-28.

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

Entity A		
Consolidated Statement of Cash Flows		
For the Year Ended December 31, 19X1		
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities:		
Net income		\$ 760
Depreciation and amortization	\$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Entity B:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(2,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under finance lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		<u>\$1,665</u>

230-10-55-14 The following table illustrates the supplemental disclosures of cash flow information.

Cash paid during the year for:

Interest (net of amount capitalized)	\$ 220
Income taxes	325

230-10-55-15 The supplemental schedule of noncash investing and financing activities is as follows.

Entity A purchased all of the capital stock of Entity B for \$950. In conjunction with the acquisition, liabilities were assumed as follows.

Fair value of assets acquired	\$ 1,580
Cash paid for the capital stock	<u>(950)</u>
Liabilities assumed	<u>\$ 630</u>

A ~~finance~~ capital lease obligation of \$850 was incurred when Entity A entered into a lease for new equipment.

Additional common stock was issued upon the conversion of \$500 of long-term debt.

230-10-55-19 The following summarizes financial information for the current year for Entity A, which provides the basis for the statements of cash flows presented in paragraphs 230-10-55-10 through 55-18.

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

Entity A
Consolidated Statement of Financial Position

	<u>1/1/X1</u>	<u>12/31/X1</u>	<u>Change</u>
Assets:			
Cash and cash equivalents	\$ 600	\$ 1,665	\$ 1,065
Accounts receivable (net of allowance for losses of \$600 and \$450)	1,770	1,940	170
Notes receivable	400	150	(250)
Inventory	1,230	1,375	145
Prepaid expenses	110	135	25
Investments	250	275	25
Property, plant, and equipment, at cost	6,460	8,460	2,000
Accumulated depreciation	<u>(2,100)</u>	<u>(2,300)</u>	<u>(200)</u>
Property, plant, and equipment, net	4,360	6,160	1,800
Intangible assets	<u>40</u>	<u>175</u>	<u>135</u>
Total assets	<u>\$ 8,760</u>	<u>\$ 11,875</u>	<u>\$ 3,115</u>
Liabilities:			
Accounts payable and accrued expenses	\$ 1,085	\$ 1,090	\$ 5
Interest payable	30	45	15
Income taxes payable	50	85	35
Short-term debt	450	750	300
Finance lease obligation	-	725	725
Long-term debt	2,190	2,425	275
Deferred taxes	375	525	150
Other liabilities	225	275	50
Total liabilities	<u>4,365</u>	<u>5,920</u>	<u>1,555</u>
Stockholders' equity:			
Capital stock	2,000	3,000	1,000
Retained earnings	<u>2,395</u>	<u>2,955</u>	<u>560</u>
Total stockholders' equity	<u>4,395</u>	<u>5,955</u>	<u>1,560</u>
Total liabilities and stockholders' equity	<u>\$ 8,760</u>	<u>\$ 11,875</u>	<u>\$ 3,115</u>

Entity A
Consolidated Statement of Income
For the Year Ended December 31, 19X1

Sales	\$ 13,965
Cost of sales	(10,290)
Depreciation and amortization	(445)
Selling, general, and administrative expenses	(1,890)
Interest expense	(235)
Equity in earnings of affiliate	45
Gain on sale of facility	80
Interest income	55
Insurance proceeds	15
Loss from patent infringement lawsuit	(30)
Income before income taxes	1,270
Provision for income taxes	(510)
Net income	<u>760</u>

230-10-55-20 The following transactions were entered into by Entity A during 19X1 and are reflected in the preceding financial statements:

- a. Entity A wrote off \$350 of accounts receivable when a customer filed for bankruptcy. A provision for losses on accounts receivable of \$200 was included in Entity A's selling, general, and administrative expenses.
- b. Entity A collected the third and final annual installment payment of \$100 on a note receivable for the sale of inventory and collected the third of four annual installment payments of \$150 each on a note receivable for the sale of a plant. Interest on these notes through December 31 totaling \$55 was also collected.
- c. Entity A received a dividend of \$20 from an affiliate accounted for under the equity method of accounting.
- d. Entity A sold a facility with a book value of \$520 and an original cost of \$750 for \$600 cash.
- e. Entity A constructed a new facility for its own use and placed it in service. Accumulated expenditures during the year of \$1,000 included capitalized interest of \$10.
- f. Entity A entered into a capital lease for new equipment with a fair value of \$850. The entity classified the lease as a finance lease. Principal payments under the lease obligation totaled \$125.

- g. Entity A purchased all of the capital stock of Entity B for \$950 in a business combination. The fair values of Entity B's assets and liabilities at the date of acquisition are presented below.

Cash	\$ 25
Accounts receivable	155
Inventory	350
Property, plant, and equipment	900
Patents	80
Goodwill	70
Accounts payable and accrued expenses	(255)
Long-term note payable	(375)
Net assets acquired	<u>\$950</u>

- h. Entity A borrowed and repaid various amounts under a line-of-credit agreement in which borrowings are payable 30 days after demand. The net increase during the year in the amount borrowed against the line-of-credit totaled \$300.
- i. Entity A issued \$400 of long-term debt securities.
- j. Entity A's provision for income taxes included a deferred provision of \$150.
- k. Entity A's depreciation of property, plant, and equipment and amortization of right-of-use assets arising from a finance lease totaled \$430, and amortization of intangible assets totaled \$15.
- l. Entity A's selling, general, and administrative expenses included an accrual for incentive compensation of \$50 that has been deferred by executives until their retirement. The related obligation was included in other liabilities.
- m. Entity A collected insurance proceeds of \$15 from a business interruption claim that resulted when a storm precluded shipment of inventory for one week.
- n. Entity A paid \$30 to settle a lawsuit for patent infringement.
- o. Entity A issued \$1,000 of additional common stock of which \$500 was issued for cash and \$500 was issued upon conversion of long-term debt.
- p. Entity A paid dividends of \$200.

Amendments to Subtopic 255-10

17. Amend the heading preceding paragraph 255-10-55-6 and paragraphs 255-10-55-8 and 255-10-55-11 and its related heading and add paragraph 255-10-55-

7A and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Changing Prices—Overall

Implementation Guidance and Illustrations

> > > The Unguaranteed Residual Value of Property Owned by a Lessor and Leased under ~~Direct Financing, Sales-type, and Leveraged Leases~~

255-10-55-6 The unguaranteed residual value is included with the minimum lease payments, at present value, in the net investment in the lease.

255-10-55-7 The minimum lease payments are monetary items because they are claims to fixed sums of money. The residual value is not a claim to a fixed sum of money, so it is a nonmonetary item. Some assets and liabilities, of which the net investment in the lease is a good example, are combinations of claims to (or obligations of) fixed amounts and claims to (or obligations of) variable amounts. Ideally, those claims should be separated for purposes of classifying them as monetary and nonmonetary. However, if the information necessary to make the separation is not available or is impracticable to obtain, such items need not be divided into monetary and nonmonetary components and would be classified according to their dominant element. If the net investment in leases is principally claims to fixed amounts, it would be classified as monetary; it would be classified as nonmonetary if it is principally claims to residuals.

> > > The Unguaranteed Residual Asset Arising from Sales-Type and Direct Financing Leases

255-10-55-7A The lease receivable arising from a sales-type lease or a direct financing lease is a monetary item because it is a claim to a fixed sum of money. The unguaranteed residual asset arising from a sales-type lease or a direct financing lease is not a claim to a fixed sum of money, so it is a nonmonetary item. Some assets and liabilities, of which the net investment in the lease is a good example, are combinations of claims to (or obligations of) fixed amounts and claims to (or obligations of) variable amounts. Because the net investment in a sales-type or direct financing lease is predominantly a claim to a fixed sum of money, it should be classified as monetary. In accordance with Subtopic 842-30, a lessor includes the unguaranteed residual asset as part of its net investment in the lease. Consequently, the unguaranteed residual asset is accounted for in the same manner as a monetary item so long as it is part of the net investment in the lease. If the lessor sells the lease receivable but retains an interest in the unguaranteed residual asset, the remaining unguaranteed residual asset is accounted for as a nonmonetary item after the sale of the lease receivable.

> > > Investment Tax Credits That Are Deferred by a Lessor as Part of the Unearned Income of a Leveraged Lease

255-10-55-8 Under paragraph 840-30-35-33842-50-35-2, the deferred investment tax credit related to the ~~leased asset~~underlying asset is subtracted from rentals receivable and estimated residual value as part of the calculation of the lessor's investment in the ~~{add glossary link}~~leveraged lease~~{add glossary link}~~. The ~~lessor's investment in a leveraged lease~~, including the deferred investment tax credit related to the leveraged lease, is presented as one amount in the balance sheet. As indicated in the ~~preceding paragraph~~ 255-10-55-7, the investment in a leveraged lease would be classified as monetary or nonmonetary according to its dominant element.

255-10-55-9 As indicated in the table in paragraph 255-10-55-1, a deferred investment tax credit should be classified as nonmonetary but, if it is part of an investment in a leveraged lease and if the information necessary to separate its elements is not available or is impracticable to obtain, the investment would be classified according to its dominant element.

> > > Portion of the Carrying Amount of Lessors' Assets Leased under Noncancellable Operating Leases That Represent Claims to Fixed Sums of Money

255-10-55-10 These assets are carried at depreciated **historical cost** under generally accepted accounting principles (GAAP) and are classified with or near property, plant and equipment, which are nonmonetary.

255-10-55-11 The classification of a ~~{add glossary link}~~lease~~{add glossary link}~~ as an operating lease under paragraph 840-10-25-1~~paragraphs 842-10-25-2 through 25-3~~ indicates that the ~~lessee has not obtained control of the nonmonetary underlying asset as a result of the lease has not transferred substantially all of the benefits and risks incident to ownership to the lessee~~. Thus, the economic significance of the asset continues to depend heavily on the value of the future lease rentals, residual values, and associated costs that do not represent fixed sums of money. Therefore, an asset subject to an operating lease should be classified as nonmonetary.

Amendments to Subtopic 270-10

18. Add paragraph 270-10-50-6A and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Interim Reporting—Overall

Disclosure

> Leases

270-10-50-6A A lessor shall disclose a table of all lease-related income items in its interim financial statements (see paragraph 842-30-50-5 for lease-related income items).

Amendments to Subtopic 274-10

19. Amend paragraph 274-10-50-2(m), with a link to transition paragraph 842-10-65-1, as follows:

Personal Financial Statements—Overall

Disclosure

274-10-50-2 Personal financial statements disclosures shall include, but are not limited to, all of the following:

- m. Noncancellable commitments that do not have the characteristics discussed in paragraph 274-10-35-13, for example, operating leases.

Amendments to Subtopic 310-10

20. Amend paragraph 310-10-35-13, with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Overall

Subsequent Measurement

> > Loans That Are Identified for Evaluation or That Are Individually Considered Impaired

> > > Applicability

310-10-35-13 This guidance applies to all creditors. It addresses the accounting by creditors for impairment of a loan by specifying how allowances for credit losses related to certain loans shall be determined. The accounting for impaired loans

shall be consistent among all creditors and for all types of lending except for loans that are measured at **fair value** or at the lower of cost or fair value in accordance with specialized industry practice. Therefore, this guidance applies to all loans that are identified for evaluation, uncollateralized as well as collateralized, except the following:

- a. Large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. Those loans may include but are not limited to credit card, residential mortgage, and consumer installment loans.
- b. Loans that are measured at fair value or at the lower of cost or fair value, for example, in accordance with Topic 948 or other specialized industry practice.
- c. Subparagraph superseded by Accounting Standards Update No. 2016-02, Leases as defined in Topic 840.
- d. Debt securities as defined in Topic 320.

This guidance does not address when a creditor should record a direct write-down of an impaired loan, nor does it address how a creditor should assess the overall adequacy of the allowance for credit losses.

21. Amend paragraph 310-10-40-5, with a link to transition paragraph 842-10-65-1, as follows:

Derecognition

Acquisition, Development, and Construction Arrangements

310-10-40-5 If a financial institution was the seller of the property at the initiation of the project, the entity shall apply the guidance in paragraphs 360-10-40-3A through 40-3B. However, if the sale is part of a sale-leaseback-sale and leaseback transaction, gain recognition, if any, should be determined by reference to Section 360-20-40 Subtopic 842-40.

22. Amend paragraph 310-10-55-14, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Meaning of *Financing Receivable*

310-10-55-13 This implementation guidance addresses the meaning of the term **financing receivable**.

310-10-55-14 All of the following are examples of financing receivables:

- a. Loans
- b. Trade accounts receivable
- c. Notes receivable
- d. Credit cards
- e. Receivables relating to a lessor's right(s) to payment(s) from a **leveraged lease** other than an operating lease that should be recognized as an asset in accordance with paragraph 842-10-65-1(z) the following paragraphs:
 1. Subparagraph superseded by Accounting Standards Update No. 2016-02.Paragraph 840-30-25-8 (for leveraged leases)
 2. Subparagraph superseded by Accounting Standards Update No. 2016-02.Paragraph 840-30-25-7 (for direct financing leases)
 3. Subparagraph superseded by Accounting Standards Update No. 2016-02.Paragraph 840-30-25-6 (for sales-type leases).
- f. **Lease receivables** arising from **sales-type leases** or **direct financing leases**.

Amendments to Subtopic 310-20

23. Amend paragraph 310-20-15-1, with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Nonrefundable Fees and Other Costs

Scope and Scope Exceptions

> Entities

310-20-15-1 The guidance in this Subtopic applies to entities as follows:

- a. All paragraphs apply to both lenders and purchasers.
- b. Subparagraph superseded by Accounting Standards Update No. 2016-02.Paragraphs 310-20-25-2 through 25-3 and 310-20-35-2 through 35-3 and the definition of **direct loan origination costs** apply to lessors in determining the net amount of initial direct costs as that term is used in Topic 840.

Amendments to Subtopic 310-30

24. Amend paragraph 310-30-15-2, with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality

Scope and Scope Exceptions

> Transactions

310-30-15-2 The guidance in this Subtopic applies to all loans with evidence of deterioration of credit quality since origination acquired by **completion of a transfer** for which it is **probable**, at acquisition, that the investor will be unable to collect all **contractually required payments receivable**, except for any of the following:

- a. Loans that are measured at **fair value** if all changes in fair value are included in earnings or, for an NFP, loans that are measured at fair value if all changes in fair value are included in the statement of activities and included in the performance indicator if a performance indicator is presented. Examples include those loans classified as trading securities under Topic 320 and Subtopic 948-310.
- b. Mortgage loans classified as held for sale under paragraph 948-310-35-1.
- c. ~~Subparagraph superseded by Accounting Standards Update No. 2016-02 Leases as defined in Topic 840. Only contracts that are classified by the purchaser as leases under that Topic meet this exclusion. The distinction between purchasing a lease and purchasing a stream of cash flows must be drawn to determine applicability of this Section.~~
- d. Loans acquired in a business combination accounted for at historical cost, including business combinations of two or more NFPs, the acquisition of a for-profit business entity by an NFP, and combinations of two or more mutual entities.
- e. Loans held by liquidating banks (financial reporting by liquidating banks is discussed in Topic 942).
- f. Revolving credit agreements, such as credit cards and home equity loans, if at the acquisition date the borrower has **revolving privileges**.
- g. Loans that are a transferor's interests (see Subtopic 325-40).

Amendments to Subtopic 310-40

25. Amend paragraph 310-40-15-11(a), with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Scope and Scope Exceptions

> Other Considerations

> > Troubled Debt Restructuring

310-40-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

- a. Lease modifications Changes in lease agreements. For guidance, see Topic 842-10-65-1.

Amendments to Subtopic 323-740

26. Amend paragraph 323-740-25-3, with a link to transition paragraph 842-10-65-1, as follows:

Investments—Equity Method and Joint Ventures—Income Taxes

Recognition

Qualified Affordable Housing Project Investments

323-740-25-3 A liability shall be recognized for delayed equity contributions that are unconditional and legally binding. A liability also shall be recognized for equity contributions that are contingent upon a future **event** when that contingent event becomes probable. Topic 450 and paragraph 842-50-55-2840-30-55-15 provide additional guidance on the accounting for delayed equity contributions.

Amendments to Subtopic 340-10

27. Amend paragraph 340-10-60-1, with a link to transition paragraph 842-10-65-1, as follows:

Other Assets and Deferred Costs—Overall

Relationships

> Receivables

340-10-60-1 For accounting for nonrefundable fees and costs associated with lending, committing to lend, or purchasing a group of loans and for accounting for fees and initial direct costs associated with leasing, see Subtopic 310-20.

Amendments to Subtopic 360-10

28. Amend paragraph 360-10-05-1, with a link to transition paragraph 842-10-65-1, as follows:

Property, Plant, and Equipment—Overall

Overview and Background

General

360-10-05-1 The Property, Plant, and Equipment Topic includes the following SubtopicsSubtopic:

- a. Overall
- b. ~~Real Estate Sales Sale-Leaseback Accounting Subparagraph~~
superseded by Accounting Standards Update No. 2016-02.

29. Amend paragraph 360-10-15-4, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

Impairment or Disposal of Long-Lived Assets

> Transactions

360-10-15-4 The guidance in the Impairment or Disposal of Long-Lived Assets Subsections applies to the following transactions and activities:

- a. Except as indicated in (b) and the following paragraph, all of the transactions and activities related to recognized long-lived assets of an entity to be held and used or to be disposed of, including:
 1. **Right-of-use assets of lessees**~~Capital leases of lessees~~
 2. Long-lived assets of lessors subject to operating leases
 3. Proved oil and gas properties that are being accounted for using the successful-efforts method of accounting
 4. Long-term prepaid assets.
- b. The following transactions and activities related to assets and liabilities that are considered part of an **asset group** or a **disposal group**:
 1. If a long-lived asset (or assets) is part of a group that includes other assets and liabilities not covered by the Impairment or Disposal of Long-Lived Assets Subsections, the guidance in the Impairment or Disposal of Long-Lived Assets Subsections applies to the group. In those situations, the unit of accounting for the long-lived asset is its group. For a long-lived asset or assets to be held and used, that group is referred to as an asset group. For a long-lived asset or assets to be disposed of by sale or otherwise, that group is referred to as a disposal group. Examples of liabilities included in a disposal group are legal obligations that transfer with a long-lived asset, such as certain environmental obligations, and obligations that, for business reasons, a potential buyer would prefer to settle when assumed as part of a group, such as warranty obligations that relate to an acquired customer base.
 2. The guidance in the Impairment or Disposal of Long-Lived Assets Subsections does not change generally accepted accounting principles (GAAP) applicable to those other individual assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by the Impairment or Disposal of Long-Lived Assets Subsections that are included in such groups.

30. Amend paragraph 360-10-30-8, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Other Asset Acquisition Concepts

> > Accounting for Leases

360-10-30-8 See Subtopic ~~840-30~~842-20 for guidance related to assets acquired under a capital lease.

31. Amend paragraph 360-10-40-2 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Derecognition

> Sale of Leased Property**Assets**

360-10-40-2 Paragraph ~~840-20-40-5~~ states that if a sale to a third party of property subject to an operating lease (or of property that is leased by or intended to be leased by the third party purchaser to another party) is not to be recorded as a sale the entity has not transferred control over the promised asset to the third party in accordance with paragraph 606-10-25-30, the transaction shall be accounted for as a borrowing. To determine when an asset subject to a lease shall be derecognized, an entity shall apply the following paragraphs in Topic 606 on revenue from contracts with customers:

- a. Paragraphs 606-10-25-1 through 25-8 on the existence of a contract
- b. Paragraph 606-10-25-30, or when an entity satisfies a performance obligation by transferring control of an asset.

32. Amend paragraph ~~360-10-55-43~~, with a link to transition paragraph 842-10-65-1, as follows:

[Note: Paragraph 360-10-45-9 is shown for context.]

Other Presentation Matters

Impairment or Disposal of Long-Lived Assets

> Long-Lived Assets Classified as Held for Sale

> > Initial Criteria for Classification as Held for Sale

360-10-45-9 A long-lived asset (disposal group) to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

- a. Management, having the authority to approve the action, commits to a plan to sell the asset (disposal group).

- b. The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups). (See Examples 5 through 7 [paragraphs 360-10-55-37 through 55-41], which illustrate when that criterion would be met.)
- c. An active program to locate a buyer and other actions required to complete the plan to sell the asset (disposal group) have been initiated.
- d. The sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale, within one year, except as permitted by paragraph 360-10-45-11. (See Example 8 [paragraph 360-10-55-43], which illustrates when that criterion would be met.) The term *probable* refers to a future sale that is likely to occur.
- e. The asset (disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value. The price at which a long-lived asset (disposal group) is being marketed is indicative of whether the entity currently has the intent and ability to sell the asset (disposal group). A market price that is reasonable in relation to fair value indicates that the asset (disposal group) is available for immediate sale, whereas a market price in excess of fair value indicates that the asset (disposal group) is not available for immediate sale.
- f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Implementation Guidance and Illustrations

Impairment or Disposal of Long-Lived Assets

> Illustrations

> > Example 8: Proposed Disposition Not Expected to Qualify as Completed Sale

360-10-55-43 This Example illustrates the classification as held for sale of a long-lived asset (disposal group) in accordance with the criterion in paragraph 360-10-45-9(d). The following illustrates situations in which that criterion would not be met:

- a. An entity that is a commercial leasing and finance company is holding for sale or lease equipment that has recently come off lease and the ultimate form of a future transaction (sale or lease) has not yet been determined.
- b. An entity commits to a plan to sell an asset that is in use and lease back that asset; however, a property that is in use, and the transfer of the property asset will not be accounted for as a sale and leaseback

transaction because the buyer-lessor does not obtain control of the asset based on the guidance in paragraphs 842-40-25-1 through 25-3 sale-leaseback through which the seller-lessee will retain more than a minor portion of the use of the property. The property asset would continue to be classified as held and used following the appropriate guidance in Sections 360-10-35, 360-10-45, and 360-10-50. If at the date of the sale-leaseback the fair value of the property is less than its undepreciated cost, a loss would be recognized immediately up to the amount of the difference between undepreciated cost and fair value in accordance with paragraphs 840-40-25-3(e) and 840-40-30-3.

Amendments to Subtopic 360-20

33. Supersede Subtopic 360-20, Property, Plant, and Equipment—Real Estate Sales, with a link to transition paragraph 842-10-65-1.

[On the effective date of the amendments in FASB Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), the title of Subtopic 360-20 will be amended as follows: Property, Plant, and Equipment—Real Estate Sales—Sale-Leaseback Accounting.]

Amendments to Subtopic 410-20

34. Amend paragraphs 410-20-15-2 through 15-3, with a link to transition paragraph 842-10-65-1, as follows:

Asset Retirement and Environmental Obligations—Asset Retirement Obligations

Scope and Scope Exceptions

> Transactions

410-20-15-2 The guidance in this Subtopic applies to the following transactions and activities:

- a. **Legal obligations** associated with the **retirement** of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, including any legal obligations that require **disposal** of a replaced part that is a component of a tangible long-lived asset.

- b. An environmental remediation liability that results from the normal operation of a long-lived asset and that is associated with the retirement of that asset. The fact that partial settlement of an obligation is required or performed before full retirement of an asset does not remove that obligation from the scope of this Subtopic. If environmental contamination is incurred in the normal operation of a long-lived asset and is associated with the retirement of that asset, then this Subtopic will apply (and Subtopic 410-30 will not apply) if the entity is legally obligated to treat the contamination.
- c. A conditional obligation to perform a retirement activity. Uncertainty about the timing of settlement of the **asset retirement obligation** does not remove that obligation from the scope of this Subtopic but will affect the measurement of a liability for that obligation (see paragraph 410-20-25-10).
- d. Obligations of a ~~{add glossary link} lessor~~~~{add glossary link}~~ in connection with an underlying asset ~~leased property~~ that meet the provisions in (a). ~~Paragraph 840-10-25-16 requires that lease classification tests performed in accordance with the requirements of Subtopic 840-10 incorporate the requirements of this Subtopic to the extent applicable.~~
- e. The costs associated with the retirement of a specified asset that qualifies as historical waste equipment as defined by EU Directive 2002/96/EC. (See paragraphs 410-20-55-23 through 55-30 and Example 4 [paragraph 410-20-55-63] for illustration of this guidance.) Paragraph 410-20-55-24 explains how the Directive distinguishes between new and historical waste and provides related implementation guidance.

410-20-15-3 The guidance in this Subtopic does not apply to the following transactions and activities:

- a. Obligations that arise solely from a plan to sell or otherwise dispose of a long-lived asset covered by Subtopic 360-10.
- b. An environmental remediation liability that results from the improper operation of a long-lived asset (see Subtopic 410-30). Obligations resulting from improper operations do not represent costs that are an integral part of the tangible long-lived asset and therefore should not be accounted for as part of the cost basis of the asset. For example, a certain amount of spillage may be inherent in the normal operations of a fuel storage facility, but a catastrophic accident caused by noncompliance with an entity's safety procedures is not. The obligation to clean up the spillage resulting from the normal operation of the fuel storage facility is within the scope of this Subtopic. The obligation to clean up after the catastrophic accident results from the improper use of the facility and is not within the scope of this Subtopic.
- c. Activities necessary to prepare an asset for an alternative use as they are not associated with the retirement of the asset.

- d. Historical waste held by private households. (The guidance in this paragraph does not pertain to an asset retirement obligation in the scope of this Subtopic.) For guidance on accounting for historical electronic equipment waste held by private households for obligations associated with Directive 2002/96/EC on Waste Electrical and Electronic Equipment adopted by the European Union, see Subtopic 720-40.
- e. Obligations of a **{add glossary link}** lessee **{add glossary link}** in connection with an **underlying asset** leased property, whether imposed by a **{add glossary link}** lease **{add glossary link}** agreement or by a party other than the lessor, that meet the definition of either **minimum** **{add glossary link}** lease payments **{add glossary link}** or **variable lease payments** contingent rentals in **Subtopic 842-10** paragraphs 840-40-25-4 through 25-7. Those obligations shall be accounted for by the lessee in accordance with the requirements of Subtopic 842-10 840-40. However, if obligations of a lessee in connection with an **underlying asset** leased property, whether imposed by a lease agreement or by a party other than the lessor, meet the provisions in paragraph 410-20-15-2 but do not meet the definition of either **minimum** lease payments or **variable lease payments** contingent rentals in **Subtopic 842-10** paragraphs 840-40-25-4 through 25-7, those obligations shall be accounted for by the lessee in accordance with the requirements of this Subtopic.
- f. An obligation for asbestos removal that results from the other-than-normal operation of an asset. Such an obligation may be subject to the provisions of Subtopic 410-30.
- g. Costs associated with complying with funding or assurance provisions. Paragraph 410-20-35-9 otherwise addresses the measurement effects of funding and assurance provisions.
- h. Obligations associated with maintenance, rather than retirement, of a long-lived asset.
- i. The cost of a replacement part that is a component of a long-lived asset.

35. Amend paragraph 410-20-55-44, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Recognition and Measurement

> > > Case D: Conditional with Low Likelihood of Enforcement

410-20-55-44 This Case illustrates a timber lease in which the **{add glossary link}** lessor **{add glossary link}** has an option to require the **{add glossary link}**

~~link}lessee{add glossary link} to settle an asset retirement obligation. Assume an entity enters into a five-year {add glossary link}lease{add glossary link} agreement that grants it the right to harvest timber on a tract of land and that agreement grants the lessor an option to require that the lessee reforest the underlying land at the end of the {add glossary link}lease term{add glossary link}. Based on past history, the lessee believes that the likelihood that the lessor will exercise that option is low. Rather, at the end of the lease, the lessor will likely accept the land without requiring reforestation. The lessee estimates that there is only a 10 percent probability that the lessor will elect to enforce reforestation. Paragraph 840-10-45-15842-10-15-1 explains that Topic 842840 does not apply to leases of biological assets, including timberlease agreements concerning the rights to explore for or to exploit natural resources such as timber.~~

Amendments to Subtopic 420-10

36. Amend paragraph 420-10-05-2, with a link to transition paragraph 842-10-65-1, as follows:

Exit or Disposal Cost Obligations—Overall

Overview and Background

420-10-05-2 Those costs include, but are not limited to, the following:

- a. Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract
- b. Costs to terminate a contract that is not a capital—{add glossary link}lease{add glossary link}
- c. Other associated costs, including costs to consolidate or close facilities and relocate employees.

37. Amend paragraph 420-10-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

> Transactions

420-10-15-3 The guidance in the Exit or Disposal Cost Obligations Topic applies to the following transactions and activities:

- a. Termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance,

is not an ongoing benefit arrangement or an individual deferred compensation contract (referred to as **one-time employee termination benefits**)

- b. Costs to terminate a contract that is not a capital lease ~~{add glossary link}~~ (see paragraphs 420-10-25-11 through 25-13 for further description of contract termination costs and paragraph 842-20-40-1840-30-40-4 for terminations of a capital lease)
- c. Costs to consolidate facilities or relocate employees
- d. Costs associated with a disposal activity covered by Subtopic 205-20
- e. Costs associated with an exit activity, including exit activities associated with an entity newly acquired in a business combination or an **acquisition by a not-for-profit entity**.

38. Amend paragraph 420-10-25-11, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

> Contract Termination Costs

420-10-25-11 For purposes of this Subtopic, costs to terminate an operating lease or other a contract (excluding leases within the scope of Topic 842) are either of the following:

- a. Costs to terminate the contract before the end of its term
- b. Costs that will continue to be incurred under the contract for its remaining term without economic benefit to the entity.

39. Supersede paragraph 420-10-30-8, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Contract Termination Costs

420-10-30-8 Paragraph superseded by Accounting Standards Update No. 2016-02. If the contract is an operating lease, the fair value of the liability at the ~~cease-use date~~ shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.

40. Supersede paragraphs 420-10-55-11 through 55-15 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

>> Example 4: Costs to Terminate an Operating Lease

420-10-55-11 Paragraph superseded by Accounting Standards Update No. 2016-02. This Example illustrates the guidance in paragraphs 420-10-25-11 through 25-13 and paragraphs 420-10-30-7 through 30-9 related to terminating an operating lease at the ~~cease-use date~~ and after the cease-use date.

420-10-55-12 Paragraph superseded by Accounting Standards Update No. 2016-02. An entity leases a facility under an operating lease that requires the entity to pay lease rentals of \$100,000 per year for 10 years. After using the facility for five years, the entity commits to an exit plan. In connection with that plan, the entity will cease using the facility in 1 year (after using the facility for 6 years), at which time the remaining lease rentals will be \$400,000 (\$100,000 per year for the remaining term of 4 years). In accordance with paragraphs 420-10-30-7 through 30-9, a liability for the remaining lease rentals, reduced by actual (or estimated) sublease rentals, would be recognized and measured at its fair value at the cease-use date (as illustrated in the following paragraph). In accordance with paragraphs 420-10-35-1 through 35-4, the liability would be adjusted for changes, if any, resulting from revisions to estimated cash flows after the cease-use date, measured using the credit-adjusted risk-free rate that was used to measure the liability initially (as illustrated in paragraph 420-10-55-15).

420-10-55-13 Paragraph superseded by Accounting Standards Update No. 2016-02. Based on market rentals for similar leased property, the entity determines that if it desired, it could sublease the facility and receive sublease rentals of \$300,000 (\$75,000 per year for the remaining lease term of 4 years). However, for competitive reasons, the entity decides not to sublease the facility (or otherwise terminate the lease) at the cease-use date. The fair value of the liability at the cease-use date is \$89,427, estimated using an expected present value technique. The expected net cash flows of \$100,000 (\$25,000 per year for the remaining lease term of 4 years) are discounted using a credit-adjusted risk-free rate of 8 percent. In this case, a risk premium is not considered in the present value measurement. Because the lease rentals are fixed by contract and the estimated sublease rentals are based on market prices for similar leased property for other entities having similar credit standing as the entity, there is little uncertainty in the amount and timing of the expected cash flows used in estimating fair value at the cease-use date and any risk premium would be insignificant. In other circumstances, a risk premium would be appropriate if it is significant. Thus, a liability (expense) of \$89,427 would be recognized at the cease-use date.

420-10-55-14 Paragraph superseded by Accounting Standards Update No. 2016-02. Accretion expense would be recognized after the cease-use date in accordance

with the guidance beginning in paragraph 420-10-35-1 and in paragraph 420-10-45-5. (The entity will recognize the impact of deciding not to sublease the property over the period the property is not subleased. For example, in the first year after the cease-use date, an expense of \$75,000 would be recognized as the impact of not subleasing the property, which reflects the annual lease payment of \$100,000 net of the liability extinguishment of \$25,000.)

420-10-55-15 Paragraph superseded by Accounting Standards Update No. 2016-02. At the end of one year, the competitive factors referred to above are no longer present. The entity decides to sublease the facility and enters into a sublease. The entity will receive sublease rentals of \$250,000 (\$83,333 per year for the remaining lease term of 3 years), negotiated based on market rentals for similar leased property at the sublease date. The entity adjusts the carrying amount of the liability at the sublease date to \$46,388 to reflect the revised expected net cash flows of \$50,000 (\$16,667 per year for the remaining lease term of 3 years), which are discounted at the credit-adjusted risk-free rate that was used to measure the liability initially (8 percent). Accretion expense would be recognized after the sublease date in accordance with the guidance beginning in paragraph 420-10-35-1 and in paragraph 420-10-45-5.

Amendments to Subtopic 440-10

41. Amend paragraphs 440-10-25-1 through 25-2, with a link to transition paragraph 842-10-65-1, as follows:

Commitments—Overall

Recognition

Unconditional Purchase Obligations

440-10-25-1 Depending on its terms, an **unconditional purchase obligation** can be subject to the guidance in Topic 842840, to the guidance in Topic 815, or to neither.

440-10-25-2 The guidance in Section 842-10-15840-10-15 and paragraph 840-10-55-26 shall be applied first to determine whether an unconditional purchase obligation is within the scope of Topic 840842.

42. Amend paragraphs 440-10-50-1 and 440-10-50-3, with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

General

440-10-50-1 Notwithstanding more explicit disclosures required elsewhere in this Codification, all of the following situations shall be disclosed in financial statements:

- a. Unused letters of credit
- b. ~~Leases~~ Long-term leases (see ~~Section 842-20-50~~ Sections 840-10-50, 840-20-50, and 840-30-50)
- c. Assets pledged as security for loans
- d. Pension plans (see Section 715-20-50)
- e. The existence of cumulative preferred stock dividends in arrears
- f. Commitments, including:
 1. A commitment for plant acquisition
 2. An obligation to reduce debts
 3. An obligation to maintain working capital
 4. An obligation to restrict dividends.

Unconditional Purchase Obligations

440-10-50-3 Future minimum ~~{add glossary link}~~ lease payments ~~{add glossary link}~~ under ~~{add glossary link}~~ leases ~~{add glossary link}~~ that meet the conditions in paragraph 440-10-50-2 need not be disclosed in accordance with the following paragraph 440-10-50-4, or paragraph 440-10-50-6 if those future minimum lease payments are disclosed in accordance with Section 842-20-50 the Lessee Subsections of Sections 840-10-50; 840-20-50; and 840-30-50.

43. Amend paragraphs 440-10-60-12 through 60-13, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

440-10-60-12 For commitments under leases ~~lease agreements~~, see Topic ~~842~~840.

440-10-60-13 For nuclear fuel leases structured as **take-or-pay contracts**, see paragraph 840-10-55-7 ~~842-10-55-1~~.

Amendments to Subtopic 450-10

44. Amend paragraph 450-10-60-8, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Overall

Relationships

> Leases

450-10-60-8 For variable lease paymentscontingent rentals, see paragraphs 842-20-55-1 through 55-2paragraph 840-10-25-35.

Amendments to Subtopic 450-20

45. Amend paragraphs 450-20-60-15 through 60-16, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Loss Contingencies

Relationships

> Leases

450-20-60-15 For variable lease paymentscontingent rent, see paragraphs 842-20-55-1 through 55-2paragraph 840-10-25-35.

450-20-60-16 For the classification effects of a provision in a lease that requires lessee indemnifications for environmental contamination caused by the lessee during its use of the property, see paragraph ~~840-10-25-12~~842-10-55-15.

Amendments to Subtopic 450-30

46. Amend paragraph 450-30-60-5, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Gain Contingencies

Relationships

> Leases

450-30-60-5 For a lessor's accounting for income from variable lease paymentscontingent rental income, see paragraphs 842-30-25-2 (for sales-type

leases), 842-30-25-9 (for **direct financing leases**), and 842-30-25-11 (for **operating leases**) paragraph 840-10-50-5.

Amendments to Subtopic 460-10

47. Amend paragraph 460-10-15-7, with a link to transition paragraph 842-10-65-1, as follows:

Guarantees—Overall

Scope and Scope Exceptions

> Transactions

> > Transactions That Are Excluded from the Scope of This Topic

460-10-15-7 The guidance in this Topic does not apply to the following types of guarantee contracts:

- a. A guarantee or an indemnification that is excluded from the scope of Topic 450 (see paragraph 450-20-15-2—primarily employment-related guarantees)
- b. A lessee's guarantee of the residual value of the ~~leased property~~ **underlying asset** at the expiration of the **lease term** under Topic 842, if the lessee (guarantor) accounts for the lease as a capital lease under Subtopic 840-30
- c. A contract that meets the characteristics in paragraph 460-10-15-4(a) but is accounted for as **variable lease payments** ~~contingent rent~~ under Topic 842 Subtopic 840-30
- d. A guarantee (or an indemnification) that is issued by either an insurance entity or a reinsurance entity and accounted for under Topic 944 (including guarantees embedded in either insurance contracts or investment contracts)
- e. A contract that meets the characteristics in paragraph 460-10-15-4(a) but provides for payments that constitute a vendor rebate (by the guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party
- f. A contract that provides for payments that constitute a vendor rebate (by the guarantor) based on the volume of purchases by the buyer (because the underlying relates to an asset of the seller, not the buyer who receives the rebates)
- g. A guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale

- of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction
- h. A registration payment arrangement within the scope of Subtopic 825-20 (see Section 825-20-15)
- i. A guarantee or an indemnification of an entity's own future performance (for example, a guarantee that the guarantor will not take a certain future action)
- j. A guarantee that is accounted for as a **credit derivative** at fair value under Topic 815
- k. A sales incentive program in which a manufacturer contractually guarantees to reacquire the equipment at a guaranteed price or guaranteed prices at a specified time, or at specified time periods (for example, the entity is obligated to reacquire the equipment or the entity is obligated at the **customer's** request to reacquire the equipment). That program shall be evaluated in accordance with Topic 606 on **revenue** from **contracts** with customers, specifically the implementation guidance on repurchase agreements in paragraphs 606-10-55-66 through 55-78.

For related implementation guidance, see Section 460-10-55.

48. Amend paragraph 460-10-25-1, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

460-10-25-1 The following types of guarantees are not subject to the recognition provisions of this Subsection:

- a. A guarantee that is accounted for as a derivative instrument at fair value under Topic 815.
- b. A product **warranty** or other guarantee for which the **underlying** is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party (see paragraph 460-10-15-9 for related guidance).
- c. A guarantee issued in a business combination or an **acquisition by a not-for-profit entity** that represents contingent consideration (as addressed in Subtopics 805-30 and 958-805).
- d. A guarantee for which the guarantor's obligation would be reported as an equity item rather than a liability under generally accepted accounting principles (GAAP) (see Topics 480 and 505).
- e. A guarantee by an original **{add glossary link}**lessee**{add glossary link}** that has become secondarily liable under a new **{add glossary link}**lease**{add glossary link}** that relieved the original lessee from being the primary obligor (that is, principal debtor) under the original lease, as discussed in paragraph 840-30-40-5842-20-40-3. This exception shall

not be applied by analogy to other secondary obligations ~~that are not accounted for under that paragraph.~~

- f. A guarantee issued either between parents and their subsidiaries or between corporations under common control.
- g. A parent's guarantee of its subsidiary's debt to a third party (whether the parent is a corporation or an individual).
- h. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

49. Amend paragraph 460-10-30-2, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Fair Value Objective

460-10-30-2 Except as indicated in paragraphs 460-10-30-3 through 30-4, the objective of the initial measurement of a guarantee liability is the fair value of the guarantee at its inception. For example:

- a. If a guarantee is issued in a standalone arm's-length transaction with an unrelated party, the liability recognized at the inception of the guarantee shall be the premium received, or receivable by the guarantor as a practical expedient.
- b. If a guarantee is issued as part of a transaction with multiple elements with an unrelated party (such as in conjunction with selling an asset or entering into an operating lease), the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, a guarantor shall consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction with an unrelated party as a practical expedient.
- c. If a guarantee is issued as a contribution to an unrelated party, the liability recognized at the inception of the guarantee shall be measured at its fair value, consistent with the requirement to measure the contribution made at fair value, as prescribed in Section 720-25-30. For related implementation guidance, see paragraph 460-10-55-14.

50. Amend paragraphs 460-10-55-17 and 460-10-55-23, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope Guidance—Guarantees Outside the Scope of This Topic Entirely

> > Guarantees That Prevent Sale Accounting

460-10-55-17 The following are examples of contracts ~~is an example of a contract that are~~ outside the scope of this Topic because ~~they are~~ it is of the type described in paragraph 460-10-15-7(g):

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2016-02. A seller's guarantee of the return of a buyer's investment or return on investment of a real estate property as discussed in paragraph 360-20-40-41 for real estate sale leaseback transactions.~~
- b. ~~Subparagraph superseded by Accounting Standards Update No. 2016-02. A seller's guarantee of a specified level of operations of a real estate property, as discussed in paragraphs 360-20-40-42 through 40-44 for real estate sale leaseback transactions.~~
- c. A transaction that involves sale of a marketable security to a third-party buyer with the buyer having an option to put the security back to the seller at a specified future date or dates for a fixed price, if the existence of the put option prevents the transferor from accounting for the transaction as a sale, as described in paragraphs 860-20-55-20 through 55-23.
- d. ~~Subparagraph superseded by Accounting Standards Update No. 2016-02. A seller-lessee's residual value guarantee if that guarantee results in the seller-lessee deferring profit from the sale greater than or equal to the gross amount of the guarantee (see paragraphs 840-40-55-26 through 55-28).~~
- e. ~~Subparagraph superseded by Accounting Standards Update No. 2014-09.~~

> > Recognition and Measurement Guidance—Overall Guidance

460-10-55-23 Although paragraph 460-10-25-4 does not prescribe a specific account, the following illustrate a guarantor's offsetting entries when it recognizes the liability at the inception of the guarantee:

- a. If the guarantee were issued in a standalone transaction for a premium, the offsetting entry would be consideration received (such as cash or a receivable).
- b. If the guarantee were issued in conjunction with the sale of assets, a product, or a business, the overall proceeds (such as the cash received or receivable) would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from the sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
- c. If the guarantee were issued in conjunction with the formation of a partially owned business or a venture accounted for under the equity

method, the recognition of the liability for the guarantee would result in an increase to the carrying amount of the investment.

- d. Subparagraph superseded by Accounting Standards Update No. 2016-02. If a residual value guarantee were provided by a lessee guarantor when entering into an operating lease, the offsetting entry (representing a payment in kind made by the lessee when entering into the operating lease) would be reflected as prepaid rent, which would be accounted for under Section 840-20-25.
- e. If a guarantee were issued to an unrelated party for no consideration on a standalone basis (that is, not in conjunction with any other transaction or ownership relationship), the offsetting entry would be to expense.

51. Amend paragraphs 460-10-60-3, 460-10-60-16 through 60-18, 460-10-60-20 through 60-24, and 460-10-60-32 and supersede paragraphs 460-10-60-19, 460-10-60-25 through 60-27, 460-10-60-29 through 60-31, and 460-10-60-33, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Property, Plant, and Equipment

460-10-60-3 For a seller's guarantee of a return of the buyer's investment in real estate or a seller's guarantee of a return on that investment for an extended period, see paragraph 360-20-40-41 Subtopic 842-40 for real estate sale leaseback sale and leaseback transactions.

> Leases

460-10-60-16 For the effect on the {add glossary link}lease term{add glossary link} of a provision or condition that in substance is a guarantee of a {add glossary link}lessor's{add glossary link} debt or a loan to a lessor by the {add glossary link}lessee{add glossary link} that is related to the underlying asset leased ~~property~~ but is structured in such a manner that it does not represent a direct guarantee or loan, see the definition of {remove glossary link}lease term{remove glossary link}.

460-10-60-17 For the effects on ~~minimum~~{add glossary link}lease payments{add glossary link} of a guarantee by the lessee of the lessor's debt, see paragraph 842-10-30-6840-10-25-5.

460-10-60-18 For the effects on ~~minimum~~lease payments of a guarantee by the lessee of the residual value of the leased ~~property~~underlying asset at the expiration of the lease term, see paragraphs 840-10-25-6 and 840-10-55-8 through 55-40842-10-30-5 and 842-10-55-34 through 55-36.

~~460-10-60-19 Paragraph superseded by Accounting Standards Update No. 2016-02. For allocation of a residual value or first-loss guarantee to minimum lease payments in leases involving land and building(s), see paragraphs 840-10-25-21 through 25-22.~~

~~460-10-60-20 For a determination of whether a residual value guarantee is subject to the requirements of Topic 815, see paragraph 840-10-15-20842-10-15-43.~~

~~460-10-60-21 For the classification of a lease that includes a commitment by a lessor to guarantee performance of the leased property underlying asset in a manner more extensive than a typical product warranty or to effectively protect the lessee from obsolescence of the leased property underlying asset, see paragraphs 840-10-25-42 through 25-43842-10-55-32 through 55-33.~~

~~460-10-60-22 For a manufacturer's guarantee of the resale value of equipment to the purchaser, see paragraphs 840-10-55-12 through 55-25842-30-55-1 through 55-15.~~

~~460-10-60-23 For a lessee's indemnification for environmental contamination, see paragraph 840-10-25-13842-10-55-15.~~

~~460-10-60-24 For a guarantee by a lessee of the leased property underlying asset's residual value in an operating lease transaction, see paragraph 840-20-30-1 paragraphs 842-10-30-5 and 842-10-55-34 through 55-36.~~

~~460-10-60-25 Paragraph superseded by Accounting Standards Update No. 2016-02. For a guarantee by a lessee of the leased property's residual value in a capital lease transaction, see Section 840-30-35.~~

~~460-10-60-26 Paragraph superseded by Accounting Standards Update No. 2016-02. For classification of a lease that contains an entity's unsecured guarantee of its own lease payments, see paragraph 840-40-25-15.~~

~~460-10-60-27 Paragraph superseded by Accounting Standards Update No. 2016-02. For classification of a lease that contains an unsecured guarantee of the lease payments of one member of a consolidated group by another member of the consolidated group, see paragraph 840-40-25-16.~~

~~460-10-60-28 Paragraph superseded by Accounting Standards Update No. 2012-04.~~

~~460-10-60-29 Paragraph superseded by Accounting Standards Update No. 2016-02. For an indemnification or guarantee of an owner-lessor against third-party claims relating to construction completion in a sale leaseback transaction, see paragraph 840-40-55-9.~~

~~460-10-60-30 Paragraph superseded by Accounting Standards Update No. 2016-02. For an indemnification or guarantee of an owner-lessor against third-party damage claims other than claims caused by or resulting from the lessee's own~~

actions or failures to act while in possession or control of the construction project in a sale leaseback transaction, see paragraph 840-40-55-15.

460-10-60-31 Paragraph superseded by Accounting Standards Update No. 2016-02. For an indemnification or guarantee by the seller-lessee to a party other than the owner-lessor in a sale leaseback transaction, see paragraph 840-40-55-15.

460-10-60-32 For a guarantee by the seller-lessee of the leased property's underlying asset's residual value in a sale leaseback sale and leaseback transaction, see paragraph 840-40-55-26842-40-55-19.

460-10-60-33 Paragraph superseded by Accounting Standards Update No. 2016-02. For the effect of providing an independent third-party guarantee of the lease payments in a sale leaseback transaction, see paragraph 840-40-25-14.

Amendments to Subtopic 470-10

52. Amend paragraph 470-10-60-4, with a link to transition paragraph 842-10-65-1, as follows:

Debt—Overall

Relationships

> Leases

470-10-60-4 For guidance on the classification of obligations under capital ~~(add glossary link)~~ leases ~~(add glossary link)~~, see paragraphs 840-30-45-1 through 45-3842-20-45-1 through 45-4.

Amendments to Subtopic 470-60

53. Amend paragraph 470-60-15-11, with a link to transition paragraph 842-10-65-1, as follows:

Debt—Troubled Debt Restructurings by Debtors

Scope and Scope Exceptions

> Other Considerations

> > Troubled Debt Restructuring

470-60-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

- a. **Lease modifications**~~Changes in lease agreements~~ (for guidance, see Topic ~~842-10-65-1~~ 842-10-65-1)
- b. Changes in employment-related agreements, for example, pension plans and deferred compensation contracts
- c. Unless they involve an agreement between debtor and creditor to restructure, neither of the following:
 1. Debtors' failures to pay trade accounts according to their terms
 2. Creditors' delays in taking legal action to collect overdue amounts of interest and principal.

Amendments to Subtopic 606-10

54. Amend paragraph 606-10-15-2(a), with a link to transition paragraph 842-10-65-1, as follows:

Revenue from Contracts with Customers—Overall

Scope and Scope Exceptions

> Transactions

606-10-15-2 An entity shall apply the guidance in this Topic to all **contracts** with **customers**, except the following:

- a. Lease contracts within the scope of Topic 842-10-65-1, Leases.

55. Amend paragraphs 606-10-55-68, 606-10-55-72, and 606-10-55-407, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Repurchase Agreements

> > > A Forward or a Call Option

606-10-55-68 If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a **customer** does not obtain control of the asset because

the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity should account for the **contract** as either of the following:

- a. A **{add glossary link}lease{add glossary link}** in accordance with Topic 842-40 on leases, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity should account for the contract as a financing arrangement and not as a sale and leaseback transaction in accordance with Subtopic 842-40.
- b. A financing arrangement in accordance with paragraph 606-10-55-70, if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.

> > A Put Option

606-10-55-72 If an entity has an obligation to repurchase the asset at the **customer's** request (a put option) at a price that is lower than the original selling price of the asset, the entity should consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right, the entity should account for the agreement as a lease in accordance with Topic 842-40 on leases unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity should account for the contract as a financing arrangement and not as a sale and leaseback transaction in accordance with Subtopic 842-40.

> Illustrations

> > Repurchase Agreements

> > > Example 62—Repurchase Agreements

> > > Case B—Put Option: Lease

606-10-55-405 Instead of having a call option, the contract includes a put option that obliges the entity to repurchase the asset at the customer's request for

\$900,000 on or before December 31, 20X7. The market value is expected to be \$750,000 on December 31, 20X7.

606-10-55-406 At the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine the accounting for the transfer of the asset (see paragraphs 606-10-55-72 through 55-78). The entity concludes that the customer has a significant economic incentive to exercise the put option because the repurchase price significantly exceeds the expected market value of the asset at the date of repurchase. The entity determines there are no other relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

606-10-55-407 In accordance with paragraphs 606-10-55-72 through 55-73, the entity accounts for the transaction as a lease in accordance with Topic ~~842~~840 on leases.

Amendments to Subtopic 610-10

56. Amend paragraph 610-10-55-1, with a link to transition paragraph 842-10-65-1, as follows:

Other Income—Overall

Overview and Background

610-10-05-1 The Other Income Topic specifies standards of financial accounting and reporting for income recognized that is not in a **contract** with a **customer** within the scope of Topic 606 on **revenue** from contracts with customers, other Topics (such as Topic ~~842~~840 on leases and Topic 944 on insurance), or in accordance with other revenue or income recognition guidance.

Amendments to Subtopic 610-20

57. Amend paragraph 610-20-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets

Scope and Scope Exceptions

> Other Considerations

610-20-15-3 The guidance in this Subtopic does not apply to the following:

- a. The derecognition of a nonfinancial asset, including an in substance nonfinancial asset, in a **contract** with a **customer**, see Topic 606 on revenue from contracts with customers
- b. The derecognition of a subsidiary or group of assets that constitutes a **business** or **nonprofit activity** (excluding an in substance nonfinancial asset), see Section 810-10-40 on consolidation
- c. ~~Real-estate-sale-leaseback~~ Sale and leaseback transactions, see ~~Subtopics 360-20 and 840-40~~ Subtopic 842-40 on leases
- d. A conveyance of oil and gas mineral rights, see Subtopic 932-360 on extractive activities
- e. A transfer of a nonfinancial asset to another entity in exchange for a noncontrolling ownership interest in that entity, see the guidance on exchanges of a nonfinancial asset for a noncontrolling ownership interest in Section 845-10-30.

Amendments to Subtopic 740-10

58. Amend paragraph 740-10-25-3(c), with a link to transition paragraph 842-10-65-1, as follows:

Income Taxes—Overall

Recognition

740-10-25-2 Other than the exceptions identified in the following paragraph, the following basic requirements are applied in accounting for income taxes at the date of the financial statements:

- a. A tax liability or asset shall be recognized based on the provisions of this Subtopic applicable to tax positions, in paragraphs 740-10-25-5 through 25-17, for the estimated taxes payable or refundable on tax returns for the current and prior years.
- b. A **deferred tax liability** or **asset** shall be recognized for the estimated future tax effects attributable to **temporary differences** and **carryforwards**.

740-10-25-3 The only exceptions in applying those basic requirements are:

- c. The pattern of recognition of after-tax income for **{add glossary link}** leveraged leases **{add glossary link}** or the allocation of the purchase price in a purchase business combination to acquired leveraged leases as required by Subtopic 842-50840-30

59. Amend paragraphs 740-10-55-156 and 740-10-55-158, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 20: Interaction of Loss Carryforwards and Temporary Differences

740-10-55-156 This Example illustrates the guidance in paragraph 740-10-55-37 for the interaction of loss carryforwards and temporary differences that will result in net deductible amounts in future years. This Example has the following assumptions:

- The financial loss and the loss reported on the tax return for an entity's first year of operations are the same.
- In Year 2, a gain of \$2,500 from a transaction that is a sale for tax purposes but does not meet the sale recognition criteria for financial reporting purposes—a sale and leaseback for financial reporting—is the only difference between pretax financial income and taxable income.

740-10-55-157 Financial and taxable income in this Example are as follows.

	Financial Income	Taxable Income
Year 1: Income (loss) from operations	\$ (4,000)	\$ (4,000)
Year 2: Income (loss) from operations	\$ -	\$ -
Taxable gain on sale		2,500
Taxable income before loss carryforward		2,500
Loss carryforward from Year 1		(4,000)
Taxable income		\$ -

740-10-55-158 The \$4,000 operating loss carryforward at the end of Year 1 is reduced to \$1,500 at the end of Year 2 because \$2,500 of it is used to reduce taxable income. The \$2,500 reduction in the loss carryforward becomes \$2,500 of

deductible temporary differences that will reverse and result in future tax deductions when the sale occurs (that is, control of the asset transfers to the buyer-~~lessor~~) ~~lease payments are made~~. The entity has no deferred tax liability to be offset by those future tax deductions, the future tax deductions cannot be realized by loss carryback because no taxes have been paid, and the entity has had pretax losses for financial reporting since inception. Unless positive evidence exists that is sufficient to overcome the negative evidence associated with those losses, a valuation allowance is recognized at the end of Year 2 for the full amount of the deferred tax asset related to the \$2,500 of deductible temporary differences and the remaining \$1,500 of operating loss carryforward.

60. Amend paragraph 740-10-60-4, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

740-10-60-4 For the specific requirements for accounting for income taxes related to ~~{add glossary link}~~ leveraged leases ~~{add glossary link}~~, see Subtopic 842-50840-30.

Amendments to Subtopic 740-270

61. Amend paragraph 740-270-30-15, with a link to transition paragraph 842-10-65-1, as follows:

Income Taxes—Interim Reporting

Initial Measurement

> Exclusion of Items from Estimated Annual Effective Tax Rate

> > Certain Tax Credits

740-270-30-15 Further, paragraphs 842-50-30-1 and 842-50-35-3 through 35-4 840-30-30-14 and 840-30-35-34 through 35-35 require that investment tax credits related to leases that are accounted for as ~~{add glossary link}~~ leveraged leases ~~{add glossary link}~~ shall be deferred and accounted for as return on the net investment in the leveraged leases in the years in which the net investment is positive and explains that the use of the term *years* is not intended to preclude application of the accounting described to shorter periods. If an entity accounts for

investment tax credits related to leveraged leases in accordance with those paragraphs for interim periods, those investment tax credits shall not be taken into account in estimating the annual effective tax rate.

Amendments to Subtopic 805-10

62. Amend paragraph 805-10-55-44, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Overall

Implementation Guidance and Illustrations

> Illustrations

> > Example 5: Illustration of Disclosure Requirements

805-10-55-44 Paragraph 805-20-50-1(b)

The fair value of the financial assets acquired includes receivables under capital leases ~~sales-type leases or direct financing leases~~ of data networking equipment with a fair value of \$2,000. The gross amount due under the contracts is \$3,100, of which \$450 is expected to be uncollectible.

Amendments to Subtopic 805-20

63. Amend paragraphs 805-20-25-5, 805-20-25-8 through 25-9, 805-20-25-11 through 25-12, and 805-20-25-16 through 25-17, add paragraphs 805-20-25-10A and 805-20-25-28A through 25-28B and their related heading, and supersede paragraph 805-20-25-13, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Recognition

> Recognition Principle

> > Recognition Conditions

805-20-25-5 Paragraphs 805-20-25-11 through 25-12 ~~25-13~~ provide guidance on recognizing operating leases and paragraphs 805-20-55-2 through 55-45 provide

guidance on recognizing ~~other~~ intangible assets. Paragraphs 805-20-25-17 through ~~25-28~~ 25-28B specify the types of identifiable assets and liabilities that include items for which this Subtopic and Subtopic 805-740 provide limited exceptions to the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

> > Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in a Business Combination

805-20-25-6 At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to subsequently apply other GAAP. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the acquisition date.

805-20-25-8 This Section provides the following two exceptions to the principle in paragraph 805-20-25-6:

- a. Classification of a lease of an acquiree contract as either an operating lease or a capital lease shall be in accordance with the guidance in paragraph ~~840-10-25-27~~ 842-10-55-11.
- b. Classification of a contract written by an entity that is in the scope of Subtopic 944-10 as an insurance or reinsurance contract or a deposit contract. The acquirer shall classify these contracts that contract on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date). **[Content amended as shown and moved from below]**

The acquirer shall classify these contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date). **[Content amended and moved to (b) above]**

> Recognizing Particular Assets Acquired and Liabilities Assumed

805-20-25-9 Guidance on recognizing identifiable intangible assets, including operating leases and reacquired rights, follows.

> > Identifiable Intangible Assets

805-20-25-10 The acquirer shall recognize separately from goodwill the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in the definition of identifiable. Additional guidance on applying that definition is provided in paragraphs 805-20-25-14 through 25-15, 805-20-55-2 through 55-45, and Example 1 (see paragraph 805-20-55-52). For guidance on the recognition and subsequent measurement of a **defensive intangible asset**, see Subtopic 350-30.

805-20-25-10A An identifiable intangible asset may be associated with a ~~an~~ ~~operating~~ ~~{add glossary link}~~ lease ~~{add glossary link}~~, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, such as a customer relationship. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph 805-20-25-10. **[Content amended as shown and moved from paragraph 805-20-25-13]**

> > Operating Leases

805-20-25-11 The acquirer shall recognize no assets or liabilities related to an ~~{add glossary link}~~ operating lease ~~{add glossary link}~~ in which the acquiree is the ~~{add glossary link}~~ lessee ~~{add glossary link}~~ except as required by paragraphs 805-20-25-12 through 25-13 ~~805-20-25-10A and 805-20-25-28A~~.

805-20-25-12 Regardless of whether the acquiree is the lessee or the ~~{add glossary link}~~ lessor ~~{add glossary link}~~, the acquirer shall determine whether the terms of each of an acquiree's operating leases are favorable or unfavorable compared with the market terms of leases of the same or similar items at the acquisition date. ~~If the acquiree is a lessor, the~~ The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms. If the acquiree is a lessee, the acquirer shall adjust the measurement of the acquired right-of-use asset for any favorable or unfavorable terms in accordance with paragraph 805-20-30-24.

805-20-25-13 Paragraph superseded by Accounting Standards Update No. 2016-02. ~~An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, such as a customer relationship. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph 805-20-25-10. [Content amended and moved to paragraph 805-20-25-10A]~~

> Exceptions to the Recognition Principle

805-20-25-16 This Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-25-17 through ~~25-28~~25-28B specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the recognition principle in paragraph 805-20-25-1. The acquirer shall apply the specified GAAP or the specified requirements rather than that recognition principle to determine when to recognize the assets or liabilities identified in paragraphs 805-20-25-17 through ~~25-28~~25-28B. That will result in some items being recognized either by applying recognition conditions in addition to those in paragraphs 805-20-25-2 through 25-3 or by applying the requirements of other GAAP, with results that differ from applying the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

805-20-25-17 Guidance is presented on all of the following exceptions to the recognition principle:

- a. Assets and liabilities arising from contingencies
- b. Income taxes
- c. Employee benefits
- d. Indemnification assets.
- e. Leases.

> > Leases

805-20-25-28A ~~The acquirer shall recognize assets and liabilities arising from leases of an acquiree in accordance with Topic 842 on leases (taking into account the requirements in paragraph 805-20-25-8(a)).~~

805-20-25-28B For leases for which the acquiree is a lessee, the acquirer may elect, as an accounting policy election by class of underlying asset and applicable to all of the entity's acquisitions, not to recognize assets or liabilities at the acquisition date for leases that, at the acquisition date, have a remaining lease term of 12 months or less. This includes not recognizing an intangible asset if the terms of an operating lease are favorable relative to market terms or a liability if the terms are unfavorable relative to market terms.

64. Amend paragraphs 805-20-30-10 through 30-12 and add paragraphs 805-20-30-24 through 30-25 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement**> Exceptions to the Measurement Principle**

805-20-30-10 Paragraph 805-20-25-16 notes that the Business Combinations Topic provides limited exceptions to the recognition and measurement principles

applicable to business combinations. Paragraphs 805-20-30-12 through ~~30-2530-23~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the paragraph 805-20-30-1 measurement principle. The acquirer shall apply the specified GAAP or the specified requirements rather than that measurement principle to determine how to measure the assets or liabilities identified in paragraphs 805-20-30-12 through ~~30-2530-23~~. That will result in some items being measured at an amount other than their acquisition-date fair values.

805-20-30-11 As noted at in paragraph ~~805-20-25-17~~~~805-20-25-16~~, income taxes, employee benefits, and indemnification assets, and leases are also exceptions to the recognition principle in paragraph 805-20-25-1.

805-20-30-12 Guidance is presented on all of the following exceptions to the measurement principle:

- a. Income taxes
- b. Employee benefits
- c. Indemnification assets
- d. Reacquired rights
- e. Share-based payment awards
- f. Assets held for sale
- g. Certain assets and liabilities arising from contingencies.
- h. Leases.

> > Measurement of Lease Assets and Lease Liabilities Arising from Leases in Which the Acquiree Is the Lessee

805-20-30-24 For leases in which the acquiree is a lessee, the acquirer shall measure the lease liability at the present value of the remaining lease payments, as if the acquired lease were a new lease of the acquirer at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability as adjusted to reflect favorable or unfavorable terms of the lease when compared with market terms.

> > Measurement of Assets and Liabilities Arising from Leases in Which the Acquiree Is the Lessor

805-20-30-25 For leases in which the acquiree is a lessor of a sales-type lease or a direct financing lease, the acquirer shall measure its net investment in the lease as the sum of both of the following (which will equal the fair value of the underlying asset at the acquisition date):

- a. The lease receivable at the present value, discounted using the rate implicit in the lease, of the following, as if the acquired lease were a new lease at the acquisition date:
 1. The remaining lease payments

2. The amount the lessor expects to derive from the underlying asset following the end of the lease term that is guaranteed by the lessee or any other third party unrelated to the lessor.
- b. The **unguaranteed residual asset** as the difference between the fair value of the underlying asset at the acquisition date and the carrying amount of the lease receivable, as determined in accordance with (a), at that date.

The acquirer shall take into account the terms and conditions of the lease in calculating the acquisition-date fair value of an underlying asset that is subject to a sales-type lease or a direct financing lease by the acquiree-lessor.

65. Amend paragraph 805-20-35-6, with a link to transition paragraph 842-10-65-1, as follows:

Subsequent Measurement

> Additional Guidance on Subsequent Measurement of Assets Acquired, Liabilities Assumed or Incurred, and Any Noncontrolling Interests in a Business Combination

805-20-35-6 Leasehold improvements acquired in a business combination shall be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured (as used in the definition of **lease term**) and the remaining **lease term** at the date of acquisition. However, if the lease transfers ownership of the underlying asset to the lessee, or the lessee is reasonably certain to exercise an option to purchase the underlying asset, the lessee shall amortize the leasehold improvements to the end of their useful life.

66. Amend paragraph 805-20-50-1(b), with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

> Business Combinations Occurring during a Current Reporting Period or after the Reporting Date but before the Financial Statements Are Issued

805-20-50-1 Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a **business combination**. To meet that objective, the **acquirer** shall disclose all of the following information for each business combination that occurs during the reporting period:

- b. For acquired receivables not subject to the requirements of Subtopic 310-30, all of the following:

1. The **fair value** of the receivables (unless those receivables arise from **sales-type leases** or **direct financing leases** by the lessor for which the acquirer shall disclose the amounts recognized as of the acquisition date)
2. The gross contractual amounts receivable
3. The best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, net investment in sales-type or direct financing leases in accordance with Subtopic 842-30 on leases—lessor~~840-30~~, and any other class of receivables.

67. Amend paragraphs 805-20-55-2 and 805-20-55-31, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Recognition of Intangible Assets Separately from Goodwill

805-20-55-2 Paragraph 805-20-25-10 establishes that an intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in the definition of identifiable. An **intangible asset** that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the **acquiree** or from other rights and obligations. For example:

- a. An acquiree leases a manufacturing facility to a lessee under an **{add glossary link}**operating lease**{add glossary link}** that has terms that are favorable relative to market terms. The lease terms explicitly prohibit transfer of the **{add glossary link}**lease**{add glossary link}** (through either sale or **{add glossary link}**sublease**{add glossary link}**). The amount by which the lease terms are favorable compared with the pricing of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal criterion for recognition separately from **goodwill**, even though the **acquirer** cannot sell or otherwise transfer the lease contract. See also paragraph paragraphs 805-20-25-12 through 25-13.
- b. An acquiree owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the **fair value** of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

- c. An acquirer owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

> > Examples of Intangible Assets That Are Identifiable

> > > Contract-Based Intangible Assets

805-20-55-31 Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one type of contract-based intangible asset. If the terms of a contract give rise to a liability (for example, if the terms of ~~a~~ an operating lease or customer contract are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the business combination. Examples of contract-based intangible assets are:

- a. Licensing, royalty, standstill agreements #
- b. Advertising, construction, management, service or supply contracts #
- c. ~~Lease~~ Operating lease agreements of a lessor (whether the acquirer is the lessee or the lessor) #
- d. Construction permits #
- e. Franchise agreements #
- f. Operating and broadcast rights #
- g. Servicing contracts such as mortgage servicing contracts #
- h. Employment contracts #
- i. Use rights such as drilling, water, air, timber cutting, and route authorities. #

Amendments to Subtopic 805-740

68. Amend paragraph 805-740-25-4, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Income Taxes

Recognition

805-740-25-4 Guidance on tax-related matters related to the portion of goodwill for which amortization is not deductible for tax purposes is in paragraphs 805-740-25-8 through 25-9; guidance on accounting for the acquisition of ~~{add glossary~~

~~link}~~leveraged leases~~{add glossary link}~~ in a business combination is in paragraph ~~840-30-30-15~~Subtopic 842-50; and guidance on the specific acquired temporary differences identified in paragraph 740-10-25-3(a) is referred to in that paragraph.

69. Amend paragraph 805-740-30-1, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

805-740-30-1 An **acquirer** shall measure a **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a **business combination** in accordance with Subtopic 740-10. Discounting deferred tax assets or liabilities is prohibited for **temporary differences** (except for ~~{add glossary link}~~leveraged leases~~{add glossary link}~~, see Subtopic ~~842-50~~840-30) related to business combinations as it is for other temporary differences.

Amendments to Subtopic 810-10

70. Amend paragraph 810-10-25-56, with a link to transition paragraph 842-10-65-1, as follows:

Consolidation—Overall

Recognition

> > Variable Interest and Interests in Specific Assets of a VIE

810-10-25-56 Expected losses related to variable interests in specified assets are not considered part of the expected losses of the legal entity for purposes of determining the adequacy of the equity at risk in the legal entity or for identifying the primary beneficiary unless the specified assets constitute a majority of the assets of the legal entity. For example, expected losses absorbed by a guarantor of the residual value of leased property underlying asset are not considered expected losses of a VIE if the fair value of the leased property underlying asset is not a majority of the fair value of the VIE's total assets.

71. Amend paragraphs 810-10-50-2AD and 810-10-50-2AF, with a link to transition paragraph 842-10-65-1, as follows:

Consolidation—Overall

Disclosure

Variable Interest Entities

> Accounting Alternative

810-10-50-2AD A private company {add glossary link} lessee {add glossary link} that does not apply the requirements of the Variable Interest Entities Subsections to one or more {add glossary link} lessor {add glossary link} legal entities because it meets the criteria in paragraph 810-10-15-17A shall disclose the following:

- a. The amount and key terms of liabilities (for example, debt, environmental liabilities, and asset retirement obligations) recognized by the lessor legal entity that expose the private company lessee to providing financial support to the legal entity. For example, a private company lessee exposed to debt of the legal entity should disclose information such as the amount of debt, interest rate, maturity, pledged collateral, and guarantees associated with the debt.
- b. A qualitative description of circumstances (for example, certain commitments and contingencies) not recognized in the financial statements of the lessor legal entity that expose the private company lessee to providing financial support to the legal entity.

810-10-50-2AF In disclosing information about the lessor legal entity, a private company lessee shall present the disclosures in combination with the disclosures required by other guidance (for example, in Topics 460 on guarantees, 850 on related party disclosures, and 842-840 on leases). Those disclosures could be combined in a single note or by including cross-references within the notes to financial statements.

72. Amend paragraphs 810-10-55-50, 810-10-55-78 through 55-80, 810-10-55-93, and 810-10-55-172 through 55-176, and 810-10-55-178 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

Variable Interest Entities

> Illustrations

> > **Example 2: Calculation of Expected Losses If There Is No History of, nor Future Expectation of, Net Losses**

810-10-55-50 This Example illustrates the calculation of expected losses if a legal entity has no history of net losses and expects continued profitability. This Example has the following assumptions:

- a. On January 1, 2004, Entity A is formed to purchase a building, 95 percent of which is financed by debt and 5 percent by equity. The lenders will have recourse only to the building in the event that Entity A does not make the required debt payments.
- b. On the same day, Entity B enters into a five-year-market-rate lease for the building from Entity A that includes a guarantee of a portion of the building's residual value. The sum of the present value of the ~~minimum~~ {add glossary link} lease payments {add glossary link}, including and the residual value ~~guarantee~~ guarantee, is less than ~~90 percent of~~ substantially all the fair value of the building.
- c. There are no other interests in Entity A.
- d. The appropriate discount rate is assumed to be 5 percent.

> > Example 3: Determining the Variability to Be Considered

810-10-55-55 The following Cases illustrate the application of the guidance in paragraphs 810-10-25-21 through 25-36 for determining the variability to be considered in the following situations:

- a. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed-rate debt (Case A)
- b. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed- and variable-rate debt (with a fixed-rate swap) (Case B)
- c. Financial VIE primarily financed by fixed-rate debt, holding investments in foreign-currency-denominated debt (with a currency swap) (Case C)
- d. Financial VIE primarily financed by floating-rate debt, holding investments in fixed-rate securities (Case D)
- e. Financial VIE financed by credit-linked notes holding highly rated floating-rate investments and a credit default swap (Case E)
- f. Retail-operating VIE (Case F)
- g. Lessor VIE (direct financing lease) with single lessee (operating lease) (Case G)
- h. VIE holding both a fixed-price forward contract to buy and a fixed-price forward contract to sell electricity (Case H).

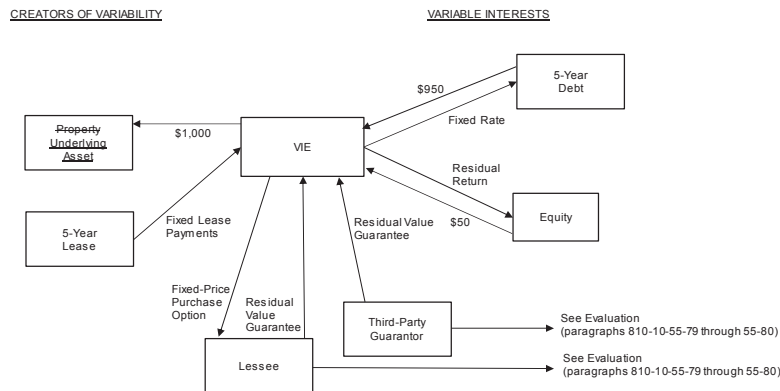
810-10-55-56 Cases A–H share all of the following assumptions:

- a. All the entities are presumed to be VIEs.
- b. All variable interests are variable interests in the VIE (as a whole) rather than variable interests in specified assets of the VIE, based on the guidance in paragraphs 810-10-25-55 through 25-59.

- c. A primary beneficiary has not been identified; however, the determination of the primary beneficiary should be made in accordance with the guidance in paragraphs 810-10-25-38A through 25-38G.

> > Case G: Lessor VIE (Direct Financing Lease) with Single Lessee (Operating Lease)

810-10-55-78 A VIE is created and financed with \$950 of 5-year fixed-rate debt and \$50 of equity. The VIE uses the proceeds from the issuance to purchase ~~property~~an underlying asset to be leased to a {add glossary link}lessee{add glossary link} with a AA credit rating. The equity provides protection (up to \$50) to the debt related to both credit risk and interest rate risk because the debt is paid before any cash flows are available to the equity investors. The {add glossary link}lease{add glossary link} has a five-year term and is classified as a ~~direct finance lease~~direct financing lease by the {add glossary link}lessor{add glossary link} and as an {add glossary link}operating lease{add glossary link} by the lessee. The lessee is required to provide a first-loss residual value guarantee for the expected future value of the ~~leased property~~underlying asset at the end of five years, and it has a fixed-price purchase option to acquire the ~~underlying asset~~property for the same amount. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor. The governing documents for the VIE do not permit the VIE to buy additional assets or sell existing assets during the five-year holding period. The VIE was formed so that the lessee will have rights to occupy and use the ~~property~~underlying asset under an operating lease and retain substantially all of the risks and rewards from appreciation or depreciation in value of the ~~leased property~~underlying asset. The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by ~~leased property~~an underlying asset that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return provided to the debt investors because the equity is subordinated with respect to the obligation of the lessee to the VIE. The following diagram illustrates this situation.



810-10-55-79 The VIE is exposed to the following risks:

- Price risk with respect to changes in fair value of the underlying property asset.
- Credit risk associated with possible default by the lessee of the property underlying asset with respect to the lease payments.
- Interest rate risk associated with changes in the fair value of the future lease payments.

810-10-55-80 The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

- Although the lease payments are fixed, the VIE was not designed to be exposed to interim changes in fair value of those lease payments due to interest rate risk because the VIE is not expected to sell the property underlying asset before maturity of the fixed-rate debt.
- The primary purpose for which the VIE was created was to provide the lessee with use of the property underlying asset for five years with substantially all of the rights and obligations of ownership.
- The residual value guarantee effectively transfers substantially all of the risk associated with the underlying property asset (that is, declines in value) to the lessee. Therefore, the variability that is transferred to that interest holder is strongly indicated as variability that the VIE is designed to create and pass along to its interest holders.
- The fixed-price purchase option effectively transfers substantially all of the rewards from the underlying property asset (that is, increases in value) to the lessee.
- The VIE is designed to be exposed to the risks associated with a cumulative change in fair value of the leased property underlying asset at

the end of five years as well as credit risk from possible default by the lessee with regard to ~~minimum~~ lease payments.

- f. The VIE was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by ~~leased property~~ an underlying asset that would provide a fixed-rate return to debt holders equivalent to AA-rated assets.
- g. The role of the residual value guarantee and fixed-price purchase option in the design of the VIE, regardless of their legal form or accounting classification, dictates whether those interests shall be treated as creating risk for the VIE or absorbing risk from the VIE. Therefore, price risk with respect to changes in fair value of the underlying ~~property~~ asset is a relevant risk for the VIE, even though the lessor VIE records a net investment in the direct financing lease ~~receivable~~, rather than the ~~property underlying asset~~ itself, on its balance sheet for accounting purposes.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risk in (a) in the preceding paragraph 810-10-55-79 to the third-party guarantor and the lessee (with respect to the residual value guarantee and fixed-price purchase option) and the risk in (b) in the preceding paragraph 810-10-55-79 to the note and equity holders, all of which are the VIE's variable interest holders.

> > Example 5: Identifying a Primary Beneficiary

810-10-55-93 The following cases are provided solely to illustrate the application of the guidance in paragraphs 810-10-25-38A through 25-38J related to the identification of a primary beneficiary:

- a. Commercial mortgage-backed securitization (Case A)
- b. Asset-backed collateralized debt obligation (Case B)
- c. Structured investment vehicle (Case C)
- d. Commercial paper conduit (Case D)
- e. Guaranteed mortgage-backed securitization (Case E)
- f. Residential mortgage-backed securitization (Case F)
- g. ~~Property lease~~ Lease entity (Case G)
- h. Collaboration—Joint venture arrangement (Case H)
- i. Furniture manufacturing entity (Case I)
- j. Investment fund 1—Annual and performance-based fees and additional interests (Case J)
- k. Investment fund 2—Annual and performance-based fees and no additional interests (Case K)
- l. eCommerce Entity (Case L).

> > Case G: ~~Property~~ Lease Entity

810-10-55-172 A VIE is created and financed with \$950 of 5-year fixed-rate debt and \$50 of equity. The VIE uses the proceeds from the issuance to purchase ~~property~~ an asset to be leased to a lessee with an AA credit rating. The equity is subordinate to the debt because the debt is paid before any cash flows are available to the equity investors. The lease has a five-year term and is classified as a direct ~~finance~~ financing lease by the lessor and as an operating lease by the lessee. The lessee, however, is considered the owner of the ~~property~~ underlying asset for tax purposes and, thus, receives tax depreciation benefits.

810-10-55-173 The lessee is required to provide a first-loss residual value guarantee for the expected future value of the ~~leased property~~ underlying asset at the end of five years (the option price) up to a specified percentage of the option price, and it has a fixed-price purchase option to acquire the ~~property~~ underlying asset for the option price. If the lessee does not exercise the fixed-price purchase option at the end of the lease term, the lessee is required to remarket the ~~property~~ underlying asset on behalf of the VIE. If the ~~property~~ underlying asset is sold for an amount less than the option price, the lessee is required to pay the VIE the difference between the option price and the sales proceeds, which is not to exceed a specified percentage of the option price. If the ~~property~~ underlying asset is sold for an amount greater than the option price, the lessee is entitled to the excess of the sales proceeds over the option price. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor VIE, which allows the lessor to achieve direct financing lease treatment.

810-10-55-174 The governing documents for the VIE do not permit the VIE to buy additional assets or sell existing assets during the five-year holding period, and the terms of the lease agreement and the governing documents for the VIE do not provide the equity holders with the power to direct any activities of the VIE. The VIE was formed so that the lessee would have rights to use the ~~property~~ underlying asset under an operating lease and would retain substantially all of the risks and rewards from appreciation or depreciation in value of the ~~leased property~~ underlying asset.

810-10-55-175 The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by ~~leased property~~ an underlying asset that is leased that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return to the debt investors because the equity is subordinated to the debt.

810-10-55-176 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

- a. The primary purpose for which the VIE was created was to provide the lessee with use of the ~~property~~underlying asset for five years with substantially all of the rights and obligations of ownership, including tax benefits.
- b. The VIE was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by ~~leased property~~an underlying asset that is leased that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return to the debt investors because the equity is subordinated to the debt.
- c. The residual value guarantee effectively transfers substantially all of the risk associated with the underlying ~~property~~asset (that is, decreases in value) to the lessee and the fixed-price purchase option effectively transfers substantially all of the rewards from the underlying ~~property~~asset (that is, increases in value) to the lessee.
- d. The VIE is designed to be exposed to the risks associated with a cumulative change in fair value of the ~~leased property~~underlying asset at the end of five years as well as credit risk related to the potential default by the lessee of its contractually required lease payments.

810-10-55-177 The debt investors, the equity investors, and the lessee are the variable interest holders in the VIE.

810-10-55-178 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is significantly impacted by the fair value of the underlying ~~property~~asset and the credit of the lessee. The lessee's maintenance and operation of the ~~leased property~~underlying asset has a direct effect on the fair value of the underlying ~~property~~asset, and the lessee directs the remarketing of the ~~property~~underlying asset. The lessee also has the ability to increase the benefits it can receive and limit the losses it can suffer by the manner in which it uses the ~~property~~underlying asset and how it remarkets the ~~property~~underlying asset.

73. Amend paragraph 810-10-60-4, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

810-10-60-4 For {add glossary link}leases{add glossary link} sold by a manufacturer to a leasing subsidiary, see paragraph 840-30-45-4842-30-45-3.

Amendments to Subtopic 815-10

74. Amend paragraphs 815-10-15-63 and 815-10-15-79 through 15-81, with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

> Instruments

> > Instruments Not within Scope

> > > Derivative Instruments That Impede Sale Accounting

815-10-15-63 A derivative instrument (whether freestanding or embedded in another contract) whose existence serves as an impediment to recognizing a related contract as a sale by one party or a purchase by the counterparty is not subject to this Subtopic. For example, the existence of a guarantee of the residual value of a leased asset by the lessor may be an impediment to treating a contract as a sales type lease, in which case the contract would be treated by the lessor as an operating lease. Another example is the existence of a call option enabling a transferor to repurchase transferred assets that is an impediment to sales accounting under Topic 860. Such a call option on transferred financial assets that are not readily obtainable would prevent accounting for that transfer as a sale. The consequence is that to recognize the call option would be to count the same thing twice. The holder of the option already recognizes in its financial statements the assets that it has the option to purchase.

> > > Leases

815-10-15-79 Leases that are within the scope of Topic 842 are not derivative instruments subject to this Subtopic, although a derivative instrument embedded in a lease may be subject to the requirements of paragraph 815-15-25-1.

> > > Residual Value Guarantees

815-10-15-80 Residual value guarantees that are subject to the requirements of Topic 842 on leases are not subject to the requirements of this Subtopic.

815-10-15-81 A third-party residual value guarantor shall consider the guidance in this Subtopic for all residual value guarantees that it provides to determine whether

they are derivative instruments and whether they qualify for any of the scope exceptions in this Subtopic. The guarantees described in paragraph ~~842-10-15-43~~~~840-10-15-20~~ for which the exceptions of paragraphs 460-10-15-7(b) and 460-10-25-1(a) do not apply are subject to the initial recognition, initial measurement, and disclosure requirements of Topic 460.

75. Amend paragraph 815-10-55-60, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope Application to Certain Contracts

> > > Take-or-Pay Contracts

815-10-55-60 Whether a **take-or-pay contract** is subject to this Subtopic depends on its terms. For example, if the product to be delivered is not readily convertible to cash and there is no net settlement option, the contract fails to meet the net settlement criterion in paragraph 815-10-15-83(c) and is not subject to the requirements of this Subtopic. In certain circumstances, a take-or-pay contract may represent or contain a lease that should be accounted for in accordance with Topic 842840. (Paragraph 815-10-15-79 explains that leases subject to that Topic are not subject to this Subtopic.)

Amendments to Subtopic 815-15

76. Amend paragraph 815-15-25-22 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Embedded Derivatives

Recognition

> > > Variable Lease PaymentsContingent Rentals Based on a Variable Interest Rate

815-15-25-22 The obligation to make future payments for the use of leased assets and the adjustment of those payments to reflect changes in a variable-interest-rate index are considered to be clearly and closely related. Thus, leases that include variable lease paymentscontingent rentals based on changes in the prime rate

would not have the ~~contingent-rental-related~~ embedded derivative that is related to the variable lease payment separated from the host contract.

77. Amend paragraphs 815-15-55-4 and 815-15-55-7 and the related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope—Features Involving Certain Currencies—Certain Insurance Contracts

815-15-55-4 Insurance contracts are **financial instruments** that are not covered by the scope exception in paragraph 815-15-15-10 that applies to nonfinancial contracts; however, that paragraph applies to this situation in which a normal insurance contract involves payment in the functional currency of either of the two parties to the contract. The insurance contracts described in this guidance are ~~similar to operating leases, which are covered by the exception in paragraph 815-15-15-10, because neither contract gives the insurance contracts do not give rise~~ to a recognized asset or liability that would be measured under Subtopic 830-20 until an amount becomes receivable or payable under the contract. Therefore, as discussed in paragraph 815-15-15-20, the exception in paragraph 815-15-15-10 also applies to insurance contracts that involve payment of losses in the functional currency of either of the two parties to the contract.

> > Applying the Bifurcation Criteria

> > > Applying the Separate Instrument Criterion

> > > Variable Lease Payments ~~Contingent Rentals~~ Based on Related Sales

815-15-55-7 Lease contracts that include variable lease payments ~~contingent rentals based on certain sales of the lessee would not have the contingent-rental-related~~ **embedded derivative** that is related to the variable lease payment separated from the host contract because, under paragraph 815-10-15-59(d), a non-exchange-traded contract whose **underlying** is specified volumes of sales by one of the parties to the contract would not be subject to the requirements of Subtopic 815-10.

Amendments to Subtopic 815-20

78. Amend paragraph 815-20-55-11 and supersede paragraphs 815-20-55-73 and 815-20-55-198 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Hedging—General

Implementation Guidance and Illustrations

> > > Application of the Definition of Firm Commitment

815-20-55-11 A firm commitment that represents an asset or liability that a specific accounting standard prohibits recognizing (such as a lessor's ~~noncancellable~~ noncancelable operating lease or an unrecognized mortgage servicing right) may nevertheless be designated as the hedged item in a fair value hedge.

> > > Applicability of the Shortcut Method

815-20-55-73 Paragraph superseded by Accounting Standards Update No. 2016-02. Based on paragraph 815-20-55-71(c), the shortcut method cannot be applied to a cash flow hedge of the variability in lease payments for an interest rate-indexed operating lease because that lease is not a recognized interest-bearing asset or liability. Although a capital lease is reported as a leased asset and an interest-bearing obligation under Subtopic 840-30 (and thus the shortcut method could potentially be applied to a fair value hedge of a capital lease's exposure to interest rate risk), an operating lease is accounted for as an executory contract that is not recognized as an interest-bearing asset or liability.

> > Example 23: Use of Shortcut Method for Cash Flow Hedge of Variable-Rate Operating Lease

815-20-55-198 Paragraph superseded by Accounting Standards Update No. 2016-02. This Example addresses the application of the shortcut method as discussed beginning in paragraph 815-20-25-102. Assume that an entity leases property under a lease agreement that provides for rental payments indexed to changes in interest rates and accounted for as an operating lease. The payments on the lease agreement are reset quarterly based on changes in three-month LIBOR. To hedge the variability in expected future cash flows attributable to interest rate risk, the entity enters into a pay fixed, receive variable interest rate swap based on three-month LIBOR and designates the swap as the hedging instrument in a cash flow hedge of the variability in the lease payments. Assume that the term, notional amounts, repricing dates, and maturity on the operating lease and the interest rate swap match, and the fair value of the interest rate swap at the inception of the hedge is zero. The contract in this Example is a lease agreement with an escalation clause whose rental payments are dependent on LIBOR-based interest rate levels; the contract is not a recognized interest-bearing

~~financial instrument~~ for accounting purposes. Thus, the shortcut method cannot be applied to the operating lease in the Example.

Amendments to Subtopic 820-10

79. Amend paragraph 820-10-15-2, with a link to transition paragraph 842-10-65-1, as follows:

Fair Value Measurement—Overall

Scope and Scope Exceptions

> Other Considerations

> > Topics and Subtopics Not within Scope

820-10-15-2 The Fair Value Measurement Topic does not apply as follows:

- a. To accounting principles that address shares-based payment transactions (this includes Subtopic 505-50 and all Subtopics in Topic 718 except for 718-40, which is within the scope of Topic 820)
- b. To Sections, Subtopics, or Topics that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including both of the following:
 1. Sections, Subtopics, or Topics that permit measurements that are determined on the basis of, or otherwise use, **standalone selling price**
 2. Topic 330.
- c. Subparagraph superseded by Accounting Standards Update No. 2016-02. To accounting principles that address fair value measurements for purposes of lease classification or measurement in accordance with Topic 840. This scope exception does not apply to assets acquired and liabilities assumed in a business combination or an **acquisition by a not-for-profit entity** that are required to be measured at fair value in accordance with Topic 805, regardless of whether those assets and liabilities are related to leases.
- d. To the recognition and measurement of **revenue** from **contracts** with **customers** in accordance with Topic 606
- e. To the recognition and measurement of gains and losses upon the derecognition of nonfinancial assets in accordance with Subtopic 610-20.

Amendments to Subtopic 825-10

80. Amend paragraph 825-10-15-5, with a link to transition paragraph 842-10-65-1, as follows:

Financial Instruments—Overall

Scope and Scope Exceptions

Fair Value Option

> Instruments

825-10-15-5 No entity may elect the fair value option for any of the following financial assets and financial liabilities:

- a. An investment in a subsidiary that the entity is required to consolidate.
- b. An interest in a variable interest entity (VIE) that the entity is required to consolidate.
- c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
- d. Financial assets and financial liabilities recognized under leases as defined in Subtopic ~~842-10-40-10~~ 842-10-40-10. (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
- e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions.
- f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity (including temporary equity) (for example, a convertible debt instrument with the scope of the Cash Conversion Subsections of Subtopic 470-20 or a convertible debt security with a noncontingent beneficial conversion feature).

81. Amend paragraph 825-10-50-8, with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

> Applicability of This Subsection

> > Transactions

825-10-50-8 In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for any of the following:

- a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710, 712, 715, 718, and 960)
- b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20
- c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20
- d. Lease contracts as defined in Topic 842⁸⁴⁰ (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)
- e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)
- f. Unconditional purchase obligations as defined in paragraph 440-10-50-2
- g. Investments accounted for under the equity method in accordance with the requirements of Topic 323
- h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)
- i. Equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position (see Topic 505)
- j. Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)
- k. **Fully benefit-responsive investment contracts** held by an employee benefit plan
- l. Investments in equity securities accounted for under the measurement guidance for equity securities without readily determinable fair values (see Topic 321)
- m. Trade receivables and payables due in one year or less
- n. Deposit liabilities with no defined or contractual maturities.

Amendments to Topic 840

82. Supersede Topic 840, Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 845-10

83. Supersede paragraph 845-10-30-20 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Nonmonetary Transactions—Overall

Initial Measurement

Barter Credit Transactions

> ~~Transfers of Operating Leases for Barter Credits~~

~~845-10-30-20 Paragraph superseded by Accounting Standards Update No. 2016-02. If an exchange involves the transfer or assumption of an operating lease for barter credits, impairment of that lease shall be measured as the amount of the remaining lease costs (discounted rental payments and unamortized leasehold improvements) in excess of the discounted amount of probable sublease rentals for the remaining lease term.~~

Amendments to Subtopic 853-10

84. Amend paragraph 853-10-25-2, with a link to transition paragraph 842-10-65-1, as follows:

Service Concession Arrangements—Overall

Recognition

> The Operating Entity's Rights over the Infrastructure

853-10-25-2 The infrastructure that is the subject of a service concession arrangement within the scope of this Topic shall not be recognized as property, plant, and equipment of the operating entity. Service concession arrangements within the scope of this Topic are not within the scope of Topic ~~840-10-15-9A~~ 840842 on leases, as indicated in paragraph ~~840-10-15-9A~~.

Amendments to Subtopic 860-10

85. Amend paragraph 860-10-15-4, with a link to transition paragraph 842-10-65-1, as follows:

Transfers and Servicing—Overall

Scope and Scope Exceptions

> Transactions

860-10-15-4 The guidance in this Topic does not apply to the following transactions and activities:

- a. Except for transfers of servicing assets (see Section 860-50-40) and for the transfers noted in the following paragraph, transfers of nonfinancial assets
- b. Transfers of unrecognized financial assets, for example, ~~minimum~~ lease payments to be received under operating leases
- c. Transfers of custody of financial assets for safekeeping
- d. Contributions (for guidance on accounting for contributions, see Subtopic 958-605)
- e. Transfers of ownership interests that are in substance sales of nonfinancial assets (For guidance related to transfers or investments that are in substance a sale of a nonfinancial asset, see Subtopic 610-20. For guidance related to sale and leaseback transactions involving real estate, including real estate with equipment, such as manufacturing facilities, power plants, and office buildings with furniture and fixtures, see Subtopic 840-40 842-40 on sale and leaseback transactions.)
- f. Investments by owners or distributions to owners of a business entity
- g. Employee benefits subject to the provisions of Topic 712
- h. Leveraged leases subject to Topic 842 840
- i. **Money-over-money** and wrap lease transactions involving nonrecourse debt subject to Topic 840 842.

86. Amend paragraphs 860-10-55-5 through 55-6 and the related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope

> > > Application of the Term Financial Asset

860-10-55-5 The following implementation guidance addresses whether certain instruments are financial assets, the transfer of which is subject to the guidance in this Subtopic, specifically:

- a. ~~Minimum lease payments and guaranteed residual values under certain leases~~Lease receivables from sales-type leases and direct financing leases
- b. Securitized stranded costs
- c. Judgment from litigation
- d. Forward contract on a financial instrument
- e. Ownership interest in a consolidated subsidiary by its parent if the subsidiary holds nonfinancial assets
- f. Investment in a nonconsolidated investee.

> > > ~~Minimum Lease Payments and Guaranteed Residual Values under Certain Leases~~Lease Receivables from Sales-Type and Direct Financing Leases

860-10-55-6 ~~Lease receivables from sales-type~~Sales-type and direct financing leases receivables secured by leased equipment, referred to as gross investment in lease receivables, are made up of two components: minimum ~~the right to receive~~ lease payments and guaranteed residual values. ~~Minimum lease~~Lease payments for sales-type and direct financing leases involve requirements for lessees to pay cash to lessors and meet the definition of a financial asset. Thus, transfers of minimum lease payments are subject to the requirements of this Subtopic. Residual values represent the lessor's estimate of the salvage value of the leased equipment ~~underlying asset~~ at the end of the lease term and may be either guaranteed or unguaranteed. Residual values meet the definition of financial assets to the extent that they are guaranteed at the inception commencement of the lease. Thus, transfers of residual values guaranteed at inception ~~also are~~ lease receivables from sales-type and direct financing leases are subject to the requirements of this Subtopic. ~~{add glossary link}~~{add glossary link} Unguaranteed residual values ~~assets~~{add glossary link} do not meet the definition of financial assets, nor do residual values guaranteed after ~~commencement~~inception, and transfers of them are not subject to the requirements of this Subtopic.

Amendments to Subtopic 860-20

87. Amend paragraphs 860-20-55-1, 860-20-55-26 through 55-27 and their related heading, and 860-20-55-58 through 55-59 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Transfers and Servicing—Sales of Financial Assets

Implementation Guidance and Illustrations

> Implementation Guidance

860-20-55-1 The following is implementation guidance related to the guidance in this Subtopic, specifically:

- a. Subparagraph superseded by Accounting Standards Update No. 2009-16
- b. Estimating the fair value of certain beneficial interests
- c. Accrued interest receivable
- d. Options embedded in transferred securities
- e. Credit risk associated with transferred assets
- f. **Transfer** of a bond purchased at a premium
- g. Sales or **securitizations** of lease ~~financing~~-receivables
- h. Subparagraph superseded by Accounting Standards Update No. 2009-16
- i. Forward contracts in **revolving-period securitizations**
- j. Subsequent measurement of interests issued in securitization transactions
- k. **Transferor** regains control of assets through a removal-of-accounts provision.

> > Sales or Securitizations of Lease ~~Financing~~-Receivables

860-20-55-26 A transferor of lease ~~financing~~-receivables shall allocate the gross investment in receivables between ~~minimum~~—{add glossary link} lease payments{add glossary link}, residual values guaranteed at inception~~commencement~~, and residual values not guaranteed at inception~~commencement~~ using the individual carrying amounts of those components at the date of transfer. Those transferors also shall record a servicing asset or liability in accordance with Subtopic 860-50, if appropriate.

860-20-55-27 See paragraph 860-10-55-6 for further discussion of lease ~~financing~~ receivables.

> Illustrations

> > Example 5: Transfer of Lease ~~Financing~~-Receivables with Residual Values

860-20-55-58 This Example illustrates the guidance in paragraph 860-20-25-1. At the beginning of the second year in a 10-year sales-type lease, Entity E transfers

for \$505 a nine-tenths participating interest in the ~~minimum-lease payments receivable~~ to an independent third party, and the transfer is accounted for as a sale. Entity E retains a one-tenth participating interest in the ~~minimum-lease payments receivable~~ and a 100 percent interest in the unguaranteed residual ~~asset value of leased equipment~~, which is not subject to the requirements of this Subtopic as discussed in paragraph 860-10-55-6 because it is not a financial asset and, therefore, is excluded from the analysis of whether the transfer of the nine-tenths participating interest in the ~~minimum-lease payments receivable~~ meets the definition of a participating interest. The servicing asset has a fair value of zero because Entity E estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities. The carrying amounts and related gain computation are as follows.

Carrying Amounts

~~Minimum-lease payments~~ Lease receivable	\$ 540
Unearned income related to ~~minimum-lease receivable payments~~	370
Gross investment in ~~minimum-lease receivable payments~~	910
Unguaranteed residual ~~asset value~~	\$ 30
Unearned income related to unguaranteed residual ~~asset value~~	60
Gross investment in unguaranteed residual ~~asset value~~	90
Total gross investment in ~~financing-lease receivable~~	<u>\$ 1,000</u>

Gain on Sale

Cash received	\$ 505
Nine-tenths of carrying amount of gross investment in ~~minimum-lease receivable payments~~	\$819
Nine-tenths of carrying amount of unearned income related to ~~minimum-lease receivable payments~~	333
Net carrying amount of ~~minimum-lease receivable payments~~ sold	486
Gain on sale	<u>\$ 19</u>

860-20-55-59 The following journal entry is made by Entity E.

Journal Entry

Cash	\$ 505
Unearned income	333
Lease receivable	\$ 819
Gain on sale	19

To record sale of nine-tenths of the ~~minimum-lease receivable payments~~ at the beginning of Year 2

Amendments to Subtopic 908-360

88. Amend paragraph 908-360-55-1, with a link to transition paragraph 842-10-65-1, as follows:

Airlines—Property, Plant, and Equipment

Implementation Guidance and Illustrations

> Implementation Guidance

> > Purchase Incentives

908-360-55-1 Credit received as a purchase incentive from an aircraft manufacturer to induce a purchase of that manufacturer's aircraft should be accounted for in accordance with paragraphs 705-20-25-1 through 25-5 for the aircraft that is owned or, if the aircraft is leased, as a lease incentive in accordance with Topic 842 ~~or under a capital lease, or, in the case of an aircraft under an operating lease, amortized over the life of the related aircraft.~~

Amendments to Subtopic 954-470

89. Amend paragraph 954-470-25-1, with a link to transition paragraph 842-10-65-1, as follows:

Health Care Entities—Debt

Recognition

> Financing Authorities

954-470-25-1 When a financing authority issues tax-exempt bonds or similar debt instruments and uses the proceeds for the benefit of a health care entity, the obligation shall be reported as a liability in the entity's balance sheet if the health care entity is responsible for repayment. In some cases, this obligation may take the form of a liability arising from a capital lease. If a health care entity has no obligation to make payments of principal and interest on the debt or capital or operating lease payments on related buildings or equipment, the entity shall not reflect the liability on its balance sheet. In such circumstances, proceeds from the bond issue shall be reported as **contributions** from the sponsoring entity.

90. Amend paragraph 954-470-40-1, with a link to transition paragraph 842-10-65-1, as follows:

Derecognition

954-470-40-1 In a crossover refunding, because the old bonds are not defeased until the crossover date, no immediate gain or loss shall be recognized. If the retirement dates of the old debt have been established, the call premium, unamortized premium or discount, and initial issue costs shall be recognized systematically in the income statement over the remaining life of the old debt as an adjustment of the cost of borrowing related to the old debt. In addition, the income earned on the funds used to consummate the [{add glossary link}](#) advance refunding [{add glossary link}](#) and the interest expense on both the old and new debts shall be recognized in the income statement. The funds used to consummate the advance refunding shall be reported as an asset and both the old and new debts shall be reported as liabilities. The assets and liabilities shall not be offset.

Amendments to Subtopic 958-805

91. Amend paragraphs 958-805-25-9 and 958-805-25-11, with a link to transition paragraph 842-10-65-1, as follows:

Not-for-Profit Entities—Business Combinations

Recognition

Merger of Not-for-Profit Entities

> Classifying or Designating Assets and Liabilities in a Merger

958-805-25-9 In some situations, GAAP provides for different accounting depending on how an entity classifies or designates a particular asset or liability. Paragraphs 805-20-25-7 through 25-8 provide examples of such classifications and designations. The new NFP shall carry forward into the opening balances in its financial statements (see paragraph 958-805-45-2(a)) the merging entities' classifications and designations unless either of the following situations applies:

- a. The merger results in a modification of a contract in a manner that would change those previous classifications or designations; for example, if the provisions of a lease are modified and the modification is not accounted for as a separate contract in accordance with ~~in a way that would require~~

~~the revised agreement to be considered a new agreement under paragraph 842-10-25-8840-10-35-4~~

- b. Reclassifications are necessary to conform accounting policies in accordance with paragraph 958-805-30-2.

958-805-25-10 In situation (a) in the preceding paragraph, the new NFP shall classify or designate the asset or liability on the basis of the contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the date of that modification. In situation (b) in the preceding paragraph, the new NFP shall classify or designate the asset or liability on the basis of the conformed accounting policies at the merger date.

958-805-25-11 At the merger date, the new NFP may contemplate renegotiating and modifying leases of the business or nonprofit activity acquired. Modifications made after the merger date, including those that were planned at the time of the combination, are postcombination events that should be accounted for separately by the new NFP in accordance with Topic ~~842~~840.

Amendments to Subtopic 958-810

- 92. Amend paragraph 958-810-25-10, with a link to transition paragraph 842-10-65-1, as follows:

Not-for-Profit Entities—Consolidation

Recognition

> Special-Purpose-Entity Lessors

958-810-25-8 Notwithstanding the guidance in this Subtopic, an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor shall consider whether it should consolidate such lessor. Specifically, such an NFP shall consolidate an SPE lessor if all of the following conditions exist:

- a. Substantially all of the activities of the SPE involve assets that are to be leased to a single lessee.
- b. The expected substantive residual risks and substantially all the residual rewards of the leased asset(s) and the obligation imposed by the underlying debt of the SPE reside directly or indirectly with the lessee through means such as any of the following:
 1. The lease agreement
 2. A residual value guarantee through, for example, the assumption of first-dollar-of-loss provisions
 3. A guarantee of the SPE's debt

4. An option granting the lessee a right to do either of the following:
 - i. To purchase the leased asset at a fixed price or at a defined price other than fair value determined at the date of exercise
 - ii. To receive any of the lessor's sales proceeds in excess of a stipulated amount.
- c. The owner (or owners) of record of the SPE has not made an initial substantive residual equity capital investment that is at risk during the entire **lease term**. This criterion shall be considered met if the majority owner (or owners) of the lessor is not an independent third party, regardless of the level of capital investment.

958-810-25-9 To satisfy the at-risk requirement in item (c) in the preceding paragraph, an initial substantive residual equity capital investment shall meet all of the following conditions:

- a. It represents an equity interest in legal form.
- b. It is subordinate to all debt interests.
- c. It represents the residual equity interest during the entire lease term.

958-810-25-10 If all of the conditions in paragraph 958-810-25-8 exist, the assets, liabilities, results of operations, and cash flows of the SPE shall be consolidated in the lessee's financial statements. This conclusion shall be applied to SPEs that are established for both the construction and subsequent lease of an asset for which the lease would meet all of the conditions in paragraph 958-810-25-8. In those cases, the consolidation by the lessee shall begin at the **lease inception** rather than the beginning of the lease term. For related implementation guidance, see paragraphs 958-810-55-7 through 55-16 and 958-840-55-1.

93. Amend paragraphs 958-810-55-7 and 958-810-55-14, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Special-Purpose-Entity Lessors

958-810-55-7 For an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor, this implementation guidance addresses the following matters:

- a. Multiple properties within a single SPE lessor
- b. Multitiered SPE structures
- c. Payments to equity owners of an SPE during the **lease term**
- d. Fees paid to owners of record of an SPE
- e. Source of initial minimum equity investment

- f. Payment to owners of record of an SPE before the lease term
- g. Subparagraph superseded by Accounting Standards Update No. 2016-02, Interest-only payments.

> > > Fees Paid to Owners of Record of an SPE

958-810-55-14 Paragraph ~~840-10-25-6(e)~~842-10-30-5(e) states that, for a lessee, ~~minimum~~ lease payments include fees that are paid by the lessee to the owners of the special-purpose entity for structuring the lease transaction. Paragraph ~~840-10-25-6(e)~~842-10-30-5(e) states that such fees shall be included as part of ~~minimum~~ lease payments (but shall not be included in the fair value of the ~~leased property underlying asset~~) for purposes of applying the ~~90-percent test criterion~~ in paragraph ~~840-10-25-1(d)~~842-10-25-2(d). With respect to the SPE and the application of the guidance in paragraph 958-810-25-8, the fees paid by the lessee to the owners of the SPE shall be considered a return of the owners' initial equity capital investment. To the extent that the fees reduce the equity capital investment below the minimum amount required, the owners of record would not be considered to have a substantive residual equity capital investment that is at risk during the entire term of the lease.

Amendments to Subtopic ~~958-840~~

94. Supersede Subtopic 958-840, Not-for-Profit Entities—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 970-10

95. Amend paragraph 970-10-05-1, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—General—Overall

Overview and Background

General

970-10-05-1 The Codification contains several Topics for Real Estate due to the differing accounting treatment for various real estate subindustries. The Topics include:

- a. Real Estate—General
- b. Real Estate—Common Interest Realty Associations
- c. Real Estate—Real Estate Investment Trusts

- d. Real Estate—Retail Land
- e. Real Estate—Time-Sharing Activities.

Additionally, Subtopic ~~360-20~~ 842-40 provides accounting guidance for the sale of real estate that is part of a sale-leaseback sale and leaseback transaction.

96. Amend paragraph 970-10-15-8, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

Real Estate Project Costs

> Transactions

970-10-15-8 The guidance in the Real Estate Project Costs Subsections does not apply to the following transactions and activities:

- a. Real estate developed by an entity for use in its own operations, other than for sale or rental. In this context, real estate developed by a member of a consolidated group for use in the operations of another member of the group (for example, a manufacturing facility developed by a subsidiary for use in its parent's operations) when the property is reported in the group's consolidated financial statements. However, this does not include property reported in the separate financial statements of the entity that developed it.
- b. Initial direct costs of ~~sales type, operating, and other types of leases,~~ which are defined in Topic ~~842~~ 840. The accounting for initial direct costs of leases is prescribed in that Topic.
- c. Costs directly related to manufacturing, merchandising, or service activities as distinguished from real estate activities.

Amendments to Subtopic 970-340

97. Amend paragraph 970-340-25-16, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—General—Other Assets and Deferred Costs

Recognition

Real Estate Project Costs

> Costs Incurred to Sell and Rent Real Estate Projects, Including Initial Rental Operations

> > Costs Incurred to Rent Real Estate Projects

970-340-25-16 If costs incurred to rent real estate projects, other than {add glossary link}initial direct costs{add glossary link}, under {add glossary link}operating leases{add glossary link} or direct financing leases are related to and their recovery is reasonably expected from future rental operations, they shall be capitalized. Examples are costs of model units and their furnishings, rental facilities, semipermanent signs, grand openings, and unused rental brochures. Costs that do not meet the criteria for capitalization shall be expensed as incurred, for example, rental overhead. Initial direct costs are defined in Topic 842³⁴⁰ and the accounting for initial direct costs is prescribed in that Topic^{Subtopic 840-20}.

98. Amend paragraph 970-340-35-2, with a link to transition paragraph 842-10-65-1, as follows:

Subsequent Measurement

Real Estate Project Costs

> Determining Amounts to Be Capitalized or Expensed

> > Costs Incurred to Rent Real Estate Projects

970-340-35-2 Capitalized rental costs directly related to revenue from a specific {add glossary link}operating lease{add glossary link} or direct financing lease, other than initial direct costs, shall be amortized over the {add glossary link}lease term{add glossary link}. Capitalized rental costs^{costs, other than initial direct costs}, not directly related to revenue from a specific-operating-{add glossary link}lease{add glossary link} shall be amortized over the period of expected benefit. The amortization period shall begin when the project is substantially completed and held available for occupancy. See paragraphs 970-340-25-18 through 25-19 for the definition of substantially completed and held available for occupancy. Initial direct costs are defined in Topic 842 on leases, and the accounting for initial direct costs is prescribed in that Topic. Topic 842 does not address whether a lessee that accounts for the sale or rental of real estate projects under Topic 970 should capitalize rental costs associated with ground and building leases.

Amendments to Subtopic 972-10

99. Amend paragraph 972-10-05-1, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Common Interest Realty Associations—Overall

Overview and Background

General

972-10-05-1 The Codification contains several Topics for real estate due to the differing accounting treatment for various real estate subindustries. The Topics include:

- a. Real Estate—General
- b. Real Estate—Common Interest Realty Associations
- c. Real Estate—Real Estate Investment Trusts
- d. Real Estate—**Time-Sharing** Activities
- e. Real Estate—Retail Land.

See also Subtopic 360-20-842-10 for accounting guidance for the sale of real estate that is part of a sale-leaseback sale and leaseback transaction.

Amendments to Subtopic 974-10

100. Amend paragraph 974-10-05-1, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Real Estate Investment Trusts

Overview and Background

General

974-10-05-1 The Codification contains several Topics for real estate due to the differing accounting treatment for various real estate subindustries. The Topics include:

- a. Real Estate—General
- b. Real Estate—Common Interest Realty Associations
- c. Real Estate—Real Estate Investment Trusts

- d. Real Estate—Time-Sharing Activities
- e. Real Estate—Retail Land.

See also Subtopic ~~360-20842-40~~ for accounting guidance for the sale of real estate that is part of a ~~sale-leaseback sale and leaseback~~ transaction.

Amendments to Subtopic 974-840

101. Supersede Subtopic 974-840, Real Estate—Real Estate Investment Trusts—Leases, with a link to transition paragraph 842-10-65-1.

[Paragraphs 974-840-05-1 and 974-840-15-1 moved to paragraphs 974-842-05-1 and 974-842-15-1, and paragraph 974-840-25-1 amended and moved to paragraph 974-842-25-1]

Addition of Subtopic 974-842

102. Add Subtopic 974-842, Real Estate—Real Estate Investment Trusts—Leases, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Real Estate—Real Estate Investment Trusts—Leases

Overview and Background

General

974-842-05-1 This Subtopic addresses recognition issues for a **real estate investment trust** with an investment in a **service corporation** providing leasing services. **[Content moved from paragraph 974-840-05-1]**

Scope and Scope Exceptions

General

> Overall Guidance

974-842-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 974-10-15. [Content moved from paragraph 974-840-15-1]

Glossary

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Initial Direct Costs

Incremental costs of a **lease** that would not have been incurred if the lease had not been obtained.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Real Estate Investment Trust

Real estate investment trusts generally are formed as trusts, associations, or corporations. They employ equity capital, coupled with substantial amounts of debt financing, in making real estate loans and investments. Real estate investment trusts must distribute substantially all of their taxable income to their shareholders annually in order to retain their favorable tax status (that is, dividends paid are treated as deductions in arriving at taxable income).

Service Corporation

A real estate investment trust may establish a service corporation to perform services for the real estate investment trust or for third parties. Service corporations may provide property management and leasing services, as well as services to acquire, develop, construct, finance, or sell real estate projects.

Recognition

General

974-842-25-1 Regardless of the method of accounting used by a **real estate investment trust** for its investment in a **service corporation**, the service corporation shall not be considered an independent third party and the amount of

costs capitalized by the real estate investment trust for leasing services provided by the service corporation shall be no greater than the amount of {add glossary link}initial direct costs{add glossary link} (see paragraphs 842-10-30-9 through 30-10840-20-25-17 through 25-20) that would have been capitalized had the real estate investment trust incurred the costs directly. [Content amended as shown and moved from paragraph 974-840-25-1]

Amendments to Subtopic 976-10

103. Amend paragraph 976-10-05-1, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Retail Land—Overall

Overview and Background

General

976-10-05-1 The Codification contains several Topics for real estate due to the differing accounting treatment for various real estate subindustries. The Topics include:

- a. Real Estate—General
- b. Real Estate—Common Interest Realty Associations
- c. Real Estate—Real Estate Investment Trusts
- d. Real Estate—Retail Land
- e. Real Estate—Time-Sharing Activities.

See also Subtopic 360-20-842-40 for accounting guidance for the sale of real estate that is part of a sale-leaseback-sale and leaseback transaction.

Amendments to Subtopic 978-10

104. Amend paragraphs 978-10-05-1 and 978-10-05-2, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Time-Sharing Activities—Overall

Overview and Background

978-10-05-1 The Codification contains several Topics for real estate due to the differing accounting treatment for various real estate subindustries. The Topics include:

- a. Real Estate—General
- b. Real Estate—Common Interest Realty Associations
- c. Real Estate—Real Estate Investment Trusts
- d. Real Estate—Time-Sharing Activities
- e. Real Estate—Retail Land.

See also Subtopic ~~360-20-842-40~~ for accounting guidance for the sale of real estate that is part of a ~~sale-leaseback sale and leaseback~~ transaction.

978-10-05-2 The Real Estate—Time-Sharing Activities Topic addresses the unique accounting and reporting issues for real estate **time-sharing** activities. This Topic includes the following Subtopics:

- a. Overall
- b. Statement of Cash Flows
- c. Accounting Changes and Error Corrections
- d. Receivables
- e. Inventory
- f. Other Assets and Deferred Costs
- g. Subparagraph superseded by Accounting Standards Update No. 2014-09
- h. Other Expenses
- i. Consolidation
- j. Subparagraph superseded by Accounting Standards Update No. 2016-02, Leases.

Amendments to Subtopic 978-330

105. Amend paragraph 978-330-35-6, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Time-Sharing Activities—Inventory

Subsequent Measurement

> Operations during Holding Periods

978-330-35-6 If rental activities occur other than during the holding period, the corresponding units shall be depreciated and those activities shall be accounted

for as rental operations in accordance with Subtopic 842-30 on leases—lessor840-29.

Amendments to Subtopic 978-840

106. Supersede Subtopic 978-840, Real Estate—Time-Sharing Activities—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 980-250

107. Amend paragraph 980-250-55-3, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Accounting Changes and Error Corrections

Implementation Guidance and Illustrations

> Implementation Guidance

>> Accounting Changes

~~980-250-55-3~~ If a regulated entity changes accounting methods and the change does not affect costs that are allowable for rate-making purposes, the regulated entity would apply the change in the same manner as would an unregulated entity. ~~Capitalization of leases with no income statement effect (see paragraphs 980-840-45-1 through 45-4) is an example of that type of change.~~ If a regulated entity changes accounting methods and the change affects **allowable costs** for rate-making purposes, the change generally would be implemented in the way that it is implemented for regulatory purposes. A change in the method of accounting for research and development costs, either from a policy of capitalization and amortization to one of charging those costs to expense as incurred or vice versa, is an example of that type of change.

Amendments to Subtopic 980-340

108. Amend paragraph 980-340-25-4, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Other Assets and Deferred Costs

Recognition

> Effects of Regulation

> > Phase-In Plans

980-340-25-4 The following Examples illustrate various circumstances that may or may not constitute phase-in plans:

- a. Example 1 (see paragraph 980-340-55-9) illustrates a sale with leaseback as a capital finance lease.
- b. Example 2 (see paragraph 980-340-55-12) illustrates a sale with leaseback as an operating lease.
- c. Example 3 (see paragraph 980-340-55-15) illustrates a sale with leaseback with profit recognition accelerated.
- d. Example 4 (see paragraph 980-340-55-18) illustrates the modified depreciation method.
- e. Example 5 (see paragraph 980-340-55-21) illustrates deferred costs before a rate order is issued.
- f. Example 7 (see paragraph 980-340-55-39) illustrates a phase-in plan for two plants completed at different times that share common facilities.

109. Amend paragraphs 980-340-55-10 through 55-11 and their related heading, 980-340-55-13 through 55-14 and 980-340-55-16 through 55-17 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Sale with Leaseback—Capital Finance Lease

980-340-55-9 This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.

980-340-55-10 Utility B sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The arrangement would not qualify for sale and leaseback accounting in accordance with Subtopic 842-40 because the leaseback would be classified as a finance lease. However, the arrangement previously qualified as a sale and a capital leaseback in accordance with Subtopic 840-40 before the effective date of Topic 842. Therefore, Utility B continues to account for the arrangement as a sale and a leaseback. The sale meets the criteria

of Section 360-20-40 for recognition as a sale, and the leaseback meets the criteria of Subtopic 840-30 for a capital lease. Utility B's regulator includes the lease rentals in allowable cost as they accrue. In the past, Utility B's regulator has treated other leases entered into by Utility B in the same manner, but those leases were for much less significant items of equipment—not for an interest in an electric generating plant.

980-340-55-11 The rate-making method described is a phase-in plan under the definition in this Subtopic. Generally accepted accounting principles (GAAP) applicable to entities in general require a capital/finance lease to be accounted for much like a purchase of the leased property/underlying asset. The resulting expense related to the lease consists of interest on the remaining lease obligation and depreciation based on the method used for similar owned property/assets. In the early years of a lease, the lease rentals included in allowable cost as they accrue are significantly less than the sum of interest on the lease obligation and depreciation on the leased asset. Thus, significant deferrals will result. The method also defers recognition of expenses compared with the methods of expense recognition used by Utility B's regulator for similar assets of Utility B prior to 1982 because Utility B's interests in electric generating plants were included in **allowable costs** in the past based on current provisions for depreciation and for the cost of capital invested in the plants. The use of this rate-making method in the past for leases of equipment does not change this conclusion. The definition is based on the method of rate-making used prior to 1982 for similar allowable costs. Similar allowable costs would be those resulting from electric generating plants.

> > **Example 2: Sale with Leaseback—Operating Lease**

980-340-55-12 This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.

980-340-55-13 Utility C sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The arrangement qualifies as a sale, and the leaseback in accordance with meets the criteria of Subtopic 842-40. The leaseback is classified as 840-20 for an operating lease. Utility C's regulator includes the lease payments/rentals in allowable cost as they accrue. In the past, Utility C's regulator has treated other leases entered into by Utility C in the same manner, but those leases were not for an interest in an electric generating plant.

980-340-55-14 The rate-making method applied to Utility C is not a phase-in plan under the definition in this Subtopic because it recognizes rent/lease expense for rate-making purposes in the same way as that expense would be recognized for entities in general for this type of lease.

> > Example 3: Sale with Leaseback—Profit Recognition Accelerated—Finance Lease

980-340-55-15 This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.

980-340-55-16 Utility D sells its interest in a 5-year-old electric generating plant for an amount that exceeds its undepreciated cost by \$500,000 and leases that interest back. The leaseback term is 20 years, and there are no renewal options. The arrangement would not qualify for sale and leaseback accounting in accordance with Subtopic 842-40 because the leaseback would be classified as a finance lease. However, the arrangement previously qualified as a sale and a capital leaseback in accordance with Subtopic 840-40 before the effective date of Topic 842. Therefore, Utility D continues to account for the arrangement as a sale and a leaseback. The sale meets the criteria of Section 360-20-40 for recognition ~~as a sale with full profit recognition, and the leaseback meets the criteria of Subtopic 840-20 for an operating lease.~~ Utility D's regulator includes the lease ~~rentals~~ payments in allowable cost as they accrue and orders Utility D to amortize the profit, for rate-making purposes, over 10 years. The sale occurred at a time when Utility D was about to place a newly completed plant in service. Utility D has not had any similar transactions in the past.

980-340-55-17 The rate-making method described is a phase-in plan under the definition in this Subtopic. GAAP applicable to entities in general at the time of entering into this arrangement require a profit on a ~~sale-leaseback~~ sale and leaseback transaction to be amortized over the term of the leaseback. Amortization of that profit, for rate-making purposes, over 10 years when GAAP applicable to entities in general at that time ~~required~~ require amortization over the 20-year leaseback term is equivalent to a deferral of allowable costs. In view of the timing of the rate order on the sale and leaseback ~~sale-leaseback~~ transaction, the presumption is that the order was issued in connection with the newly completed plant. The method cannot be compared with methods in use prior to 1982 because Utility D has had no previous transactions of this type.

Amendments to Subtopic 980-605

110. Amend paragraph 980-605-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Revenue Recognition

Scope and Scope Exceptions

> Transactions

980-605-15-3 The scope of this Subtopic excludes long-term power supply contracts if they are within the scope of Topic 842 on leases that would qualify for lease accounting pursuant to Topic 840. For a discussion of the considerations required to determine whether a long-term power sales contract arrangement contains a lease, see Subtopic 842-10-840-10.

Amendments to Subtopic 980-815

111. Amend paragraph 980-815-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Derivatives and Hedging

Scope and Scope Exceptions

> Transactions

980-815-15-3 The scope of this Subtopic excludes long-term power supply contracts if they are within the scope of that would qualify for lease accounting pursuant to Topic 842 on leases 840. For a discussion of the considerations required to determine whether a long-term power sales contract arrangement contains a lease, see Subtopic 842-10-840-10.

Amendments to Subtopic 980-840

112. Supersede Subtopic 980-840, Regulated Operations—Leases, with a link to transition paragraph 842-10-65-1.

[Paragraphs 980-840-05-1 and 980-840-15-1 moved to paragraphs 980-842-05-1 and 980-842-15-1; paragraphs 980-840-25-1 through 25-3 and their related heading amended and moved to paragraphs 980-842-25-1 through 25-3; paragraph 980-840-35-2 and its related heading amended and moved to paragraph 980-842-35-1; and paragraphs 980-840-45-1 through 45-4 and 980-840-55-1 amended and moved to paragraphs 980-842-45-1 through 45-4 and 980-842-55-1]

Addition of Subtopic 980-842

113. Add Subtopic 980-842, Regulated Operations—Leases, with a link to transition paragraph 842-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Regulated Operations—Leases

Overview and Background

General

980-842-05-1 This Subtopic provides guidance on accounting for leases for entities with regulated operations. [Content moved from paragraph 980-840-05-1]

Scope and Scope Exceptions

General

> Overall Guidance

980-842-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 980-10-15. [Content moved from paragraph 980-840-15-1]

Glossary

Allowable Costs

All costs for which revenue is intended to provide recovery. Those costs can be actual or estimated. In that context, allowable costs include interest cost and amounts provided for earnings on shareholders' investments.

Phase-In Plan

Any method of recognition of allowable costs in rates that meets all of the following criteria:

- a. The method was adopted by the regulator in connection with a major, newly completed plant of the regulated entity or of one of its suppliers or a major plant scheduled for completion in the near future.
- b. The method defers the rates intended to recover allowable costs beyond the period in which those allowable costs would be charged to expense

under generally accepted accounting principles (GAAP) applicable to entities in general.

- c. The method defers the rates intended to recover allowable costs beyond the period in which those rates would have been ordered under the rate-making methods routinely used prior to 1982 by that regulator for similar allowable costs of that regulated entity.

Recognition

General

> ~~Sale-Leaseback~~Sale and Leaseback Transactions

980-842-25-1 Accounting for ~~sale and leaseback~~sale and leaseback transactions in accordance with the guidance in Subtopic ~~842-40~~840-40 may result in a difference between the timing of income and expense recognition required by that Subtopic and the timing of income and expense recognition for rate-making purposes. **[Content amended as shown and moved from paragraph 980-840-25-1]**

980-842-25-2 That difference shall be accounted for as follows:

- a. If the difference in timing of income and expense recognition constitutes all or a part of a phase-in plan, it shall be accounted for in accordance with Subtopic 980-340.
- b. Otherwise, the timing of income and expense recognition related to the sale and leaseback~~sale and leaseback~~ transaction shall be modified as necessary to conform to the Regulated Operations Topic. That modification required for a transaction that is accounted for by the ~~deposit method or~~ for as a financing is further described in the following paragraph and paragraphs 980-840-35-1 through 35-2. **[Content amended as shown and moved from paragraph 980-840-25-2]**

980-842-25-3 The difference between the amount of income or expense recognized for a transaction that is not part of a phase-in plan and that is accounted for by the ~~deposit method or~~ as a financing under Subtopic ~~842-40~~840-40 and the amount of income or expense included in allowable cost for rate-making purposes shall be capitalized or accrued as a separate regulatory-created asset or liability, as appropriate, if that difference meets the criteria of the Regulated Operations Topic. **[Content amended as shown and moved from paragraph 980-840-25-3]**

Subsequent Measurement

General

> ~~Sale-Leaseback~~ Sale and Leaseback Transactions

980-842-35-1 Similarly, if the ~~sale-leaseback~~ sale and leaseback transaction is accounted for as a financing and the sale is recognized for rate-making purposes, the total of interest imputed under the interest method for the financing and the ~~amortization~~ depreciation of the underlying asset shall be modified to equal the total ~~rental~~ lease expense and the gain or loss allowable for rate-making purposes. **[Content amended as shown and moved from paragraph 980-840-35-2]**

Other Presentation Matters

General

> Treatment of Leases for Rate-Making Purposes

980-842-45-1 Topic 842840 specifies criteria for classification of leases and the method of accounting for each type of lease. For rate-making purposes, a lease may be treated as an operating lease even though the lease would be classified as a finance ~~capital~~ lease under those criteria. In effect, the amount of the lease payment is included in **allowable costs** as rental expense in the period it covers. **[Content amended as shown and moved from paragraph 980-840-45-1]**

980-842-45-2 For financial reporting purposes, the classification of the lease is not affected by the regulator's actions. The regulator cannot eliminate an obligation that was not imposed by the regulator (see paragraph 980-405-40-1). Also, by including the lease payments as allowable costs, the regulator sets rates that will provide revenue approximately equal to the combined amount of the ~~capitalized leased~~ right-of-use asset and interest on the lease ~~liability~~ obligation over the term of the lease and, thus, provides reasonable assurance of the existence of an asset (see paragraph 980-340-25-1). Accordingly, regulated entities shall classify leases in accordance with Topic 842840. **[Content amended as shown and moved from paragraph 980-840-45-2]**

980-842-45-3 The nature of the expense elements related to a finance ~~capitalized~~ lease (amortization of the ~~leased~~ right-of-use asset and interest on the lease ~~obligation~~ liability) is not changed by the regulator's action; however, the timing of expense recognition related to the lease would be modified to conform to the rate treatment. Thus, amortization of the ~~leased~~ right-of-use asset shall be modified so that the total of interest on the lease ~~liability~~ obligation and amortization of the ~~leased~~ right-of-use asset shall equal the ~~rental~~ lease expense that was allowed for

rate-making purposes. For newly completed plants such regulatory treatment could result in a **phase-in plan** as defined in Subtopic 980-340. **[Content amended as shown and moved from paragraph 980-840-45-3]**

980-842-45-4 Paragraph 840-30-45-3842-20-45-4 states that an entity is not required to classify the interest expense ~~or~~ amortization of the right-of-use asset in a finance lease ~~leased assets to be classified~~ as separate items in an income statement. For example, the amounts of amortization of the right-of-use asset ~~capitalized leased nuclear fuel~~ and interest on the related lease ~~obligation~~ liability could each be combined with other costs and ~~displayed as fuel cost~~ presented in a manner consistent with how the entity presents depreciation or amortization of similar assets and other interest expense. However, the disclosure of total interest cost incurred, required by Subtopic 835-20, shall include the interest on that lease ~~liability~~ obligation; and the disclosure of the total amortization ~~of the entity's right-of-use assets arising under a finance lease and interest on finance lease liabilities~~ charge, required by ~~Section 842-20-50~~ Topic 840, shall include amortization of that ~~leased asset~~ right-of-use asset and interest on that lease liability. **[Content amended as shown and moved from paragraph 980-840-45-4]**

Implementation Guidance and Illustrations

> Implementation Guidance

> > Income Statement Classification

980-842-55-1 Paragraph 840-30-45-3842-20-45-4 states that an entity is not required to classify the interest expense ~~or~~ amortization of leased assets the right-of-use asset in a finance lease as separate items in an income statement. However, that paragraph also states that the interest expense and unless the charge to income resulting from the amortization of the right-of-use asset in a finance lease should be presented in a manner consistent with how the entity presents depreciation or amortization of similar assets and other interest expense ~~assets recorded under capital leases is included by the lessee with depreciation expense and the fact that it is so included is disclosed, the amortization charge shall be separately disclosed by the lessee in the financial statements or footnotes thereto~~. For example, the amounts of amortization of ~~capitalized leased nuclear fuel~~ the right-of-use asset and interest on the related lease ~~obligation~~ liability could each be combined with other costs and presented in a manner consistent with how the entity presents depreciation or amortization of similar assets and other interest expense ~~displayed as fuel cost~~. However, in that circumstance, the disclosure of total interest cost incurred, required by Subtopic 835-20, would include the interest on that lease ~~liability~~ obligation; and the disclosure of the total amortization of the entity's right-of-use assets arising under

a finance lease and interest on finance lease liabilities charge, required by Section 842-20-50 paragraph 840-30-45-3, would include amortization of that leased asset right-of-use asset and interest on that lease liability. **[Content amended as shown and moved from paragraph 980-840-55-1]**

114. Amend paragraph 205-40-00-1, by adding the following items to the table, as follows:

205-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
205-40-55-3	Added	2016-02	02/25/2016

115. Amend paragraph 210-20-00-1, by adding the following items to the table, as follows:

210-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
210-20-15-3	Amended	2016-02	02/25/2016
210-20-60-4	Amended	2016-02	02/25/2016

116. Amend paragraph 230-10-00-1, by adding the following items to the table, as follows:

230-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Liability	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Right-of-Use Asset	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
230-10-50-4	Amended	2016-02	02/25/2016
230-10-55-10	Amended	2016-02	02/25/2016
230-10-55-11	Amended	2016-02	02/25/2016
230-10-55-13	Amended	2016-02	02/25/2016
230-10-55-15	Amended	2016-02	02/25/2016
230-10-55-19	Amended	2016-02	02/25/2016
230-10-55-20	Amended	2016-02	02/25/2016

117. Amend Paragraph 255-10-00-1, by adding the following items to the table, as follows:

255-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016

Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Net Investment in the Lease	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Unguaranteed Residual Asset	Added	2016-02	02/25/2016
255-10-55-6	Amended	2016-02	02/25/2016
255-10-55-7A	Added	2016-02	02/25/2016
255-10-55-8	Amended	2016-02	02/25/2016
255-10-55-10	Amended	2016-02	02/25/2016
255-10-55-11	Amended	2016-02	02/25/2016

118. Amend paragraph 270-10-00-1, by adding the following items to the table, as follows:

270-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
270-10-50-6A	Added	2016-02	02/25/2016

119. Amend paragraph 274-10-00-1, by adding the following item to the table, as follows:

274-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
274-10-50-2	Amended	2016-02	02/25/2016

120. Amend paragraph 310-10-00-1, by adding the following items to the table, as follows:

310-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Sales-type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
310-10-35-13	Amended	2016-02	02/25/2016
310-10-40-5	Amended	2016-02	02/25/2016
310-10-55-14	Amended	2016-02	02/25/2016

121. Amend paragraph 310-20-00-1, by adding the following item to the table, as follows:

310-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-20-15-1	Amended	2016-02	02/25/2016

122. Amend paragraph 310-30-00-1, by adding the following item to the table, as follows:

310-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-30-15-2	Amended	2016-02	02/25/2016

123. Amend paragraph 310-40-00-1, by adding the following items to the table, as follows:

310-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Modification	Added	2016-02	02/25/2016
310-40-15-11	Amended	2016-02	02/25/2016

124. Amend paragraph 323-740-00-1, by adding the following item to the table, as follows:

323-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
323-740-25-3	Amended	2016-02	02/25/2016

125. Amend paragraph 340-10-00-1, by adding the following item to the table, as follows:

340-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
340-10-60-1	Amended	2016-02	02/25/2016

126. Amend paragraph 360-10-00-1, by adding the following items to the table, as follows:

360-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Lease	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Performance Obligation	Added	2016-02	02/25/2016
Revenue	Added	2016-02	02/25/2016
Right-of-Use Asset	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
360-10-05-1	Amended	2016-02	02/25/2016
360-10-15-4	Amended	2016-02	02/25/2016
360-10-30-8	Amended	2016-02	02/25/2016
360-10-40-2	Amended	2016-02	02/25/2016
360-10-55-43	Amended	2016-02	02/25/2016

127. Amend paragraph 360-20-00-1, by adding the following items to the table, as follows:

360-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Conduit Debt Securities	Superseded	2016-02	02/25/2016
Cost Recovery Method	Superseded	2016-02	02/25/2016
Deposit Method	Superseded	2016-02	02/25/2016
Fair Value (2nd. def.)	Superseded	2016-02	02/25/2016
Installment Method	Superseded	2016-02	02/25/2016

Integral Equipment	Superseded	2016-02	02/25/2016
Market Participants	Superseded	2016-02	02/25/2016
Nonpublic Entity (1st def.)	Superseded	2016-02	02/25/2016
Orderly Transaction	Superseded	2016-02	02/25/2016
Reduced-Profit Method	Superseded	2016-02	02/25/2016
Related Parties	Superseded	2016-02	02/25/2016
Sale-Leaseback Accounting	Superseded	2016-02	02/25/2016
360-20-05-1	Superseded	2016-02	02/25/2016
360-20-05-2	Superseded	2016-02	02/25/2016
360-20-15-1 through 15-10	Superseded	2016-02	02/25/2016
360-20-40-1 through 40-64	Superseded	2016-02	02/25/2016
360-20-55-1 through 55-10	Superseded	2016-02	02/25/2016
360-20-55-12 through 55-17	Superseded	2016-02	02/25/2016
360-20-55-19 through 55-67	Superseded	2016-02	02/25/2016
360-20-60-1 through 60-3	Superseded	2016-02	02/25/2016

128. Amend paragraph 410-20-00-1, by adding the following items to the table, as follows:

410-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016

Lease Payments	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
410-20-15-2	Amended	2016-02	02/25/2016
410-20-15-3	Amended	2016-02	02/25/2016
410-20-55-44	Amended	2016-02	02/25/2016

129. Amend paragraph 420-10-00-1, by adding the following items to the table, as follows:

420-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
420-10-05-2	Amended	2016-02	02/25/2016
420-10-15-3	Amended	2016-02	02/25/2016
420-10-25-11	Amended	2016-02	02/25/2016
420-10-30-8	Superseded	2016-02	02/25/2016
420-10-55-11 through 55-15	Superseded	2016-02	02/25/2016

130. Amend paragraph 440-10-00-1, by adding the following items to the table, as follows:

440-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016

Underlying Asset	Added	2016-02	02/25/2016
440-10-25-1	Amended	2016-02	02/25/2016
440-10-25-2	Amended	2016-02	02/25/2016
440-10-50-1	Amended	2016-02	02/25/2016
440-10-50-3	Amended	2016-02	02/25/2016
440-10-60-12	Amended	2016-02	02/25/2016
440-10-60-13	Amended	2016-02	02/25/2016

131. Amend paragraph 450-10-00-1, by adding the following items to the table, as follows:

450-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
450-10-60-8	Amended	2016-02	02/25/2016

132. Amend paragraph 450-20-00-1, by adding the following items to the table, as follows:

450-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016

Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
450-20-60-15	Amended	2016-02	02/25/2016
450-20-60-16	Amended	2016-02	02/25/2016

133. Add paragraph 450-30-00-1 as follows:

450-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
450-30-60-5	Amended	2016-02	02/25/2016

134. Amend paragraph 460-10-00-1, by adding the following items to the table, as follows:

460-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Term	Amended	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
460-10-15-7	Amended	2016-02	02/25/2016
460-10-25-1	Amended	2016-02	02/25/2016
460-10-30-2	Amended	2016-02	02/25/2016
460-10-55-17	Amended	2016-02	02/25/2016
460-10-55-23	Amended	2016-02	02/25/2016
460-10-60-3	Amended	2016-02	02/25/2016
460-10-60-16 through 60-18	Amended	2016-02	02/25/2016
460-10-60-19	Superseded	2016-02	02/25/2016
460-10-60-20 through 60-24	Amended	2016-02	02/25/2016
460-10-60-25 through 60-27	Superseded	2016-02	02/25/2016
460-10-60-29 through 60-31	Superseded	2016-02	02/25/2016
460-10-60-32	Amended	2016-02	02/25/2016
460-10-60-33	Superseded	2016-02	02/25/2016

135. Amend paragraph 470-10-00-1, by adding the following items to the table, as follows:

470-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
470-10-60-4	Amended	2016-02	02/25/2016

136. Amend paragraph 470-60-00-1 as follows:

470-60-00-1 ~~No updates have been made to this Subtopic.~~ The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Modification	Added	2016-02	02/25/2016
470-60-15-11	Amended	2016-02	02/25/2016

137. Amend paragraph 606-10-00-1, by adding the following items to the table, as follows:

606-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Lease	Added	2016-02	02/25/2016
606-10-15-2	Amended	2016-02	02/25/2016
606-10-55-68	Amended	2016-02	02/25/2016
606-10-55-72	Amended	2016-02	02/25/2016
606-10-55-407	Amended	2016-02	02/25/2016

138. Amend paragraph 610-10-00-1, by adding the following item to the table, as follows:

610-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
610-10-05-1	Amended	2016-02	02/25/2016

139. Amend paragraph 610-20-00-1, by adding the following item to the table, as follows:

610-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
610-20-15-3	Amended	2016-02	02/25/2016

140. Amend paragraph 740-10-00-1, by adding the following items to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
740-10-25-3	Amended	2016-02	02/25/2016
740-10-55-156	Amended	2016-02	02/25/2016
740-10-55-158	Amended	2016-02	02/25/2016
740-10-60-4	Amended	2016-02	02/25/2016

141. Amend paragraph 740-270-00-1, by adding the following items to the table, as follows:

740-270-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
740-270-30-15	Amended	2016-02	02/25/2016

142. Amend paragraph 805-10-00-1, by adding the following items to the table, as follows:

805-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
805-10-55-44	Amended	2016-02	02/25/2016

143. Amend paragraph 805-20-00-1, by adding the following items to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease	Amended	2016-02	02/25/2016
Lease Liability	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Amended	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Net Investment in the Lease	Added	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Right-of-Use Asset	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Sublease	Added	2016-02	02/25/2016

Underlying Asset	Added	2016-02	02/25/2016
Unguaranteed Residual Asset	Added	2016-02	02/25/2016
805-20-25-5	Amended	2016-02	02/25/2016
805-20-25-8	Amended	2016-02	02/25/2016
805-20-25-9	Amended	2016-02	02/25/2016
805-20-25-10A	Added	2016-02	02/25/2016
805-20-25-11	Amended	2016-02	02/25/2016
805-20-25-12	Amended	2016-02	02/25/2016
805-20-25-13	Superseded	2016-02	02/25/2016
805-20-25-16	Amended	2016-02	02/25/2016
805-20-25-17	Amended	2016-02	02/25/2016
805-20-25-28A	Added	2016-02	02/25/2016
805-20-25-28B	Added	2016-02	02/25/2016
805-20-30-10 through 30-12	Amended	2016-02	02/25/2016
805-20-30-24	Added	2016-02	02/25/2016
805-20-30-25	Added	2016-02	02/25/2016
805-20-35-6	Amended	2016-02	02/25/2016
805-20-50-1	Amended	2016-02	02/25/2016
805-20-55-2	Amended	2016-02	02/25/2016
805-20-55-31	Amended	2016-02	02/25/2016

144. Amend paragraph 805-740-00-1, by adding the following items to the table, as follows:

805-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016

Underlying Asset	Added	2016-02	02/25/2016
805-740-25-4	Amended	2016-02	02/25/2016
805-740-30-1	Amended	2016-02	02/25/2016

145. Amend paragraph 810-10-00-1, by adding the following items to the table, as follows:

810-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Direct Financing Lease	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
810-10-25-56	Amended	2016-02	02/25/2016
810-10-50-2AD	Amended	2016-02	02/25/2016
810-10-50-2AF	Amended	2016-02	02/25/2016
810-10-55-50	Amended	2016-02	02/25/2016
810-10-55-78 through 55-80	Amended	2016-02	02/25/2016
810-10-55-93	Amended	2016-02	02/25/2016
810-10-55-172 through 55-176	Amended	2016-02	02/25/2016
810-10-55-178	Amended	2016-02	02/25/2016
810-10-60-4	Amended	2016-02	02/25/2016

146. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-10-15-63	Amended	2016-02	02/25/2016
815-10-15-79 through 15-81	Amended	2016-02	02/25/2016
815-10-55-60	Amended	2016-02	02/25/2016

147. Amend paragraph 815-15-00-1, by adding the following items to the table, as follows:

815-15-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
815-15-25-22	Amended	2016-02	02/25/2016
815-15-55-4	Amended	2016-02	02/25/2016
815-15-55-7	Amended	2016-02	02/25/2016

148. Amend paragraph 815-20-00-1, by adding the following items to the table, as follows:

815-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-20-55-11	Amended	2016-02	02/25/2016
815-20-55-73	Superseded	2016-02	02/25/2016
815-20-55-198	Superseded	2016-02	02/25/2016

149. Amend paragraph 820-10-00-1, by adding the following item to the table, as follows:

820-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
820-10-15-2	Amended	2016-02	02/25/2016

150. Amend paragraph 825-10-00-1, by adding the following items to the table, as follows:

825-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
825-10-15-5	Amended	2016-02	02/25/2016
825-10-50-8	Amended	2016-02	02/25/2016

151. Amend paragraph 835-20-00-1, by adding the following item to the table, as follows:

835-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Interest Cost	Amended	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016

152. Amend paragraph 840-10-00-1, by adding the following items to the table, as follows:

840-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Superseded	2016-02	02/25/2016
Acquirer	Superseded	2016-02	02/25/2016
Acquisition by a Not-for-Profit Entity	Superseded	2016-02	02/25/2016
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Business	Superseded	2016-02	02/25/2016
Business Combination	Superseded	2016-02	02/25/2016
Capital Lease	Superseded	2016-02	02/25/2016
Contingent Rentals	Superseded	2016-02	02/25/2016
Contract	Superseded	2016-02	02/25/2016
Customer	Superseded	2016-02	02/25/2016
Direct Financing Leases	Superseded	2016-02	02/25/2016
Estimated Economic Life	Superseded	2016-02	02/25/2016
Fair Value of Lease Property	Superseded	2016-02	02/25/2016
Fiscal Funding Clause	Superseded	2016-02	02/25/2016
Heat Supply (or Burn-Up) Contracts	Superseded	2016-02	02/25/2016
Incremental Borrowing Rate	Superseded	2016-02	02/25/2016

Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Interest Rate Implicit in the Lease	Superseded	2016-02	02/25/2016
Lease	Superseded	2016-02	02/25/2016
Lease Inception	Superseded	2016-02	02/25/2016
Lease Term	Superseded	2016-02	02/25/2016
Legal Entity	Superseded	2016-02	02/25/2016
Leveraged Lease	Superseded	2016-02	02/25/2016
Minimum Lease Payments	Superseded	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Nonprofit Activity	Superseded	2016-02	02/25/2016
Not-for-Profit Entity	Superseded	2016-02	02/25/2016
Operating Lease	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
Performance Obligation	Superseded	2016-02	02/25/2016
Probable	Superseded	2016-02	02/25/2016
Reasonably Possible	Superseded	2016-02	02/25/2016
Remote	Superseded	2016-02	02/25/2016
Revenue	Superseded	2016-02	02/25/2016
Sales-Type Lease	Superseded	2016-02	02/25/2016
Significant Influence	Superseded	2016-02	02/25/2016
Standalone Selling Price	Superseded	2016-02	02/25/2016
Sublease	Superseded	2016-02	02/25/2016
Substantially All	Superseded	2016-02	02/25/2016

Take-or-Pay Contract	Superseded	2016-02	02/25/2016
Variable Interest Entity	Superseded	2016-02	02/25/2016
840-10-05-1 through 05-10	Superseded	2016-02	02/25/2016
840-10-10-1	Superseded	2016-02	02/25/2016
840-10-15-1 through 15-23	Superseded	2016-02	02/25/2016
840-10-25-1 through 25-69	Superseded	2016-02	02/25/2016
840-10-30-1	Superseded	2016-02	02/25/2016
840-10-30-2	Superseded	2016-02	02/25/2016
840-10-35-1 through 35-10	Superseded	2016-02	02/25/2016
840-10-40-1 through 40-4	Superseded	2016-02	02/25/2016
840-10-45-1 through 45-4	Superseded	2016-02	02/25/2016
840-10-50-1 through 50-5	Superseded	2016-02	02/25/2016
840-10-55-1 through 55-10	Superseded	2016-02	02/25/2016
840-10-55-12 through 55-47	Superseded	2016-02	02/25/2016
840-10-60-1	Superseded	2016-02	02/25/2016
840-10-60-2	Superseded	2016-02	02/25/2016
840-10-60-4 through 60-6	Superseded	2016-02	02/25/2016

153. Amend paragraph 840-20-00-1, by adding the following items to the table, as follows:

840-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Bargain Purchase Option	Superseded	2016-02	02/25/2016

Bargain Renewal Option	Superseded	2016-02	02/25/2016
Capital Lease	Superseded	2016-02	02/25/2016
Construction Period Lease Payments	Superseded	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease	Superseded	2016-02	02/25/2016
Lease Incentive	Superseded	2016-02	02/25/2016
Lease Inception	Superseded	2016-02	02/25/2016
Lease Term	Superseded	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Operating Lease	Superseded	2016-02	02/25/2016
Original Lessee	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
Sales-Type Lease	Superseded	2016-02	02/25/2016
Sublease	Superseded	2016-02	02/25/2016
840-20-05-1 through 05-4	Superseded	2016-02	02/25/2016
840-20-15-1 through 15-3	Superseded	2016-02	02/25/2016
840-20-25-1 through 25-22	Superseded	2016-02	02/25/2016
840-20-30-1	Superseded	2016-02	02/25/2016
840-20-35-1 through 35-5	Superseded	2016-02	02/25/2016
840-20-40-1	Superseded	2016-02	02/25/2016
840-20-40-2	Superseded	2016-02	02/25/2016
840-20-40-5	Superseded	2016-02	02/25/2016
840-20-40-6	Superseded	2016-02	02/25/2016
840-20-45-1 through 45-3	Superseded	2016-02	02/25/2016
840-20-50-1 through 50-4A	Superseded	2016-02	02/25/2016

840-20-55-1 through 55-6	Superseded	2016-02	02/25/2016

154. Amend paragraph 840-30-00-1, by adding the following items to the table, as follows:

840-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Superseded	2016-02	02/25/2016
Acquirer	Superseded	2016-02	02/25/2016
Acquisition by a Not-for-Profit Entity	Superseded	2016-02	02/25/2016
Advance Refunding	Superseded	2016-02	02/25/2016
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Business	Superseded	2016-02	02/25/2016
Business Combination	Superseded	2016-02	02/25/2016
Capital Lease	Superseded	2016-02	02/25/2016
Contingent Rentals	Superseded	2016-02	02/25/2016
Delayed Equity Investment	Superseded	2016-02	02/25/2016
Direct Financing Leases	Superseded	2016-02	02/25/2016
Estimated Economic Life	Superseded	2016-02	02/25/2016
Estimated Residual Value	Superseded	2016-02	02/25/2016
Financing Receivable	Superseded	2016-02	02/25/2016

Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Interest Method	Superseded	2016-02	02/25/2016
Lease	Superseded	2016-02	02/25/2016
Lease Inception	Superseded	2016-02	02/25/2016
Lease Term	Superseded	2016-02	02/25/2016
Legal Entity	Superseded	2016-02	02/25/2016
Leveraged Lease	Superseded	2016-02	02/25/2016
Money-Over-Money Lease	Superseded	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Nonrecourse Financing	Superseded	2016-02	02/25/2016
Not-for-Profit Entity	Superseded	2016-02	02/25/2016
Operating Lease	Superseded	2016-02	02/25/2016
Original Lessee	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
Sales-Type Lease	Superseded	2016-02	02/25/2016
Sublease	Superseded	2016-02	02/25/2016
Substantially All	Superseded	2016-02	02/25/2016
Variable Interest Entity	Superseded	2016-02	02/25/2016
840-30-05-1 through 05-4	Superseded	2016-02	02/25/2016
840-30-15-1 through 15-3	Superseded	2016-02	02/25/2016
840-30-25-1 through 25-4	Superseded	2016-02	02/25/2016
840-30-25-6 through 25-10	Superseded	2016-02	02/25/2016
840-30-30-1 through 30-15	Superseded	2016-02	02/25/2016

840-30-35-1 through 35-53	Superseded	2016-02	02/25/2016
840-30-40-1 through 40-9	Superseded	2016-02	02/25/2016
840-30-45-1 through 45-7	Superseded	2016-02	02/25/2016
840-30-50-1 through 50-6	Superseded	2016-02	02/25/2016
840-30-55-1 through 55-60	Superseded	2016-02	02/25/2016

155. Amend paragraph 840-40-00-1, by adding the following items to the table, as follows:

840-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Active Use of the Property	Superseded	2016-02	02/25/2016
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Capital Lease	Superseded	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease	Superseded	2016-02	02/25/2016
Lease Inception	Superseded	2016-02	02/25/2016
Lease Term	Superseded	2016-02	02/25/2016
Minor	Superseded	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Nonrecourse Financing	Superseded	2016-02	02/25/2016
Normal Leaseback	Superseded	2016-02	02/25/2016

Operating Lease	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
Profit or Loss on Sale	Superseded	2016-02	02/25/2016
Property Improvements or Integral Equipment	Superseded	2016-02	02/25/2016
Reasonably Possible	Superseded	2016-02	02/25/2016
Remote	Superseded	2016-02	02/25/2016
Sale-Leaseback Accounting	Superseded	2016-02	02/25/2016
Sales Recognition	Superseded	2016-02	02/25/2016
Sublease	Superseded	2016-02	02/25/2016
Substantially All	Superseded	2016-02	02/25/2016
Wrap Lease Transaction	Superseded	2016-02	02/25/2016
840-40-05-1 through 05-3	Superseded	2016-02	02/25/2016
840-40-05-5	Superseded	2016-02	02/25/2016
840-40-05-7 through 05-10	Superseded	2016-02	02/25/2016
840-40-15-1 through 15-10	Superseded	2016-02	02/25/2016
840-40-25-1 through 25-5	Superseded	2016-02	02/25/2016
840-40-25-8 through 25-18	Superseded	2016-02	02/25/2016
840-40-30-2	Superseded	2016-02	02/25/2016
840-40-30-3	Superseded	2016-02	02/25/2016
840-40-30-5	Superseded	2016-02	02/25/2016
840-40-30-6	Superseded	2016-02	02/25/2016
840-40-35-1 through 35-4	Superseded	2016-02	02/25/2016
840-40-50-1	Superseded	2016-02	02/25/2016
840-40-50-2	Superseded	2016-02	02/25/2016
840-40-55-1 through 55-94	Superseded	2016-02	02/25/2016

156. Add paragraph 842-10-00-1 as follows:

842-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Added	2016-02	02/25/2016
Acquirer	Added	2016-02	02/25/2016
Acquisition by a Not-for-Profit Entity	Added	2016-02	02/25/2016
Advance Refunding	Added	2016-02	02/25/2016
Business	Added	2016-02	02/25/2016
Business Combination	Added	2016-02	02/25/2016
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Consideration in the Contract	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Discount Rate for the Lease	Added	2016-02	02/25/2016
Economic Life	Added	2016-02	02/25/2016
Effective Date of the Modification	Added	2016-02	02/25/2016
Fair Value (2nd def.)	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Fiscal Funding Clause	Added	2016-02	02/25/2016
Incremental Borrowing Rate	Added	2016-02	02/25/2016
Initial Direct Costs	Added	2016-02	02/25/2016
Inventory	Added	2016-02	02/25/2016

Lease	Added	2016-02	02/25/2016
Lease Liability	Added	2016-02	02/25/2016
Lease Modification	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Legal Entity	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Market Participants	Added	2016-02	02/25/2016
Net Investment in the Lease	Added	2016-02	02/25/2016
Not-for-Profit Entity	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Orderly Transaction	Added	2016-02	02/25/2016
Penalty	Added	2016-02	02/25/2016
Period of Use	Added	2016-02	02/25/2016
Probable (2nd def.)	Added	2016-02	02/25/2016
Public Business Entity	Added	2016-02	02/25/2016
Rate Implicit in the Lease	Added	2016-02	02/25/2016
Related Parties	Added	2016-02	02/25/2016
Remote	Added	2016-02	02/25/2016
Residual Value Guarantee	Added	2016-02	02/25/2016
Right-of-Use Asset	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Selling Profit or Selling Loss	Added	2016-02	02/25/2016
Short-Term Lease	Added	2016-02	02/25/2016
Standalone Price	Added	2016-02	02/25/2016

Sublease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Unguaranteed Residual Asset	Added	2016-02	02/25/2016
Variable Interest Entity	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
Warranty	Added	2016-02	02/25/2016
842-10-05-1	Added	2016-02	02/25/2016
842-10-05-2	Added	2016-02	02/25/2016
842-10-10-1	Added	2016-02	02/25/2016
842-10-10-2	Added	2016-02	02/25/2016
842-10-15-1 through 15-43	Added	2016-02	02/25/2016
842-10-25-1 through 25-19	Added	2016-02	02/25/2016
842-10-30-1 through 30-10	Added	2016-02	02/25/2016
842-10-35-1 through 35-6	Added	2016-02	02/25/2016
842-10-55-1 through 55-254	Added	2016-02	02/25/2016
842-10-65-1	Added	2016-02	02/25/2016

157. Add paragraph 842-20-00-1 as follows:

842-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Added	2016-02	02/25/2016
Acquirer	Added	2016-02	02/25/2016
Acquisition by a Not-for-Profit Entity	Added	2016-02	02/25/2016
Business	Added	2016-02	02/25/2016
Business Combination	Added	2016-02	02/25/2016

Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Discount Rate for the Lease	Added	2016-02	02/25/2016
Fair Value (2nd def.)	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Incremental Borrowing Rate	Added	2016-02	02/25/2016
Initial Direct Costs	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Liability	Added	2016-02	02/25/2016
Lease Modification	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Legal Entity	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Market Participants	Added	2016-02	02/25/2016
Monetary Liability	Added	2016-02	02/25/2016
Not-for-Profit Entity	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Orderly Transaction	Added	2016-02	02/25/2016
Probable (2nd def.)	Added	2016-02	02/25/2016
Rate Implicit in the Lease	Added	2016-02	02/25/2016
Related Parties	Added	2016-02	02/25/2016
Residual Value Guarantee	Added	2016-02	02/25/2016

Right-of-Use Asset	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Short-Term Lease	Added	2016-02	02/25/2016
Sublease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Useful Life	Added	2016-02	02/25/2016
Variable Interest Entity	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
842-20-05-1	Added	2016-02	02/25/2016
842-20-15-1	Added	2016-02	02/25/2016
842-20-25-1 through 25-8	Added	2016-02	02/25/2016
842-20-30-1 through 30-6	Added	2016-02	02/25/2016
842-20-35-1 through 35-15	Added	2016-02	02/25/2016
842-20-40-1 through 40-3	Added	2016-02	02/25/2016
842-20-45-1 through 45-5	Added	2016-02	02/25/2016
842-20-50-1 through 50-9	Added	2016-02	02/25/2016
842-20-55-1 through 55-53	Added	2016-02	02/25/2016

158. Add paragraph 842-30-00-1 as follows:

842-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Fair Value (2nd def.)	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Initial Direct Costs	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Market Participants	Added	2016-02	02/25/2016
Net Investment in the Lease	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Orderly Transaction	Added	2016-02	02/25/2016
Probable (2nd def.)	Added	2016-02	02/25/2016
Rate Implicit in the Lease	Added	2016-02	02/25/2016
Related Parties	Added	2016-02	02/25/2016
Residual Value Guarantee	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Selling Profit or Selling Loss	Added	2016-02	02/25/2016
Sublease	Added	2016-02	02/25/2016

Underlying Asset	Added	2016-02	02/25/2016
Unguaranteed Residual Asset	Added	2016-02	02/25/2016
Useful Life	Added	2016-02	02/25/2016
Variable Lease Payments	Added	2016-02	02/25/2016
842-30-05-1	Added	2016-02	02/25/2016
842-30-15-1	Added	2016-02	02/25/2016
842-30-25-1 through 25-14	Added	2016-02	02/25/2016
842-30-30-1 through 30-4	Added	2016-02	02/25/2016
842-30-35-1 through 35-7	Added	2016-02	02/25/2016
842-30-40-1 through 40-4	Added	2016-02	02/25/2016
842-30-45-1 through 45-7	Added	2016-02	02/25/2016
842-30-50-1 through 50-13	Added	2016-02	02/25/2016
842-30-55-1 through 55-18	Added	2016-02	02/25/2016

159. Add paragraph 842-40-00-1 as follows:

842-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Fair Value (2 nd def.)	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016

Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Market Participants	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Orderly Transaction	Added	2016-02	02/25/2016
Related Parties	Added	2016-02	02/25/2016
Residual Value Guarantee	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Sublease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
842-40-05-1	Added	2016-02	02/25/2016
842-40-15-1 through 15-3	Added	2016-02	02/25/2016
842-40-25-1 through 25-5	Added	2016-02	02/25/2016
842-40-30-1 through 30-6	Added	2016-02	02/25/2016
842-40-50-1	Added	2016-02	02/25/2016
842-40-50-2	Added	2016-02	02/25/2016
842-40-55-1 through 55-44	Added	2016-02	02/25/2016

160. Add paragraph 842-50-00-1 as follows:

842-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Added	2016-02	02/25/2016
Acquirer	Added	2016-02	02/25/2016
Acquisition by a Not-for-Profit Entity	Added	2016-02	02/25/2016

Business	Added	2016-02	02/25/2016
Business Combination	Added	2016-02	02/25/2016
Commencement Date of the Lease (Commencement Date)	Added	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Delayed Equity Investment	Added	2016-02	02/25/2016
Estimated Residual Value	Added	2016-02	02/25/2016
Fair Value (2 nd def.)	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Inception	Added	2016-02	02/25/2016
Lease Modification	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Legal Entity	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Leveraged Lease	Added	2016-02	02/25/2016
Market Participants	Added	2016-02	02/25/2016
Minimum Lease Payments	Added	2016-02	02/25/2016
Not-for-Profit Entity	Added	2016-02	02/25/2016
Orderly Transaction	Added	2016-02	02/25/2016
Related Parties	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Variable Interest Entity	Added	2016-02	02/25/2016
842-50-05-1	Added	2016-02	02/25/2016
842-50-15-1	Added	2016-02	02/25/2016
842-50-25-1	Added	2016-02	02/25/2016
842-50-25-2	Added	2016-02	02/25/2016

842-50-30-1	Added	2016-02	02/25/2016
842-50-30-2	Added	2016-02	02/25/2016
842-50-35-1 through 35-21	Added	2016-02	02/25/2016
842-50-45-1 through 45-3	Added	2016-02	02/25/2016
842-50-50-1 through 50-3	Added	2016-02	02/25/2016
842-50-55-1 through 55-33	Added	2016-02	02/25/2016

161. Amend paragraph 845-10-00-1, by adding the following item to the table, as follows:

845-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
845-10-30-20	Superseded	2016-02	02/25/2016

162. Amend paragraph 853-10-00-1, by adding the following item to the table, as follows:

853-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
853-10-25-2	Amended	2016-02	02/25/2016

163. Amend paragraph 860-10-00-1, by adding the following items to the table, as follows:

860-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016

Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lease Receivable	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
Unguaranteed Residual Asset	Added	2016-02	02/25/2016
860-10-15-4	Amended	2016-02	02/25/2016
860-10-55-5	Amended	2016-02	02/25/2016
860-10-55-6	Amended	2016-02	02/25/2016

164. Amend paragraph 860-20-00-1, by adding the following items to the table, as follows:

860-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Payments	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
860-20-55-1	Amended	2016-02	02/25/2016
860-20-55-26	Amended	2016-02	02/25/2016
860-20-55-27	Amended	2016-02	02/25/2016
860-20-55-58	Amended	2016-02	02/25/2016
860-20-55-59	Amended	2016-02	02/25/2016

165. Amend paragraph 908-360-00-1, by adding the following item to the table, as follows:

908-360-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
908-360-55-1	Amended	2016-02	02/25/2016

166. Amend paragraph 954-470-00-1, by adding the following items to the table, as follows:

954-470-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Advance Refunding	Added	2016-02	02/25/2016
954-470-25-1	Amended	2016-02	02/25/2016
954-470-40-1	Amended	2016-02	02/25/2016

167. Amend paragraph 958-805-00-1, by adding the following items to the table, as follows:

958-805-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
958-805-25-9	Amended	2016-02	02/25/2016
958-805-25-11	Amended	2016-02	02/25/2016

168. Amend paragraph 958-810-00-1, by adding the following items to the table, as follows:

958-810-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Bargain Purchase Option	Superseded	2016-02	02/25/2016

Bargain Renewal Option	Superseded	2016-02	02/25/2016
Contract	Added	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Term	Amended	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
958-810-25-10	Amended	2016-02	02/25/2016
958-810-55-7	Amended	2016-02	02/25/2016
958-810-55-14	Amended	2016-02	02/25/2016

169. Add paragraph 958-840-00-1 as follows:

958-840-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Bargain Purchase Option	Superseded	2016-02	02/25/2016
Bargain Renewal Option	Superseded	2016-02	02/25/2016
Indirectly Related to the Leased Property	Superseded	2016-02	02/25/2016
Lease Term	Superseded	2016-02	02/25/2016
Noncancelable Lease Term	Superseded	2016-02	02/25/2016
Penalty	Superseded	2016-02	02/25/2016
958-840-05-1	Superseded	2016-02	02/25/2016

958-840-15-1	Superseded	2016-02	02/25/2016
958-840-55-1 through 55-4	Superseded	2016-02	02/25/2016

170. Amend paragraph 970-10-00-1, by adding the following items to the table, as follows:

970-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
970-10-05-1	Amended	2016-02	02/25/2016
970-10-15-8	Amended	2016-02	02/25/2016

171. Amend paragraph 970-340-00-1, by adding the following items to the table, as follows:

970-340-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Direct Financing Lease	Added	2016-02	02/25/2016
Finance Lease	Added	2016-02	02/25/2016
Initial Direct Costs	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Lease Term	Added	2016-02	02/25/2016
Lessee	Added	2016-02	02/25/2016
Lessor	Added	2016-02	02/25/2016
Operating Lease	Added	2016-02	02/25/2016
Sales-Type Lease	Added	2016-02	02/25/2016
Underlying Asset	Added	2016-02	02/25/2016
970-340-25-16	Amended	2016-02	02/25/2016
970-340-35-2	Amended	2016-02	02/25/2016

172. Amend paragraph 972-10-00-1, by adding the following item to the table, as follows:

972-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
972-10-05-1	Amended	2016-02	02/25/2016

173. Amend paragraph 974-10-00-1, by adding the following item to the table, as follows:

974-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
974-10-05-1	Amended	2016-02	02/25/2016

174. Add paragraph 974-840-00-1 as follows:

974-840-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Real Estate Investment Trust	Superseded	2016-02	02/25/2016
Service Corporation	Superseded	2016-02	02/25/2016
974-840-05-1	Superseded	2016-02	02/25/2016
974-840-15-1	Superseded	2016-02	02/25/2016
974-840-25-1	Superseded	2016-02	02/25/2016

175. Add paragraph 974-842-00-1 as follows:

974-842-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2016-02	02/25/2016
Initial Direct Costs	Added	2016-02	02/25/2016
Lease	Added	2016-02	02/25/2016
Real Estate Investment Trust	Added	2016-02	02/25/2016
Service Corporation	Added	2016-02	02/25/2016
974-842-05-1	Added	2016-02	02/25/2016
974-842-15-1	Added	2016-02	02/25/2016
974-842-25-1	Added	2016-02	02/25/2016

176. Amend paragraph 976-10-00-1, by adding the following item to the table, as follows:

976-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
976-10-05-1	Amended	2016-02	02/25/2016

177. Amend paragraph 978-10-00-1, by adding the following items to the table, as follows:

978-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
978-10-05-1	Amended	2016-02	02/25/2016
978-10-05-2	Amended	2016-02	02/25/2016

178. Amend paragraph 978-330-00-1, by adding the following item to the table, as follows:

978-330-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
978-330-35-6	Amended	2016-02	02/25/2016

179. Amend paragraph 978-840-00-1, by adding the following items to the table, as follows:

978-840-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract-for-Deed	Superseded	2016-02	02/25/2016
Tenancy-for-Years	Superseded	2016-02	02/25/2016
Time-Sharing	Superseded	2016-02	02/25/2016
978-840-05-1	Superseded	2016-02	02/25/2016
978-840-15-1	Superseded	2016-02	02/25/2016
978-840-25-1	Superseded	2016-02	02/25/2016
978-840-25-2	Superseded	2016-02	02/25/2016

180. Add paragraph 980-250-00-1 as follows:

980-250-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
980-250-55-3	Amended	2016-02	02/25/2016

181. Add paragraph 980-340-00-1 as follows:

980-340-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
980-340-25-4	Amended	2016-02	02/25/2016
980-340-55-9 through 55-11	Amended	2016-02	02/25/2016

980-340-55-13 through 55-17	Amended	2016-02	02/25/2016

182. Amend paragraph 980-605-00-1, by adding the following item to the table, as follows:

980-605-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
980-605-15-3	Amended	2016-02	02/25/2016

183. Amend paragraph 980-815-00-1, by adding the following item to the table, as follows:

980-815-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
980-815-15-3	Amended	2016-02	02/25/2016

184. Add paragraph 980-840-00-1 as follows:

980-840-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Allowable Costs	Superseded	2016-02	02/25/2016
Phase-In Plan	Superseded	2016-02	02/25/2016
980-840-05-1	Superseded	2016-02	02/25/2016
980-840-15-1	Superseded	2016-02	02/25/2016
980-840-25-1 through 25-3	Superseded	2016-02	02/25/2016
980-840-35-1	Superseded	2016-02	02/25/2016
980-840-35-2	Superseded	2016-02	02/25/2016
980-840-45-1 through 45-4	Superseded	2016-02	02/25/2016
980-840-55-1	Superseded	2016-02	02/25/2016

185. Add paragraph 980-842-00-1 as follows:

980-842-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Allowable Costs	Added	2016-02	02/25/2016
Phase-In Plan	Added	2016-02	02/25/2016
980-842-05-1	Added	2016-02	02/25/2016
980-842-15-1	Added	2016-02	02/25/2016
980-842-25-1 through 25-3	Added	2016-02	02/25/2016
980-842-35-1	Added	2016-02	02/25/2016
980-842-45-1 through 45-4	Added	2016-02	02/25/2016
980-842-55-1	Added	2016-02	02/25/2016

The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. Siegel dissented.

Mr. Siegel dissents from the issuance of the guidance in this Update because, on balance, he believes that the new information will not represent sufficient predictive value, confirmatory value, or both to be decision useful to financial statement users. While Mr. Siegel firmly agrees with the recognition of lease assets and liabilities for all leases, he believes that the measurement of the lessee's liability required by the guidance will provide insufficient decision-useful information for investors, such that significant adjustments will continue to be made by financial statement users. Specifically, Mr. Siegel disagrees with the guidance on renewal options and variable lease payments and believes that it is inconsistent with other Topics in the Accounting Standards Codification that address customer options and contingent or variable amounts. As such, Mr. Siegel has concluded that the guidance fails to meet the objective in this Update of reporting useful information to financial statement users about the amount, timing, and uncertainty of cash flows arising from a lease.

Mr. Siegel agrees that leases create rights and obligations that meet the definitions of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. However, he disagrees that the measurement of the obligation of the lessee should exclude amounts to be paid that are uncertain or variable. Paragraph QC7 of FASB Concepts Statement 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, states that “financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both.” Paragraph QC8 elaborates, stating that “financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes.” Mr. Siegel believes that the exclusion of all but a select few renewal options and variable payments will require significant efforts to make relevant predictions solely using the measurements recorded in the financial statements. He is concerned that excluding those amounts may be misleading to users and, as such, users may even unwind the assets and liabilities presented on the statement of financial position to come to their own estimates of the appropriate amounts. Therefore, Mr. Siegel believes that the results of the guidance would provide insufficient decision-useful information about the effects of lease contracts with uncertain future payments.

Mr. Siegel finds it inconsistent that the guidance in this Update creates a higher threshold for the measurement of variable lease payments—which are contractual amounts owed—than the measurement of noncontractual liabilities required by Subtopic 450-20, Contingencies—Loss Contingencies. Specifically, for noncontractual contingencies, paragraph 450-20-25-2, in part, requires that a liability be recognized when it is probable that a liability has been incurred. Conversely, this Update prohibits the recognition of contractual variable lease payments that do not depend on an index or a rate when there is no uncertainty a liability has been incurred. For example, Mr. Siegel believes that this Update results in no recognition of a liability for a lease of retail space if the lease payments are solely calculated as a percentage of sales. As such, Mr. Siegel believes that the measurement will fail to record amounts that meet the definition of a liability in Concepts Statement 6. He also believes that the amounts recorded will not meet the qualities of predictive value in paragraphs QC7 and QC8 of Concepts Statement 8.

Furthermore, Mr. Siegel notes that in a contract with a customer that is in the scope of Topic 606, Revenue from Contracts with Customers, variable amounts due from the customer are required to be included in the measurement of the transaction price to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. However, in the case of lease contracts, variable lease payments that do not depend on an index or a rate will never be included in the measurement of the liability. As such, Mr. Siegel believes that the measurement of the lessee liability should include these uncertain amounts for the information to be decision useful. Mr. Siegel also believes that requiring substantially different accounting for the same economic phenomena is a significant contributor to complexity in accounting standards.

Regarding lease payments to be made in optional periods, Mr. Siegel agrees with the consideration of renewal options in the consideration of the lease term. He understands the operational challenges of measuring the renewal options as a separate component of the lease contract and agrees with the discussion in paragraph BC197 of this Update that, consistent with previous GAAP, renewal

options should be reflected in the lease term where the form is optional, but there is economically little or no choice but to extend the lease. However, he disagrees with the threshold at which the renewal options should be reflected in the lease term. Mr. Siegel believes that the lease term should be defined as it was in the 2010 Exposure Draft as the longest possible term that is more likely than not to occur. He understands that this Update stipulates that the lease term includes optional renewal periods only if the lessee is reasonably certain to exercise the renewal option, but he believes that the resulting measurement will not meet the qualities of predictive value set forth in paragraphs QC7 and QC8 of Concepts Statement 8. Mr. Siegel believes that this threshold to account for renewal options is inconsistent with how renewal options are accounted for in insurance contracts (in Topic 944) and is also inconsistent with the guidance for contracts with customers (in Topic 606) that accounts for customer options whenever they provide the customer with a material right. Mr. Siegel asserts that the measurement of the lease liability should include the lease payments for those uncertain renewal periods within the lease term at a lower threshold than reasonably certain for the information to be decision useful and consistent with other areas of GAAP.

In conclusion, Mr. Siegel agrees with the recognition of lease assets and liabilities but believes that the measurement of the amounts resulting from this Update represents insufficient decision-useful information. He is concerned that users may be misled by the measurements and, therefore, will incur costs to make considerable, albeit very different, adjustments to unwind the accounting required by this Update to accommodate their analysis. He asserts that to meet the qualitative characteristics of decision-useful information outlined in the Conceptual Framework and to be consistent with guidance in other areas of the Accounting Standards Codification, variable lease payments should be included in the measurement of the lessee's lease liability and renewal options should be included in the lease term at a lower threshold than reasonably certain.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
 James L. Kroeker, *Vice Chairman*
 Daryl E. Buck
 Thomas J. Linsmeier
 R. Harold Schroeder
 Marc A. Siegel
 Lawrence W. Smith

Background Information and Basis for Conclusions

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Introduction

BC1. This basis for conclusions summarizes the Board's considerations in reaching the conclusions in Topic 842, Leases. It includes reasons for accepting particular views and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. A new standard should provide information that is useful in making business and economic decisions, and the benefits should justify the costs. Providing useful information means, among other things, producing economically "neutral" information (that is, information that faithfully represents the economics of a transaction, regardless of perceived positive or negative effects of reporting that information) that permits users to make their own decisions on the basis of the financial information.

BC3. Paragraph OB2 of FASB Concepts Statement 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, states the following:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

BC4. Given the objective of general purpose financial reporting, the Board also considered the objective of the leases project, which is to increase the decision usefulness and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position and disclosing key leasing information. For example, users of financial statements are interested in obtaining information about a lessee's leasing activities, in general, to assess the cash flows, returns, and capital structure of the lessee and to assess the lessee's ability to meet financial commitments. Most users already make adjustments that are often based on incomplete information to a lessee's reported statement of financial position to capitalize operating leases when operating leases are significant to the lessee.

BC5. As part of the due process that led to Topic 842, the Board conducted extensive outreach activities with users, preparers, and auditors of financial statements to obtain information about specific deficiencies in the accounting requirements for leases in previous GAAP (Topic 840, Leases). Input was received both before the project was added to the Board's technical agenda and throughout the duration of the project.

BC6. The FASB's *Rules of Procedure* states the following:

The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

BC7. In fulfilling that mission, the Board follows certain precepts, including the precept to promulgate standards only when the expected benefits of the resulting information justify the expected costs. The Board strives to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information.

BC8. On the basis of extensive due process and significant input received from financial statement users, the Board concluded that Topic 842 provides users with more relevant information on and a more faithful representation of leasing arrangements for both lessees and lessors than previous GAAP. The Board developed Topic 842 principally to improve users' understanding about lessees' obligations under lease contracts. Topic 842 provides transparent and economically neutral information about the assets and liabilities that arise from leases, which is in contrast to the incomplete information provided about leases in previous GAAP that did not recognize the assets and liabilities that arise from most leases. Topic 842 also provides improved financial information about a lessor's leasing activities. As such, Topic 842 results in more useful information being provided to users of financial statements. The requirements in Topic 842 will:

- a. Result in a more faithful representation of the rights and obligations arising from leases by requiring lessees to recognize the lease assets and lease liabilities that arise from leases in the statement of financial position and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases
- b. Improve understanding and comparability of lessees' financial commitments regardless of the manner they choose to finance the assets used in their businesses
- c. Clarify the definition of a lease to address practice issues that were raised about the previous definition of a lease and to align the concept of control, as it is used in the definition of a lease, more closely with the control principle in both Topic 606, Revenue from Contracts with Customers, and Topic 810, Consolidation
- d. More closely align the lessor accounting and sale and leaseback transactions guidance to the comparable guidance in Topic 606 and Topic 610, Other Income
- e. Provide users with additional information about lessors' leasing activities and lessors' exposure to credit and asset risk as a result of leasing

- f. Result in fewer opportunities for entities to structure leasing transactions to achieve a particular accounting outcome on the statement of financial position.

BC9. The Board's outreach activities also included discussions about the potential costs and feasibility of implementing its proposals for improving the accounting for leases. That outreach discussed, among other things, the costs and relevance of the various lease accounting models that the Board has considered over the course of the project. Both preparers and auditors agreed that the approach to lessee accounting that the Board decided to include in Topic 842 was among the lowest cost options considered.

BC10. The Board understands that certain reporting entities will incur additional costs as a result of Topic 842. For example, entities will, in general, incur initial costs to educate employees about how to apply the new requirements, as well as how to explain the effects of the changes in accounting for leases on the entity's financial statements to users of financial statements. In addition, many entities will need to undertake activities to ensure they have appropriately identified all of their leases and implement more robust processes and controls to ensure that they capture all material leasing activity going forward. However, the Board noted that once these implementation activities are completed, the ongoing costs for most entities of providing the information in Topic 842 are unlikely to be significantly higher than the costs of complying with the accounting model in previous GAAP. In previous GAAP, entities were similarly required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including meeting the ongoing disclosure requirements about cash flows from leases. Topic 842 will not substantially change this level of effort, and the Board concluded that, based on substantial outreach with preparers of financial statements, many entities will be able to apply the requirements in Topic 842 using similar systems and processes to what they used in previous GAAP to meet those reporting and disclosure requirements.

BC11. The Board considered an entity's initial costs to comply with the requirements in Topic 842, and this affected its conclusions both on the lessee and lessor accounting requirements and on transition to the new requirements. Regarding the lessee and lessor accounting requirements, as outlined in paragraph BC10, the Board concluded that a substantial portion of all entities will be able to apply the new requirements using systems and processes similar to those used in previous GAAP. The Board decided that a modified retrospective approach for transition, as opposed to a full retrospective approach, provides an appropriate balance between minimizing costs of transition and providing users of financial statements with comparable financial information. The practical expedients related to transition, if elected, should further significantly reduce the costs associated with transitioning to the new requirements.

BC12. The Board received considerable feedback on the 2010 Exposure Draft, *Leases (Topic 840)*, and the 2013 Exposure Draft, *Leases (Topic 842)*, and the Board made decisions during redeliberations that were responsive to the feedback. Throughout the course of developing the proposed requirements, the Board sought to minimize the cost of improving the lease accounting requirements in GAAP. This is discussed in further detail in the background section below.

BC13. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new requirements are borne primarily by the preparers' current investors. The Board's assessment of the costs and benefits likely to result from issuing new requirements is unavoidably more qualitative than quantitative because there is not an identified method to objectively quantify the costs to implement new guidance or to quantify the value of expected, improved information in financial statements.

BC14. The Board further considered the concern that the additional lease liabilities recognized as a result of adopting Topic 842 will cause some entities to violate debt covenants or may affect some entities' access to credit because of the potential effect on the entity's GAAP-reported assets and liabilities. Regarding access to credit, outreach has demonstrated that the vast majority of users, including private company users, presently adjust an entity's financial statements for operating lease obligations that are not recognized in the statement of financial position under previous GAAP and, in doing so, often estimate amounts significantly in excess of what will be recognized under Topic 842. The Board also considered potential issues related to debt covenants and noted that the following factors significantly mitigate those potential issues:

- a. A significant portion of loan agreements contain "frozen GAAP" or "semifrozen GAAP" clauses such that a change in a lessee's financial ratios resulting solely from a GAAP accounting change either:
 1. Will not constitute a default
 2. Will require both parties to negotiate in good faith when a technical default (breach of loan covenant) occurs as a result of new GAAP.
- b. Banks with whom outreach has been conducted state that they are unlikely to dissolve a good customer relationship by "calling a loan" because of a technical default arising solely from a GAAP accounting change, even if the loan agreement did not have a frozen or semifrozen GAAP provision.
- c. Topic 842 characterizes operating lease liabilities as operating liabilities, rather than debt. Consequently, those amounts may not affect certain financial ratios that often are used in debt covenants.
- d. Topic 842 provides for an extended effective date that should permit many entities' existing loan agreements to expire before reporting under Topic 842. For those loan agreements that will not expire, do not have frozen or semifrozen GAAP provisions, and have covenants that are

affected by additional operating liabilities, the extended effective date provides significant time for entities to modify those agreements.

BC15. Overall, the Board concluded that the expected benefits of Topic 842 justify the perceived costs.

Overview

Why the Need to Change Existing Accounting?

BC16. The previous accounting model for leases in GAAP and International Financial Reporting Standards (IFRS) did not require lessees to recognize the assets and liabilities arising from operating leases in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements* (and the IFRS's *Conceptual Framework for Financial Reporting*), but it did require lessees to recognize assets and liabilities arising from capital leases. The FASB, together with the IASB, initiated a joint project to improve the financial reporting of leasing activities in GAAP and IFRS in light of criticism that the previous accounting model for leases failed to meet the needs of users of financial statements. In particular:

- a. Many, including the U.S. Securities and Exchange Commission (SEC) in its 2005 *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers*, which was mandated by and issued to the United States Congress, and a number of academic studies published over the past 15 years, have recommended that changes be made to the existing lease accounting requirements to ensure greater transparency in financial reporting and to better address the needs of users of financial statements. Most users adjusted a lessee's financial statements to capitalize operating leases. Some tried to estimate the present value of future lease payments. However, because of the limited information available, many used techniques such as multiplying the lessee's annual lease expense by a factor, often in the range of six to eight, to approximate the fair value of the lessee's obligations and to assess, for example, total leverage and the capital employed in operations. Other users were unable to make adjustments—they were reliant on data sources such as data aggregators when screening potential investments or making investment decisions. Those different approaches created information asymmetry in the market because the adjustments made varied significantly depending on the assumptions made by different users.
- b. The existence of two very different accounting models in which the assets and liabilities associated with most leases were not recognized, but were recognized for a minority of leases, resulted in transactions that were economically similar being accounted for very differently in the statement of financial position. That reduced comparability for users and provided

opportunities to structure transactions to achieve a particular accounting outcome.

- c. Some users of financial statements also criticized previous GAAP applicable to lessors because that guidance did not provide adequate information about a lessor's exposure to credit risk (arising from a lease) and exposure to asset risk (arising from the lessor's retained interest in the underlying asset), particularly for those leases of assets that were previously classified as operating leases.

BC17. The Board decided to address those criticisms by modifying the lessee accounting model in GAAP to require a lessee to recognize assets and liabilities for the rights and obligations created by leases. Topic 842 requires a lessee to recognize the lease assets and lease liabilities for all leases with a lease term of more than 12 months. This approach will result in a more faithful representation of a lessee's assets and liabilities and, together with the enhanced disclosures required by Topic 842, greater transparency about a lessee's financial leverage and its leasing activities. Topic 842 also requires a lessor to provide enhanced disclosures that will improve reported information about a lessor's exposure to credit risk (of the lessee and any third party providing a residual value guarantee) and asset risk (that is, the risk associated with ownership of the underlying asset in the lease).

Background

BC18. In March 2009, the Boards published a joint Discussion Paper, *Leases: Preliminary Views*. The Discussion Paper set out the Boards' preliminary views on lessee accounting, proposing a right-of-use accounting model. Feedback on the Discussion Paper was generally supportive of the right-of-use model for lessees in which a lessee would recognize a right-of-use asset and a lease liability at the commencement date of the lease. The Discussion Paper did not discuss lessor accounting in any detail.

BC19. In August 2010, the Boards published a joint Exposure Draft, *Leases* (2010 Exposure Draft). The Boards developed the guidance in the joint 2010 Exposure Draft after considering the 302 comment letters received on the Discussion Paper, as well as input obtained from their International Working Group on Lease Accounting and from others that were interested in the financial reporting of leases. That guidance further developed the right-of-use accounting model proposed for lessees in the Discussion Paper. That guidance also set out changes to lessor accounting by proposing a changed dual lessor accounting model in which a lessor would recognize a lease receivable for all leases but, depending on the lessor's exposure to the risks and benefits of the underlying asset, would either derecognize a portion of the underlying asset or continue to recognize the underlying asset and recognize a performance obligation liability for others. The Boards decided to include lessor accounting in the proposals in response to respondents' comments on the Discussion Paper. Those respondents

recommended that the Boards develop accounting models for lessees and lessors on the basis of a consistent rationale. The Boards also saw merit in developing lessor accounting proposals at the same time as developing proposals on the recognition of revenue.

BC20. The Boards received 786 comment letters in response to the 2010 Exposure Draft from entities and organizations from a range of industries, including both public business entities and private companies.

BC21. The Boards also consulted extensively on the proposals in the 2010 Exposure Draft. Roundtable discussions were held in Hong Kong, the United Kingdom, and the United States. Workshops were organized in Australia, Brazil, Canada, Japan, South Korea, the United Kingdom, and the United States. Members of the Boards also participated in conferences, working group meetings, discussion forums, and one-on-one discussions that were held across all major geographical regions. In 2011 and 2012, while redeliberating the proposals in the 2010 Exposure Draft, the Boards conducted targeted outreach on specific issues with more than 100 organizations. The purpose of the targeted outreach was to obtain additional feedback to assist the Boards in developing particular aspects of the revised proposals. The targeted outreach meetings involved working group members, representatives from accounting firms, local standard setters, users of financial statements, and preparers, particularly those from industries most affected by the lease accounting proposals.

BC22. The main feedback received on the proposals included in the 2010 Exposure Draft was as follows:

- a. There was general support for the recognition of assets and liabilities arising from a lease by lessees, which was consistent with comments received on the Discussion Paper.
- b. Some respondents supported the effects of the proposed right-of-use model on a lessee's profit or loss in which a lessee would recognize separately amortization of the right-of-use asset and interest on the lease liability. They noted that leases are a source of financing for a lessee and should be accounted for accordingly. However, others disagreed stating that the approach would not properly reflect the economics of all lease transactions. In particular, some respondents referred to shorter term property leases as examples of leases that, in their view, were not financing transactions from either the lessee's or the lessor's perspective.
- c. Many respondents disagreed with the lessor accounting proposals:
 1. Some were concerned that the dual accounting model proposed for lessors was not consistent with the single accounting model proposed for lessees.
 2. Many did not support the performance obligation approach. According to that approach, a lessor would recognize a lease receivable and a liability at the commencement date and also would continue to recognize the underlying asset. Those respondents

indicated that, in their view, the approach would artificially inflate a lessor's assets and liabilities.

3. Some supported applying the derecognition approach to all leases. According to that approach, a lessor would derecognize the underlying asset and recognize a lease receivable and a retained interest in the underlying asset (referred to as a residual asset) at the commencement date. However, many disagreed with the proposal to prevent a lessor from accounting for the effects of the time value of money on the residual asset.
4. Others said that there are not significant issues with the lessor accounting requirements in IAS 17, *Leases*, and Topic 840, that they work well in practice, and supported retaining those requirements.
- d. Almost all respondents were concerned about the costs and complexity of the proposals, in particular the proposals on measurement of the lessee's lease liability and the lessor's lease receivable. The 2010 Exposure Draft had proposed that an entity would make an estimate of all variable lease payments to be made not only during the noncancellable period of a lease but also during any optional extension periods that the entity considered more likely than not to occur. Some questioned whether lease payments to be made during optional extension periods would meet the definition of an asset (for the lessor) or a liability (for the lessee). Others indicated that it would be extremely difficult in many cases to make a reliable estimate of variable lease payments if the amounts to be paid were dependent on future sales or use of the underlying asset. Because of the amount of judgment involved, many indicated that the cost of including variable lease payments and payments to be made during extension periods in the measurement of lease assets and lease liabilities would not justify the benefit for users of financial statements.
- e. Many respondents also were concerned about the breadth of the scope of the proposals, indicating that the proposed definition of a lease had the potential to capture some arrangements that they considered to be service contracts rather than leases.

BC23. The Boards considered all of the feedback received during the redeliberations of the proposals in the 2010 Exposure Draft and observed that it would not be possible to reflect the views of all stakeholders because stakeholders did not have a uniform view of the economics of leases. Having received significant feedback on the single model proposed in the 2010 Exposure Draft, the Boards decided to expose for comment an alternative model that was responsive to those stakeholders who said that the economics vary among different types of leases. Consequently, in May 2013 the Boards published a second joint Exposure Draft, *Leases* (2013 Exposure Draft). The 2013 Exposure Draft proposed two approaches to the recognition and measurement of expenses arising from a lease. That model distinguished between different types of leases on the basis of the level of the lessee's consumption of the economic benefits embedded in the underlying

asset. That model was based on the view held by some stakeholders that the recognition of a single lease expense in a lessee's statement of profit or loss and other comprehensive income (income statement) would provide better information about those leases for which the lessee pays only for the use of the underlying asset and is expected to consume only an insignificant amount of the economic benefits embedded in the underlying asset itself. A lessee would account for those leases for which it consumes more than an insignificant amount of the benefits embedded in the underlying asset in a similar manner to the approach proposed in the 2010 Exposure Draft. The 2013 Exposure Draft also proposed an alternative model for lessor accounting under which a lessor would account for leases in which the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset by recognizing its residual interest in the underlying asset separately from its right to receive lease payments (that is, its lease receivable). A lessor would account for all other leases in a similar manner to operating lease accounting in Topic 842.

BC24. The Boards received 657 comment letters in response to the 2013 Exposure Draft from entities and organizations from a range of industries. In addition, the Boards consulted extensively on the proposals in the 2013 Exposure Draft, including:

- a. Consultations with more than 270 users of financial statements based in the United States, the United Kingdom, Sweden, Switzerland, Belgium, the Netherlands, France, Australia, New Zealand, Hong Kong, Japan, and Canada.
- b. Fieldwork meetings with individual preparers from various industries including consumer goods, retail, aviation, oil and gas, telecommunications, and automotive. These meetings were held in Germany, France, Spain, the United States, the United Kingdom, Japan, and Brazil and included detailed discussions about the costs of implementation for those companies.
- c. Roundtables held in London, Norwalk, Los Angeles, Singapore, and Sao Paulo, Brazil. These were attended by approximately 100 stakeholder representatives.
- d. Meetings with all of the FASB's advisory groups—the Financial Accounting Standard Advisory Council (FASAC), the Investor Advisory Committee (IAC), the Not-for-Profit Advisory Committee (NAC), and the Small Business Advisory Committee (SBAC).
- e. Meetings with the Private Company Council (PCC).
- f. Outreach meetings with various other individual preparers and groups of preparers, standard setters, and regulators. These meetings included presentations during accounting conferences, keynote presentations at industry forums, and meetings with individual organizations or groups.
- g. Project webcasts that attracted over 2,000 participants.

BC25. The main feedback received on the proposals included in the 2013 Exposure Draft was as follows:

- a. Similar to feedback received on the 2010 Exposure Draft, many stakeholders supported the recognition of a right-of-use asset and a lease liability by a lessee for all leases of more than 12 months. These stakeholders included most users of financial statements consulted, who stated that the proposed recognition of assets and liabilities by a lessee would provide them with better information for their analyses.
- b. Many stakeholders disagreed with the proposed lessee accounting model. Some of those stakeholders (1) said that the lessee accounting model in Topic 840 did not need to be changed or (2) supported improving the lessee accounting model in Topic 840 by only improving the disclosure requirements instead of changing the recognition and measurement requirements. Other stakeholders disagreed with one or more specific aspects of the proposed lessee accounting model in the 2013 Exposure Draft, such as the proposed classification test or the proposal to periodically reassess lease assets and lease liabilities.
- c. Many stakeholders said that the measurement proposals in the 2013 Exposure Draft represented a significant improvement over the proposals in the 2010 Exposure Draft, especially relating to simplifications of variable lease payments and payments under renewal options and purchase options. Nonetheless, the majority of stakeholders still had concerns about the costs and complexity of the proposals in the 2013 Exposure Draft. Specific areas of the proposals that stakeholders highlighted as being particularly costly or complex included the dual lessee and lessor accounting models (both the lease classification proposals as well as the accounting requirements), the reassessment proposals, the disclosure proposals, and the scope of the transactions subject to the proposals.
- d. The majority of stakeholders disagreed with the proposed lessor accounting model because, in their view, it was not an improvement to the financial reporting model for those transactions. Most of those stakeholders said that the lessor accounting model in previous GAAP should not be changed substantially.

BC26. During redeliberations, the Boards considered all of the feedback received throughout the project and in response to the different models proposed in the 2010 and 2013 Exposure Drafts. As they did in both Exposure Drafts, the Boards decided that a lessee should be required to recognize right-of-use assets and lease liabilities for all leases (with some exceptions—for the FASB, short-term leases, and for the IASB, short-term leases and leases of “low-value assets”). However, the Boards reached different decisions on the expense recognition model. The FASB decided to adopt a lessee accounting model that distinguishes between two types of leases, classifying leases as operating leases or finance leases in a similar manner to the requirements for distinguishing between operating leases and capital leases in previous GAAP. Conversely, the IASB decided to adopt a single lessee accounting model in which a lessee accounts for all leases as finance leases. In light of all of the feedback received, the FASB

concluded that its lessee accounting approach provides useful information to the broadest range of users of financial statements and reflects the economics of each type of lease. At the same time, the FASB noted that the lessee accounting approach in Topic 842 addresses many of the concerns raised by stakeholders about cost and complexity of the previous proposals in the 2010 and 2013 Exposure Drafts. In making these decisions, the Boards observed that for a lessee with a portfolio of leases starting and ending at different times that is not significantly increasing or decreasing its leasing activity, any difference in total reported profit or loss between a lessee in GAAP and a lessee in IFRS is not expected to be significant.

BC27. Topic 842 and IFRS 16 are converged in many respects. However, there are a number of other differences—beside the differences in the core lessee accounting model—between Topic 842 and IFRS 16. Many but not all of those differences arose because of the different decisions reached on the lessee accounting model; however, others arose because of other core decisions of the two Boards such as whether and to what extent the lessor accounting guidance should substantially align with the revenue recognition guidance in Topic 606 and IFRS 15, *Revenue from Contracts with Customers*. Consequently, other than as discussed in the “Comparison with IFRS 16, *Leases*” section in paragraphs BC418–BC431, this basis for conclusions summarizes only the reasons for decisions made by the FASB and reflected in Topic 842 or the conforming amendments to the *FASB Accounting Standards Codification*®.

BC28. Topic 842 addresses many of the concerns raised by stakeholders about the costs and complexity of the proposals in the 2010 and 2013 Exposure Drafts. Largely in response to those concerns, Topic 842:

- a. Includes a lessee accounting model that recognizes two types of leases and distinguishes between those two types (finance leases and operating leases) using a classification approach substantially similar to the classification approach in the previous leases guidance for distinguishing between operating leases and capital leases. This decision, along with other simplifications described below, will permit many lessees to use their existing systems and processes for applying previous GAAP to apply the requirements in Topic 842.
- b. Substantially retains the lessor accounting model in previous GAAP.
- c. Permits a lessee to not recognize assets and liabilities for short-term leases and aligns the determination of whether a lease is a short-term lease with the definition of *lease term*.
- d. Permits a lessee to apply the leases guidance at a portfolio level for leases with similar characteristics.
- e. Simplifies the measurement of the lease liability relating to variable and optional lease payments and the reassessment requirements as compared with the guidance in the Exposure Drafts.

- f. Simplifies lessee expense recognition and the process for subsequently measuring the right-of-use asset in an operating lease as compared with the guidance in the Exposure Drafts.
- g. Permits lessees to separate lease from nonlease components in all cases and estimate the standalone prices of lease and nonlease components. This represents a simplification of the previous guidance on the separation of lease and nonlease components of a contract in the Exposure Drafts.
- h. Clarifies application of the sale guidance in Topic 606 to sale and leaseback transactions.
- i. Simplifies the lessee and lessor disclosure requirements, principally by eliminating previously proposed reconciliation disclosures.
- j. Simplifies the transition requirements for lessees, lessors, leveraged leases, and sale-leaseback transactions, while clarifying the transition for build-to-suit leases.
- k. Clarifies the definition of a lease.

Application to Private Companies

BC29. During the leases project, the FASB carefully considered the potentially different needs of private companies in deciding to modify some of the requirements. In making those decisions, the Board considered the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*; the Conceptual Framework; input from preparers, auditors, and users of private company financial statements (that is, lenders to private companies); the potentially different needs of users of private company financial statements compared with users of public business entity financial statements; and the feedback and recommendations of the PCC (as well as its predecessor, the Private Company Financial Reporting Committee [PCFRC], which was the Board's private company advisory body during most of the period of the project—that is, from 2007 through 2012), the NAC, and the SBAC. The Board observed the recommendations of the PCC, the PCFRC, and others that the accounting should be consistent for public business entities and private companies with respect to leases.

BC30. The Board also considered the generally more limited resources of private companies in considering the costs and benefits of the requirements in Topic 842. The Board observed that the lease accounting requirements in previous GAAP were identical for public business entities and private companies; therefore, the Board's views of the initial and ongoing costs to apply the new requirements (see paragraphs BC9–BC11) apply equally to public business entities and private companies. That is, for most entities, including most private companies, the ongoing costs of applying the requirements in Topic 842 should not be significantly greater than the costs of applying previous GAAP, and a significant portion of private companies will be able to apply the requirements in Topic 842 using similar

systems and processes to what they used in previous GAAP to meet those reporting and disclosure requirements.

BC31. Paragraphs BC402–BC414 discuss the Board's considerations about whether to modify some of the requirements in Topic 842 for private companies in the following areas:

- a. Recognition
- b. Measurement
- c. Disclosures
- d. Presentation
- e. Transition.

The Lessee and Lessor Accounting Models and Classification of Leases

Lessee Accounting

BC32. Contracts create rights and obligations for the parties to the contract. The lessee accounting model in Topic 842 considers the rights and obligations created by a lease, which is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. The model reflects that, at the commencement date, a lessee has a financial obligation to make lease payments to the lessor for its right to use the property, plant, or equipment (the underlying asset) during the lease term. The lessor conveys that right to use the underlying asset at lease commencement, which is the point in time that it makes the underlying asset available for use by the lessee. Consequently, the Board refers to the model as a right-of-use model.

BC33. A lessee has an obligation to make payments to the lessor as a direct consequence of the lessor making the underlying asset available for use by the lessee (that is, granting the lessee the right to use the underlying asset). The lessee also has an obligation to return the underlying asset to the lessor at the end of the lease term. Similarly, the lessor has a right to receive payments from the lessee for granting the right to use the underlying asset. The lessor also retains rights associated with the underlying asset. Having identified the rights and obligations that arise from a lease for the lessee and lessor, the Board then considered which of those rights and obligations should be recognized as assets and liabilities by the lessee and lessor.

Obligations Arising from a Lease That Create Liabilities for the Lessee

Obligation to make lease payments (lease liability)

BC34. Paragraph 35 of Concepts Statement 6 states that “liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” The Board concluded that the lessee’s obligation to make lease payments meets the definition of a liability in Concepts Statement 6 because:

- a. Under the lease contract, the lessee has a present obligation to make lease payments once the underlying asset has been delivered (or made available) to the lessee. In accordance with Concepts Statement 6, that obligation arises from a past event—the lessor’s performance in delivering (or making available) the underlying asset for use by the lessee. The lessee has no contractual right to cancel the lease and avoid the contractual lease payments (or termination penalties) before the end of the lease term. In addition, unless the lessee breaches the contract, the lessor has no contractual right to take possession of, or prevent the lessee from using, the underlying asset until the end of the lease term.
- b. The obligation results in a future outflow of economic benefits from the lessee—typically contractual cash payments—in accordance with the terms and conditions of the contract.

Obligation to return the underlying asset to the lessor

BC35. The lessee controls the use of the underlying asset during the lease term and has an obligation to return the underlying asset to the lessor at the end of the lease term. That is a present obligation that arises from a past event (the underlying asset being made available for use by the lessee in accordance with the lease contract).

BC36. It might appear that there is an outflow of economic benefits at the end of the lease term because the lessee must surrender the underlying asset, which often will still have some economic potential. However, the Board concluded that there is no outflow of economic benefits from the lessee when it returns the leased item, other than incidental costs, because the lessee does not control the economic benefits associated with the asset that it returns to the lessor. Even if the lessee has physical possession of the underlying asset, it has no right to obtain the remaining economic benefits associated with the underlying asset once the lease term expires (ignoring any options to extend the lease or purchase the underlying asset). In that case, the position of the lessee at the end of the lease term is like that of an asset custodian. The lessee is holding an asset on behalf of

a third party, the lessor, but has no right to the economic benefits embodied in that asset at the end of the lease term.

BC37. Consequently, the Board concluded that the lessee's obligation to return the underlying asset does not meet the definition of a liability in Concepts Statement 6.

Rights Arising from a Lease That Create Assets for the Lessee

Right to use the underlying asset

BC38. Paragraph 25 of Concepts Statement 6 states that "assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." The main characteristics of the definition of an asset are that the entity controls an economic resource or benefit, the resource or benefit arises from a past event, and future economic benefits are expected to flow to the entity. The Board concluded that a lessee's right to use the underlying asset meets the definition of an asset because:

- a. The lessee's right of use permits the lessee to obtain substantially all the benefits from use of the asset during the lease term and to control others' access to the identified underlying asset through its right to control the use of the underlying asset throughout the lease term. Once the underlying asset is delivered (that is, the right of use is conveyed) to the lessee, neither the lessor nor any other party is able to have access to the underlying asset without the consent of the lessee (or breach of contract). Despite being the legal owner of the underlying asset, the lessor is unable to retrieve or otherwise use the underlying asset during the lease term without breaching the contract with the lessee.
- b. The lessee's control of an asset resulting from its right of use is demonstrated by its ability to determine how and when it uses the underlying asset and, thus, how it obtains future economic benefits from that right of use. For example, assume a lessee leases a truck for 4 years, for up to a maximum of 160,000 miles over the lease term. Embedded in the right to use the truck is a particular volume of economic benefits or service potential that is used up over the period of time that the truck is driven by the lessee. Upon delivery of the truck to the lessee, the lessee can decide how (often within parameters defined in the contract) it wishes to consume the economic benefits embedded in its right of use. It could decide to drive the truck constantly during the first two years of the lease, using up all of the economic benefits in those first two years. Alternatively, it could use the truck only during particular months in each year or decide to use it evenly over the four-year lease term.
- c. In most leases, a lessee's right to use an asset includes some restrictions on its use. For example, in the truck example in (b) above, the lessee cannot drive the truck for more than 160,000 miles over the 4-year lease

term. A similar example may preclude the lessee from transporting an asset outside of, or to, a particular territory. Some suggested that those restrictions result in the lessee not having control of the right to use the underlying asset. However, the Board concluded that, although those restrictions may affect the value of and payments for the right-of-use asset, they do not affect the existence of the right-of-use asset. That is consistent with the recognition of other assets. It is not unusual for particular restrictions to be placed on the use of owned assets as well as leased assets. For example, assets that are used as security for particular borrowings may have restrictions placed on their use by the lender, or a government may place restrictions on the use or transfer of assets in a particular region for environmental or security reasons. Licenses of intellectual property also frequently have restrictions attached. Those restrictions do not necessarily result in the conclusion that the entity does not control an asset. The restrictions may limit choice in terms of decision making and affect the economic benefits that will flow to the entity from the asset, and that will be reflected in the price that the entity is willing to pay for those economic benefits.

- d. The lessee's control of the right of use arises from a past event—the lessor's performance of making the underlying asset available for use by the lessee at the commencement date. Some suggested that the lessee's right to use the underlying asset is conditional on the lessee making payments during the lease term. In other words, if the lessee does not make payments, it may forfeit its right to use the asset (which is similar to the situation that would arise if an entity failed to make payments on an installment purchase). However, unless the lessee breaches the contract, the lessee has an unconditional right to use the underlying asset.

BC39. Some Board members further observed that other rights of use that result from a supplier making an underlying asset available for use by a customer, for example, regarding intangible assets (that is, licenses of intellectual property), are recognized as assets in accordance with GAAP.

Why Leases Are Different from Service Contracts for the Lessee

BC40. Leases are different from service contracts and, therefore, generally give rise to different rights and obligations. That is because in a lease the lessee continues to benefit throughout the lease term from the lessor's performance, at lease commencement, of making the underlying asset available for use by the lessee. The lessee benefits in substantially the same manner that a licensee continues to benefit from a license to intellectual property, and from the licensor's performance that occurs at the start of the license period by making the underlying intellectual property available for the licensee's use, throughout the license period.

BC41. When the lessor delivers (or makes available) the underlying asset for use by the lessee at the commencement date, the lessor has fulfilled its obligation

to transfer the right to use that underlying asset to the lessee even if it has other obligations that require continuing performance under the contract (for example, an obligation to provide services). The lessee now controls the right-of-use asset and has an obligation to pay for that right-of-use asset, which has arisen from the past event of the lessor's performance at lease commencement. The lease liability reflects that the lessee will pay for the right-of-use asset obtained at lease commencement in the future, typically over the lease term. After the lessor makes the underlying asset available for use by the lessee, the lessee cannot avoid making the required lease payments because it cannot return the underlying asset to the lessor before the end of the lease without breaching the contract (or incurring termination penalties). Similarly, unless the lessee breaches the contract, the lessor cannot retrieve the underlying asset from the lessee (that is, revoke the lessee's right to use the underlying asset transferred to the customer at lease commencement or infringe on the lessee's "quiet enjoyment" of the use of the underlying asset) before the end of the lease without breaching the contract.

BC42. In contrast, in a typical service contract, the customer obtains economic benefits from the service only as the supplier performs the service. The supplier's performance to date does not continue to benefit the customer throughout the remaining service period. However, where it does, for example, by creating an asset for the customer, the customer typically recognizes that asset and any obligation to pay for the services provided. In a typical service contract, the vendor has a remaining obligation to perform until it has provided all of the service to its customer. Consequently, the customer typically has an obligation to pay only for the services provided to date.

BC43. Some Board members see less of a distinction between a lease contract and a service contract. Those Board members agree that leases create assets and liabilities for the lessee, but they observe that operating leases, which typically convey rights to the lessee different from those conveyed by ownership of a similar asset, are similar in at least some respects to many service contracts. Those Board members concluded that there are contracts that do not meet the definition of a lease, yet convey economically similar rights and obligations to the customer. For example, in Example 2 of Section 842-10-55 (paragraphs 842-10-55-52 through 55-54), the airport operator (Supplier) has conveyed a right to use its space at the inception of the arrangement, and the Customer has an obligation to pay that is conditional only on the continued access to space owned by the Supplier. This, in substance, is very similar to the economics of a lease and is similar, in those Board members' views, to the rights and obligations under many service contracts. Thus, it is not as definitive to those Board members that leases give rise to rights and obligations substantially different from those that arise in service contracts. Rather, those Board members support the reporting and presentation of right-of-use assets and lease liabilities separately in the statement of financial position based on the enhanced information content about leases that such reporting will provide to users of financial statements. Those Board members noted that the requirements in Topic 842 meet user demands for greater transparency about the rights and

obligations of lessees, rather than rely on a distinction between leases and service contracts. Consequently, for some of those Board members, the decision not to require the recognition of assets and liabilities arising from services in a contract that contains a lease was because they did not want to introduce changes to the accounting for services on a piecemeal basis in the leasing guidance (that is, only for services entered into in conjunction with a lease). In their view, changes to recognize assets and liabilities arising from arrangements for services would need to be addressed more comprehensively.

The Lessee Accounting Model in Topic 842

BC44. Having concluded that the lessee's obligation to make lease payments meets the definition of a liability and the lessee's right to use the underlying asset meets the definition of an asset, the Board considered whether requiring a lessee to recognize that asset and that liability for all leases would improve financial reporting to such an extent that the benefits from the improvements would justify the costs associated with such a change.

BC45. On the basis of comments from respondents to the Discussion Paper as well as to the 2010 and 2013 Exposure Drafts and from participants at consultation meetings (including meetings with more than 270 users of financial statements—including lenders for private companies), the Board concluded that there would be significant benefits from requiring a lessee to recognize a right-of-use asset and a lease liability for all leases (except short-term leases), particularly for users of financial statements and others that have raised concerns about the extent of off-balance sheet financing for operating leases. The Board considered the costs associated with that proposed change throughout its redeliberations and simplified the proposals included in the 2010 and 2013 Exposure Drafts to address concerns about costs (see paragraphs BC189–BC197, BC205–BC212, and BC375–BC381 on the lease term, variable lease payments, and short-term leases, respectively).

Determining Whether and How to Classify Leases

BC46. Having concluded that lessees should recognize a right-of-use asset and a lease liability for all leases other than short-term leases, the Board considered whether all leases should be accounted for in the same manner (that is, whether the lessee accounting model should be a model with a single approach or a model with multiple approaches).

Lessee accounting model with a single approach

BC47. One of the original objectives for the leases project was to develop a lessee accounting model that would apply a single accounting approach for all leases. The Discussion Paper and the 2010 Exposure Draft proposed a lessee accounting model that would have accounted for all leases in the same manner as

finance leases are accounted for in the amendments in this Update. To clarify, for all leases in a lessee accounting model of this nature, the lessee would have:

- a. Amortized the right-of-use asset in a similar manner to other nonfinancial assets, on a systematic basis reflecting the pattern in which the lessee is expected to consume the right-of-use asset's future economic benefits. That typically would have resulted in the lessee recognizing amortization of the right-of-use asset on a straight-line basis over the lease term.
- b. Measured the lease liability in a manner similar to other financial liabilities such that interest would have been recognized each period to produce a constant periodic rate of interest on the remaining balance of the liability. This typically would have resulted in the lessee recognizing decreasing interest costs over the lease term as the lessee makes lease payments reducing the liability balance.

BC48. The Board received differing views on the effects of this proposed single-approach model on a lessee's profit or loss. Some stakeholders agreed with the proposals in the 2010 Exposure Draft. For example:

- a. Some stakeholders noted that every lessee obtains an asset (the right to use the underlying asset) at the commencement date and has an obligation to pay for that right. Accordingly, a lessee should account for the transaction no differently from acquiring any other nonfinancial asset and separately financing that purchase, which would result in recognizing interest on the liability and amortization of the asset.
- b. Other stakeholders said that a single-approach lessee accounting model may not best reflect the economics of all lease transactions. Nonetheless, they supported the single-approach lessee accounting model proposed in the 2010 Exposure Draft because, in their view, it would be less complex and less costly to apply than a model with multiple approaches. They noted the benefits of removing the need for a lease classification test and having only one method of accounting for all leases from an administrative perspective. They also questioned whether multiple expense recognition patterns would increase the usefulness of information provided to users of financial statements.
- c. The majority of financial statement users engaged throughout the project, including most credit analysts, supported a single-approach lessee accounting model in which lessees account for the acquisition of right-of-use assets in a manner consistent with the manner in which other entities account for the acquisition of similar, physical assets. Those users generally stated that the single-approach model proposed in the 2010 Exposure Draft would most closely resemble the adjustments they make to lessees' financial statements in previous GAAP, which are to adjust a lessee's operating lease accounting to approximate capital lease accounting (that is, they split a lessee's operating lease expense into hypothetical amortization and interest expense components).

- d. A majority of practitioners generally expressed a conceptual preference for a single-approach lessee accounting model.

BC49. However, many of the Board's stakeholders, including most preparers, disagreed with having a single-approach lessee accounting model. For example:

- a. Some stakeholders noted that in a typical lease the lessee receives equal benefits from use of the underlying asset and pays equal amounts in each period. The result of separately recognizing interest on the lease liability and amortization of the right-of-use asset, which would typically result in higher total expense in the earlier years of the lease and lower total expense in the later years of the lease, would not, in their view, reflect the economics of receiving equal benefits for equal payments over the life of the lease. They suggested a lessee accounting model that would allocate the total cost of the lease to each period to reflect the pattern in which the lessee consumes benefits from use of the underlying asset for those leases accounted for as operating leases in previous GAAP, while acknowledging that some leases, effectively those accounted for as capital leases in previous GAAP, are similar in nature to the purchase of a nonfinancial asset.
- b. Other stakeholders said that because leases vary widely, ranging from those covering almost all of the life of the underlying asset to those covering a very short portion of the life of the underlying asset, a single-approach lessee accounting model would not accurately reflect the economics of all lease transactions. They suggested that the Board propose different accounting approaches for different populations of leases.
- c. Many other stakeholders commented that accounting for all leases as finance leases would be a costly way to achieve what many view as the primary improvement resulting from the amendments in this Update (that is, the recognition of lease assets and lease liabilities for all leases other than short-term leases). Even though many lessees accounted for capital leases in previous GAAP, lessees typically had a much smaller volume of capital leases than operating leases, such that many preparers commented that significant new systems capabilities and process changes would be necessary to implement the single-approach lessee accounting model and that those would be costly to implement. In addition, accounting for all leases as finance leases would break the alignment between GAAP and U.S. tax and regulatory reporting, resulting in additional costs to preparers to maintain separate accounts for those reporting purposes.
- d. A significant minority of financial statement users supported one or more alternatives that accounted for more than one type of lease, such as the model proposed in the 2013 Exposure Draft (see paragraph BC53) or an approach that would retain the income statement and cash flow results in previous GAAP (as is the result from the provisions in Topic 842).

BC50. Topic 842 does not include a single-approach lessee accounting model such as that proposed in the Discussion Paper and in the 2010 Exposure Draft, in some measure, for all of the reasons outlined in paragraph BC49. The relative importance of each of those reasons differed for each Board member. However, the principal reasons that model was rejected include the following:

- a. The lessee accounting model in Topic 842 reflects the view of those Board members that believe there are substantive economic differences between different types of leases that should be reflected in the financial statements as described in paragraphs BC56 and BC57. Those Board members concluded that the lessee accounting model in Topic 842 provides a faithful representation of those economic differences in a lessee's financial statements, even if the subsequent measurement for operating lease right-of-use assets is different from that for other nonfinancial assets.
- b. Those Board members who view the primary improvement resulting from the amendments in this Update to be the recognition of lease assets and lease liabilities for all leases (other than short-term leases) concluded that accounting for all leases in the manner of finance leases to enact this improvement will be more costly than the lessee accounting model included in Topic 842 for the reasons explained in paragraph BC49(c). Preparers in the United States stated that they generally were not concerned about having to assess lease classification in a manner substantially consistent with previous GAAP and did not consider the elimination of a lease classification assessment to be a significant source of cost savings. Therefore, the lessee accounting model (including the classification approach) in Topic 842 represents the most cost-effective way to achieve this primary improvement.

BC51. Some Board members, however, continue to support a single-approach lessee accounting model because, in their view, the generally straight-line single lease cost for operating leases required by Topic 842 does not faithfully represent the underlying economics of those leases because it is inconsistent with accounting for the time value of money and amortization of the right-of-use asset that would reasonably reflect diminution of value of that right-of-use asset. Despite preferring a single-approach lessee accounting model, those Board members support the issuance of this Update because they consider the requirements in Topic 842, in particular, the recognition of lease assets and lease liabilities for operating leases and the enhanced disclosures for lessees and lessors, to be a significant improvement in financial reporting as compared with previous GAAP.

Consumption-based lessee accounting model

BC52. The 2013 Exposure Draft proposed that there should be two different types of leases (Type A and Type B) and that different lessee accounting approaches should be applied to each type of lease. The Board proposed that the factor that would be used to distinguish between the two types of leases would be

the level of the lessee's consumption of the economic benefits embedded in the underlying asset.

BC53. Feedback on those proposals was mixed. Overall, most U.S. preparers (and preparer groups) that commented on the 2013 Exposure Draft preferred a model with multiple approaches under which some leases would be accounted for in the same manner as other financed purchases of nonfinancial assets and other leases would be accounted for in a manner more similar to operating lease accounting in previous GAAP (but with recognition of right-of-use assets and lease liabilities). This was preferred over the single lessee accounting model proposed in the Discussion Paper and in the 2010 Exposure Draft. However, most of those respondents did not support the "consumption" principle proposed in the 2013 Exposure Draft for determining which model applied to which leases. Those U.S. preparers were of the view that there should be no change from previous GAAP to the statement of comprehensive income or the statement of cash flows, which would have been the result of the lessee accounting model proposed in the 2013 Exposure Draft. Most of those practitioners that supported a dual-approach lessee accounting model were, like most preparers, not supportive of the consumption-based classification approach proposed in the 2013 Exposure Draft. In contrast, some users, particularly those using the financial statements of lessees with significant real estate leases, were supportive of the dual-approach model based on consumption proposed in the 2013 Exposure Draft, stating that it was consistent with how they analyze the leasing activity of the companies they follow.

BC54. The Board rejected the consumption-based classification approach in the 2013 Exposure Draft in favor of the classification approach in Topic 842 principally for one or more of the following reasons, which are generally consistent with the feedback received from many of the Board's stakeholders in response to the 2013 Exposure Draft:

- a. Some Board members concluded that the classification approach in the 2013 Exposure Draft would have resulted in inappropriately classified Type A and Type B leases. Those Board members generally agreed that some leases should be accounted for in a manner consistent with purchases of nonfinancial assets (Type A leases), while other leases should result in the lessee recognizing a generally straight-line single lease cost throughout the lease term (Type B leases), but those Board members concluded that a lessee should reflect a single lease cost for most (or all) leases classified as operating leases in previous GAAP. The consumption-based classification approach would have accounted for many of those leases as Type A leases.
- b. The Board generally agreed that the lease classification approach in the 2013 Exposure Draft would have been more costly and complex to apply than one mostly aligned with the classification approach in previous GAAP. The Board concluded that retaining the lease classification regime in previous GAAP, in all material respects, will substantially reduce the costs of implementing and applying Topic 842 as compared with any

other classification approach that was considered. This is because the classification approach in previous GAAP is:

1. Well established in practice such that lessees are comfortable in applying the guidance. Any new lease classification approach, such as that in the 2013 Exposure Draft, would require entities to undertake training on the new classification requirements as well as to design, develop, and implement new processes and internal controls.
2. Substantially aligned with U.S. tax and regulatory accounting and reporting requirements. Retaining the alignment between book, tax, and regulatory accounting and reporting prevents lessees from having to maintain multiple sets of records to meet different reporting requirements.

BC55. Those Board members who view the primary improvement in Topic 842 to be the recognition of lease assets and lease liabilities concluded that, in the face of diverse views about the effects of the right-of-use model on a lessee's profit or loss (including no clear consensus from users), as well as diverse views on how to effect the "line" within a lessee accounting model that accounts for more than one type of lease, substantially retaining the lease classification approach in previous GAAP is a more practical solution than attempting to introduce an entirely new classification regime.

Classification approach in Topic 842

BC56. The lessee accounting model in Topic 842 does not account for all leases in the same way on the basis that there are economic differences among leases. After considering feedback on the Discussion Paper and on both Exposure Drafts, however, the Board decided to abandon the consumption principle that was proposed in the 2013 Exposure Draft for distinguishing between leases. Instead, the lessee accounting model in Topic 842 classifies leases as finance or operating leases on the basis of whether the lease is economically similar to the purchase of a nonfinancial asset because the lessee, in effect, obtains control of the underlying asset (that is, the ability to direct the use of and obtain substantially all the remaining benefits from the underlying asset), in contrast to merely obtaining control over the *use* of the underlying asset for a period of time. This classification principle is broadly consistent with the longstanding classification principle in previous GAAP and is applied in substantially the same way as the lease classification guidance in previous GAAP.

BC57. A lease is not the same as a purchase of the underlying asset, even when the lease is a finance lease. The rights that a lessee obtains under any lease (whether that lease is classified as a finance lease or an operating lease) are different from the rights that are obtained from the outright purchase of an asset (for example, a lessee cannot sell the underlying asset). However, the Board decided that a finance lease is economically similar to an acquisition of the underlying asset because the terms of a finance lease generally (a) permit an entity

to direct the use of the underlying asset in a manner that allows it to obtain substantially all of the remaining benefits from the asset and (b) impose obligations on the lessee that are similar to those an entity incurs if it finances the purchase of an asset. The Board observed that, even within the category of finance leases, some leases are more similar than others to an acquisition of the underlying asset. Operating leases on the other hand grant different rights to and impose different obligations on the lessee than finance leases and other “rights of use,” such as licenses of intellectual property. Rather than granting rights similar to those conveyed by ownership, the lessee in an operating lease has no rights or exposure to a generally more significant residual asset (that is, the lessee does not obtain substantially all of the remaining benefits from the underlying asset—frequently, the lessee obtains only a minor portion of the remaining benefits and will not be exposed to or benefit from any changes in the value of the underlying asset during the lease term). In the case of lessee bankruptcy (at least under U.S. law), the lessee’s obligations in an operating lease are treated differently than the way its obligations in a finance lease are treated (or a license of intellectual property)—that is, operating lease obligations generally do not survive bankruptcy because they are not considered to be debt. In contrast, financial obligations arising from purchased assets, licenses, and finance leases generally survive in bankruptcy. Consequently, Topic 842 differentiates the financial statement reporting of finance leases from that of operating leases. Paragraphs BC59–BC65 explain the recognition of lease cost for finance and operating leases in Topic 842, while paragraphs BC66–BC69 explain the effect of the lessee accounting model (including its different approaches to finance and operating leases) on the statement of financial position in Topic 842. Paragraphs BC70–BC74 explain the lease classification criteria in Topic 842.

The business purpose of the lessee

BC58. Before issuing the 2013 Exposure Draft, the Board also considered a model that would have distinguished a lessee’s accounting for a lease on the basis of the lessee’s business purpose for entering into the lease. That is, a lessee that enters into a lease solely to gain access to the underlying asset for a period of time would account for the lease as an operating lease. In contrast, a lessee that is entering into the lease as a way to finance the purchase of the underlying asset would account for the lease as a finance lease. However, the Board rejected that approach for comparability reasons. Because leases would have been classified on the basis of each lessee’s assessment of its business purpose, the judgment applied by management might have varied by lessee. That would have made it more difficult for users of financial statements to understand when and how management had applied its judgment when classifying leases, both within the same entity and between entities.

Recognizing Lease Cost

BC59. Topic 842 refers to recognizing and disclosing lease cost rather than lease expense because any lease cost that is capitalized as part of the cost to acquire or construct an asset will not be recognized as lease expense in the statement of comprehensive income (for example, costs capitalized as part of manufacturing inventory or placing an item of property, plant, and equipment into service).

BC60. A lessee's recognition of lease cost for a finance lease in accordance with Topic 842 is consistent with a lessee's recognition and presentation of lease cost for a capital lease in previous GAAP. A lessee in a finance lease will recognize and present amortization of the right-of-use asset consistently with the depreciation or amortization of other nonfinancial assets and will recognize and present interest on the lease liability consistently with interest on other debt-like financial liabilities measured on a discounted basis. This is consistent with the Board's decision that finance leases are economically similar to the financed acquisition of other nonfinancial assets. While stakeholders expressed different views throughout the leases project about which leases should be accounted for in this manner, they generally agreed that separate recognition of interest on the lease liability and amortization of the right-of-use asset are appropriate for those leases that will be classified as finance leases in Topic 842.

BC61. In contrast to the recognition of lease cost for finance leases, Topic 842 recognizes a single lease cost for operating leases on the basis of the pattern in which the benefits conveyed by the lease are consumed, which is generally (but not always) on an equal basis over the lease term. This difference in lease cost recognition for finance and operating leases is based on the view of some Board members that a single operating lease cost more appropriately reflects the economics of operating leases than the separate recognition of interest and amortization that Topic 842 requires for finance leases. This conclusion is consistent with those Board members' view that operating leases grant different rights to and impose different obligations on the lessee such that they are not economically equivalent to other acquisitions of nonfinancial assets because operating leases merely grant the lessee the right to direct the use of the lessor's asset during the lease term and do not expose the lessee to (or permit the lessee to benefit from) changes in the value of the underlying asset.

BC62. Other Board members disagree that the generally straight-line single lease cost that will be recognized for operating leases faithfully represents the underlying economics of those leases because it is inconsistent with accounting for the time value of money and the amortization that should result for a right-of-use asset that the lessee consumes on a generally straight-line basis over the lease term, regardless of how it pays for that asset, and recognizes separately from the lease liability. Those Board members would have preferred a lessee accounting model that recognizes lease cost for all leases in the manner prescribed for finance leases, but they support the issuance of this Update

nonetheless because they consider the requirements in Topic 842, in particular, the recognition of lease assets and lease liabilities for operating leases and the enhanced disclosures for lessees and lessors, to be a significant improvement from previous GAAP.

BC63. The lessee accounting model in the Discussion Paper and the 2010 Exposure Draft would have recognized lease cost in the manner described in paragraph BC60 for all leases. The lessee accounting model in the 2013 Exposure Draft proposed that for some leases (Type B leases), a lessee would recognize a single lease cost, which would *combine* (a) the periodic amortization of the right-of-use asset and (b) the periodic unwinding of the discount on the lease liability to produce a single, straight-line lease cost. The lessee would recognize the periodic unwinding of the discount on the financial lease liability in accordance with the interest method (consistent with the accounting for other financial liabilities), while recognizing amortization of the right-of-use asset as a “balancing figure” that, together with the periodic unwinding of the discount on the lease liability, would achieve a straight-line total lease cost throughout the lease term (absent an impairment of the right-of-use asset). This approach attempted to reconcile the Board’s separate decisions that (1) all leases result in the creation of a nonfinancial right-of-use asset and a financial lease liability for the lessee and (2) a single lease cost recognized on a generally straight-line basis over the lease term best reflects the economics of some leases.

BC64. While a majority of respondents to the 2013 Exposure Draft agreed that a single lease cost should be recognized for some leases, many respondents said that the prescribed mechanics for the Type B single lease cost (combining separately determined amortization of the right-of-use asset and unwinding of the discount on the lease liability to achieve the single lease cost amount each period) was complex and unnecessary to achieve the Board’s objective. Some stakeholders suggested that this prescribed method for producing the single lease cost, particularly when coupled with a requirement to disclose the periodic unwinding of the discount separately from the single total lease cost amount (as was proposed in the 2013 Exposure Draft), would be costly for preparers because it would require new systems capabilities and processes to calculate and report the separate unwinding of the discount on the lease liability and the unique amortization of the right-of-use asset. In response to those concerns, the Board decided not to refer to the determination of the single lease cost for operating leases in Topic 842 as the combination of two separate elements (that is, the periodic unwinding of the discount on the lease liability plus the amortization of the right-of-use asset). That characterization was inconsistent with the view that the single lease cost represents the lessee’s singular consumption of the economic benefits embedded in an operating lease. In addition, the Board concluded that eliminating the prescribed mechanics in the 2013 Exposure Draft for the single lease cost for operating leases will permit entities to determine the single lease cost using the same operating lease cost process applied under previous GAAP (that is, when combined with the Board’s decisions on subsequent measurement

of operating lease right-of-use assets and lease liabilities), which will significantly reduce the costs to implement and apply the new leases guidance as compared with the proposals in the 2013 Exposure Draft.

BC65. In reaching its decisions (a) on how to recognize lease cost for operating leases and (b) not to require separate disclosure of either the periodic unwinding of the discount on operating lease liabilities or amortization of operating lease right-of-use assets, the Board acknowledged that many users would not receive information that they deem important to their analysis (for example, separate interest information). Therefore, the Board decided to include alternative quantitative disclosures (for example, weighted-average discount rate information) that will allow those users to receive much, but not all, of the same information without requiring lessees to implement significant new systems or processes to produce those disclosures or to produce the periodic single operating lease cost. Lessee disclosures are discussed in more detail in paragraphs BC272–BC291.

Subsequent Measurement of the Right-of-Use Asset

BC66. In the Board's view, the right-of-use asset in a finance lease is economically similar to other nonfinancial assets, conveying to the lessee rights similar to many other nonfinancial assets (for example, many licenses to intangible assets). As a consequence, in Topic 842, the right-of-use asset arising from a finance lease is measured in the same manner as any other acquired nonfinancial asset. That is, the right-of-use asset is (a) measured at cost, net of accumulated amortization, and (b) amortized on a straight-line basis from the commencement date to the end of the lease term unless another systematic basis is more representative of the pattern in which the lessee expects to consume the economic benefits of that right-of-use asset.

BC67. In contrast, Topic 842 accounts for the right-of-use asset in an operating lease differently from other nonfinancial assets on the basis that it conveys rights to the lessee that are different from other nonfinancial assets. On the basis of those different rights conveyed by an operating lease, some Board members concluded that a reasonable representation of the economics of operating leases is to recognize a single lease cost that reflects the pattern in which the benefit from the right of use conveyed by the lease is consumed. Those Board members acknowledge that recognizing a single lease cost (that is, not separately recognizing amortization of the right-of-use asset in an operating lease) does not articulate how to subsequently measure the right-of-use asset in an operating lease and results in an atypical pattern of change in the carrying amount of that asset over the lease term. For those Board members, who view accurate measurement of the lease liability as paramount, the decision to measure the right-of-use asset by reference to the lease liability throughout the lease term, adjusted for the effects of accrual-based accounting, regardless of the atypical pattern of change in the carrying amount of the right-of-use asset, is principally one of cost benefit. In their view, measuring the right-of-use asset by reference to the lease

liability represents the most cost-effective way to enact what they view as the primary improvement resulting from Topic 842 (that is, the recognition of the lease assets and lease liabilities that arise from operating leases) while still reflecting what they view as the economic substance of those leases in the income statement and the statement of cash flows and reasonably representing the future economic benefits to the lessee in the lease.

BC68. Some Board members further explain that, in their view, the apparent atypical subsequent measurement of the operating lease right-of-use asset occurs solely because of the Board's decision to present that right-of-use asset and the related lease liability on a discounted basis in the financial statements. Absent the Board's decision to discount the lease liability and, correspondingly, the right-of-use asset, the subsequent measurement of the right-of-use asset would be consistent with that of other nonfinancial assets (that is, recognizing amortization expense on a generally straight-line basis consistent with the generally equal benefits the lessee receives from its access to the underlying asset over the lease term). For those Board members, the decision to more faithfully represent the lease liability and the right-of-use asset on the statement of financial position by presenting them on a discounted basis should not override what they view as the fundamental premise of the lessee accounting model in Topic 842. That premise is that operating leases are economically different from finance leases and that recognition of a generally straight-line single lease cost for operating leases appropriately reflects the fact that, in an operating lease, the lessee solely obtains a generally equal right to use the underlying asset throughout the lease term and is not exposed to, nor does it benefit from, changes in the value of the underlying asset in the way an owner of a similar asset is exposed to (or benefits from) such changes. Because the owner of a nonfinancial asset is exposed to (or benefits from) changes in value of the underlying asset, the benefits to be derived from the asset are not directly correlated with the generally equal payments to repay the financing of the asset, which supports the changes in the carrying amount of the asset not being linked to the carrying amount of the financial liability and separate recognition of depreciation (or amortization) of the owned nonfinancial asset and interest on the financial liability. Those Board members view the measurement of the right-of-use asset in an operating lease as linked, economically, to the measurement of the lease liability because the carrying value of the right-of-use asset, which reflects the remaining economic benefits of equal access to the underlying asset during the remainder of the lease term, is directly correlated to the generally equal lease payments the lessee makes for those benefits. Because, in their view, the measurement of the right-of-use asset and the measurement of the lease liability should remain linked throughout the lease term, the measurement of the right-of-use asset should be affected by the time value of money in the same way as the lease liability such that its carrying amount changes in tandem with the changes to the lease liability over the lease term. However, this linked movement should be adjusted for the effects of increasing or decreasing lease payments (that is, the effects of accrual-based accounting) or impairment of the right-of-use asset (see paragraphs BC255–BC259 for additional discussion on

impairment of operating lease right-of-use assets). Those Board members believe that the “annuity-type” pattern of change in the carrying amount of the operating lease right-of-use asset between periods is a consequence of an accounting model under which both (a) the carrying amount of the right-of-use asset and the carrying amount of the lease liability are linked throughout the useful life of the right-of-use asset (that is, the lease term), absent impairment, and (b) the most faithful representation of the right-of-use asset and the lease liability in the statement of financial position requires discounting of those items. Those Board members would not support an annuity-type pattern of amortization outside those circumstances.

BC69. Initial and subsequent measurement of right-of-use assets and lease liabilities is further discussed in paragraphs BC187–BC259.

Lease Classification Test

BC70. The lessee accounting model in Topic 842 classifies leases as finance leases or operating leases on the basis of whether the lease is similar economically to the purchase of a nonfinancial asset because the lessee, in effect, obtains control of the underlying asset (in contrast to merely obtaining control over the use of the underlying asset) by being able to direct its use and obtain substantially all of its remaining benefits as a result of the lease.

BC71. The Board decided that a lease should be classified as a finance lease when any one of the following five criteria is met. The Board observed that some of the criteria below (for example, the transfer of ownership criterion) may provide a more concrete indication of when the lessee, in effect, obtains the ability to direct the use of, and obtain substantially all the remaining benefits from, the underlying asset as a result of the lease than other criteria (for example, the remaining economic life criterion). However, the Board concluded that the criteria, as outlined and for the reasons below, provide a reasonable, even if not absolute, basis for distinguishing leases that are economically similar to the purchase of a nonfinancial asset (finance leases) from those that are not, acknowledging that economic similarity may be greater or less for some finance leases than others and that use of these classification criteria will achieve the goal of those Board members who wanted the classification test in Topic 842 to yield similar results to the classification test in previous GAAP.

- a. *The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.* A lessee directs the use of an underlying asset during the lease term. A provision that transfers ownership of the underlying asset to the lessee by the end of the lease term means that the lessee has the right to both (1) direct the use of the underlying asset (both during the lease term and subsequently) and (2) obtain substantially all of the remaining benefits of the underlying asset.
- b. *The lease grants the lessee an option to purchase the underlying asset that it is reasonably certain to exercise.* Reasonably certain is a high

threshold, evaluated on the basis of relevant economic factors (see paragraphs BC193–BC197). Such a provision is not substantively different from a provision that automatically transfers ownership of the underlying asset to the lessee.

- c. *The lease term is for a major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion shall not be used for purposes of classifying the lease.* The Board considered whether this criterion should refer to the lease term being for “substantially all” of the remaining economic life of the underlying asset to align with the notion that for an entity to control an asset, it must have the ability to obtain substantially all the remaining benefits from the asset. The Board rejected the use of “substantially all” as the threshold for this criterion because although the lease term may represent only a major part of the remaining economic life of the underlying asset, equipment assets, in particular, depreciate in a front-loaded manner. This means that a lease term that is, for example, 75 percent of an asset’s remaining economic life will frequently give the lessee the ability to obtain a disproportionate percentage of the remaining benefits from that asset. This is because new (or newer) equipment, reflecting later technology and in better condition, can be assumed to be more efficient and hence, yield proportionately more use benefit than older equipment that has been subject to obsolescence and/or the wearing-out process. The Board also decided that an entity should assess whether the lease term is for a major part of the remaining economic life of the underlying asset at the commencement date rather than its *total* economic life, because that aligns with the notion that an entity controls an asset when, in part, it has the ability to obtain substantially all of the *remaining* benefits from that asset. Some Board members observed that this criterion may provide the most circumstantial evidence as to whether the lessee obtains the ability to direct the use of, and obtain substantially all the remaining benefits from, the underlying asset of the criteria provided. However, the Board concluded that inclusion of this criterion is important to ensuring that a lease that is expected to consume substantially all of the remaining benefits of an underlying asset is not classified inappropriately solely because all or a significant portion of the lease payments are variable lease payments. The exception to considering this criterion when the lease commences at or near the end of the economic life of the underlying asset is contrary to the lease classification principle because a lessee can direct the use of and obtain substantially all the remaining benefits from a significantly used asset just the same as it can a new or slightly used asset. However, the Board determined that an exception is appropriate because it would be inconsistent to require that a lease covering the last few years of an underlying asset’s economic life be recorded as a finance lease by a lessee (or sales-type lease by a lessor) when a similar lease of that asset earlier in its economic life would have been classified as an operating

lease. The Board concluded that this would not appropriately reflect the economics of those leases.

- d. *The sum of the present value of the lease payments and any residual value guaranteed by the lessee amounts to substantially all of the fair value of the underlying asset.* If the lessee, through its contractually obligated payments, guarantees recovery of substantially all the fair value of (that is, in essence, the lessor's investment in) the underlying asset, the lessee controls substantially all the remaining benefits of the underlying asset. Some stakeholders questioned whether this criterion should take into account those payments that would be made only to satisfy a residual value guarantee. However, when the lessee has guaranteed all or a portion of the lessor's estimated residual value, the lessee controls that portion of the underlying asset that it has guaranteed. Under the terms of the contract, the lessee could either return the asset to the lessor with the required residual value or use and consume the economic benefits in the asset, making a financial payment to the lessor to satisfy the residual value guarantee. Because the lessee controls that decision, it controls the benefits of the asset embodied in that guaranteed residual value. The Board considered whether this criterion should be based on the present value of the expected residual asset because that might be more indicative of whether the lessor had transferred substantially all the remaining benefits and, therefore, control of the underlying asset to the lessee. However, the Board decided that this might be much more subjective and complex for lessees to apply than this criterion because lessees often have much less information or technical knowledge about the underlying asset from which to make this determination. The Board decided that this criterion, which existed in previous GAAP and, therefore, is familiar to lessees (and lessors), is an effective proxy for a residual-value-focused criterion because it effectively measures the opposite.
- e. *The underlying asset is of a specialized nature such that it is expected to have no alternative use to the lessor at the end of the lease term.* In general, it is expected that lessors would lease specialized assets that have no alternative use to them at the end of the lease term only under terms that would transfer substantially all the benefits (and risks) of the asset to the lessee (thus, one of the other criteria for a finance lease also likely will be met). However, even if that is not the case, when an underlying asset has no alternative use to the lessor at the end of the lease term, the lessee consumes all (or substantially all) of the remaining benefits from the underlying asset. Absent significant rework or a change in circumstances during the lease term (for example, the emergence of another potential customer or new use for the underlying asset in its present, specialized form), there are no remaining benefits inherent in the specialized underlying asset that revert to the lessor at the end of the lease term.

BC72. Despite evaluating whether the lease is economically similar to the purchase of a nonfinancial asset from the perspective of control rather than from the perspective of risks and benefits of ownership (as was the basis in previous GAAP), the classification approach in Topic 842 is substantially similar to that in previous GAAP for determining whether a lease is a capital lease or an operating lease and will be applied similarly in most circumstances. The Board concluded that, in the absence of a compelling rationale for any other classification approach, of which many were considered during the course of the leases project, retaining an approach that is substantially similar to that in previous GAAP will reduce the costs and complexity of applying a new leases standard. Paragraphs BC54 and BC55 explain the Board's conclusion in this regard. Board members further observed that, in general, and at least partially because of U.S. tax, regulatory, and legal requirements, an entity's rights and obligations differ for leases that were classified as capital leases in previous GAAP from those that were classified as operating leases. Therefore, reflecting that "line" as the point at which the accounting for a lease should reflect differing economics in Topic 842 is reasonable.

BC73. The lease classification criteria in Topic 842 do not depend on bright-line thresholds as they did in previous GAAP. The Board observed that the bright-line classification thresholds were one of the areas most frequently criticized in previous GAAP. Those criticizing the bright-line thresholds often noted that transactions that were only immaterially different were accounted for very differently. Consequently, the Board decided that it should not mandate bright-line thresholds for the lease classification test in Topic 842. Nevertheless, the Board understands that entities need to ensure the leases guidance is operational in a scalable manner, which often requires the establishment of internal accounting policies and controls. As a result, the Board included implementation guidance in Topic 842 that states that one reasonable application of the lease classification guidance in that Topic is to conclude, consistent with previous GAAP, that 75 percent or greater is a "major part" of the remaining economic life of an underlying asset, a lease term that commences within the last 25 percent of the economic life of the underlying asset is commencing "at or near" the end of the economic life of the underlying asset, and that 90 percent or greater is "substantially all" the fair value of the underlying asset (and that anything less than those amounts is not a major part, at or near the end of the economic life of the underlying asset, or substantially all, respectively). While the Board acknowledges that this largely retains some, but not all, of the "bright lines" in the lease classification test in previous GAAP, it does not mandate those bright lines. The Board also observed that, to some extent, criticism of the previous bright-line thresholds will likely be mitigated solely by the fact that all leases (other than short-term leases for which a lessee elects the recognition and measurement exemption) are required to be recognized on the balance sheet under Topic 842.

BC74. Lastly, the Board decided that lessees should determine lease classification for each separate lease component. That is, an entity assesses lease

classification for the component, not for each lease within the component (for example, Example 13 in Section 842-10-55 [paragraphs 842-10-55-146 through 55-149] states that the entity assesses lease classification for the turbine plant and not for the turbine, the building, and the land individually). The Board decided that determining lease classification for each lease within the separate lease component would be inconsistent with determining that the separate lease component is the proper unit of account at which to apply the leases guidance to then assess lease classification at a different level. Because the Board understands that a single lease component may include multiple underlying assets, the Board has specified that when classifying a single lease component that includes the lease of multiple underlying assets, an entity considers:

- a. The remaining economic life of the predominant asset in the lease component for purposes of applying the classification criterion in paragraph 842-10-25-2(c). The Board noted that assessing the predominant asset in a lease component that includes multiple underlying assets will be straightforward in most cases. That is, the assessment is a qualitative one that requires entities to conclude on what is the most important element of the lease, which should be relatively clear in most cases. The Board also noted that if an entity is unable to identify the predominant asset, it may indicate that there is more than one separate lease component in the contract.
- b. The fair value of the separate lease component for purposes of applying the classification criterion in paragraph 842-10-25-2(d). The Board noted that the fair value of the separate lease component may be different from the sum of the fair values of the underlying assets.

The Lessor Accounting Model

Rights and Obligations Arising from a Lease for the Lessor

Lease receivable

BC75. When the lessor makes the underlying asset available for use by the lessee, the lessor has fulfilled its obligation to transfer the right to use that asset to the lessee—the lessee controls the right of use and has a liability to make lease payments (lease liability). Accordingly, the lessor has a lease receivable. The lessor controls that right to payment—for example, it can decide to sell or securitize that right. The right arises from a past event (the lessor's performance at the commencement date of making the underlying asset available for use by the lessee—that is, transferring the right-of-use asset to the lessee) and is expected to result in future economic benefits (typically cash from the lessee) flowing to the lessor.

BC76. Consequently, the Board concluded that the lessor's lease receivable meets the definition of an asset in Concepts Statement 6. Paragraphs BC88–BC90

explain the Board's rationale for lessors not recognizing the lease receivable that results from an operating lease.

Rights retained in the underlying asset

BC77. Although the lessor transfers the right to use the underlying asset to the lessee at the commencement date, the lessor has the right to the underlying asset at the end of the lease term (and retains some rights to the underlying asset during the lease term, for example, the lessor retains title to the asset). Consequently, the lessor retains some of the potential economic benefits embedded in the underlying asset.

BC78. The lessor controls the rights it retains in the underlying asset. A lessor can often, for example, sell the underlying asset (with the lease attached) or agree at any time during the initial lease term to sell or re-lease the underlying asset at the end of the lease term. The lessor's rights to the underlying asset arise from a past event—the purchase of the underlying asset or signing of the head lease, if the lessor is a sublessor. Future economic benefits from the lessor's retained rights in the underlying asset are expected to flow to the lessor, assuming that the lease is for anything other than the full economic life of the asset. The lessor would expect to obtain economic benefits either from the sale, re-lease, or use of the underlying asset at the end of the lease term.

BC79. Consequently, the Board concluded that the lessor's rights retained in the underlying asset meet the definition of an asset in Concepts Statement 6. However, consistent with the Board's decision that a lessor should not recognize separately the lease receivable that results from an operating lease (see paragraphs BC90–BC92), the Board concluded that lessors should not recognize separately their rights retained in underlying assets subject to operating leases. Instead, the lessor should continue to recognize the entire underlying asset.

The Lessor Accounting Model

BC80. Having concluded that the lessor's lease receivable and rights retained in the underlying asset both meet the definition of an asset, the Board considered whether requiring a lessor to both recognize those assets for all leases and derecognize the underlying asset would improve financial reporting to such an extent that the benefits from the improvements would justify the costs associated with such a change.

Whether to replace (or change) the lessor accounting model in previous GAAP

BC81. Both the 2010 and 2013 Exposure Drafts proposed substantial changes to the lessor accounting model from that in previous GAAP. The Board considered the lessor accounting proposals in and feedback on each of those Exposure Drafts

in deciding whether to replace (or substantially change) the lessor accounting model in previous GAAP as part of the amendments in this Update.

BC82. In the 2010 Exposure Draft, the Board proposed that a lessor would recognize a lease receivable for all leases. That is consistent with a lessee recognizing a lease liability for all leases.

BC83. If the lessor retained exposure to significant risks or benefits associated with the underlying asset, the Board proposed that the lessor would continue to recognize the underlying asset as its asset, as well as recognize a lease receivable. The lessor also would recognize a liability. This approach was described as the performance obligation approach in the 2010 Exposure Draft. Under this approach, the lease was considered to create an asset, the lease receivable, and a liability (that is, an obligation to permit the lessee to use the underlying asset over the lease term). The asset and the liability created by the lease would be separate from the underlying asset itself. The lessor would retain control of the underlying asset and would continue to recognize it. The lessor would recognize periodic lease income on the performance obligation liability (on the basis of the pattern in which the lessee consumed benefits under the lease, often straight line), periodic interest income on the lease receivable (using the effective interest method), and depreciation on the underlying asset.

BC84. If the lessor did not retain exposure to significant risks or benefits associated with the underlying asset, the Board proposed that the lessor would derecognize the portion of the underlying asset relating to the right-of-use asset transferred to the lessee and recognize a lease receivable. The rights retained in the underlying asset would be reclassified as a residual asset. That approach was described as the derecognition approach in the 2010 Exposure Draft. The lessor would recognize the difference between the initial lease receivable and the cost of the portion of the underlying asset that was derecognized as a gain or loss at lease commencement. After lease commencement, the lessor would recognize interest income each period on the lease receivable.

BC85. There was very little support for the performance obligation approach from respondents to the 2010 Exposure Draft or from participants at outreach meetings. Many viewed the approach as inappropriately inflating a lessor's assets and liabilities. Many questioned how one set of cash flows—the cash flows to be received from the lessee—could relate to both the lease receivable and the underlying asset. Many also questioned how the obligation to permit the lessee to use the asset would meet the definition of a liability. Having delivered the underlying asset to the lessee, the lessor typically would have nothing further to do in relation to the right-of-use asset other than to comply with the terms and conditions of the contract. While for most leases, the lessor must not interfere with the lessee's "quiet enjoyment" of the underlying asset unless the lessee breaches the contract, most respondents did not view complying with the terms and conditions of a contract as an obligation that should give rise to a liability, particularly because there would appear to be no expected outflow of future

economic benefits from the lessor, which is an essential component of the definition of a liability.

BC86. Some stakeholders supported applying the derecognition approach to all leases; they generally agreed that the lessor does not have a liability solely because it must comply with the terms and conditions of the contract and noted that the derecognition approach was the most consistent with the view that the lessor fulfills its obligation to transfer a right-of-use asset at lease commencement. Other stakeholders stated that the existing lessor accounting requirements were not “broken” and questioned whether the benefit of changing lessor accounting would justify the costs associated with that change. Others were concerned about the lack of consistency between the lessee accounting proposals (a single lessee accounting model) and the lessor accounting proposals (a dual lessor accounting model). Many stakeholders suggested that the Board make the lessor proposals consistent with the revenue recognition proposals, the lessee accounting proposals, or, ideally, both.

BC87. On the basis of the feedback on the 2010 Exposure Draft, the Board decided to propose an alternative lessor accounting model in the 2013 Exposure Draft. In accordance with the proposals in the 2013 Exposure Draft, a lessor would determine the appropriate lessor accounting approach using the same classification requirements as those proposed for lessee accounting (that is, based on the same “consumption” principle) in that Exposure Draft. If a lessee was expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset (a Type A lease), the lessor would account for the transfer of the right-of-use asset to the lessee as the sale of that portion of the underlying asset that the lessee is expected to consume. Accordingly, the lessor would derecognize the underlying asset and recognize a lease receivable and a residual asset, which would be measured on a cost basis. The lessor also would recognize any profit relating to the lease at the commencement date (that is, the portion of the difference between fair value of the underlying asset and its carrying amount attributable to the right-of-use asset granted to the lessee). If the lessee was not expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset (a Type B lease), the lessor would account for the lease in a manner substantially similar to operating lease accounting in previous GAAP and in Topic 842. Accordingly, the lessor would not recognize a lease receivable and a residual asset and would not derecognize the underlying asset. The lessor would recognize rental income over the lease term, typically on a straight-line basis. The Board decided that any other approach to Type B leases (such as the performance obligation approach in the 2010 Exposure Draft or netting the lease receivable and the performance obligation liability) would not be justified.

BC88. Despite concluding that under the right-of-use model the lessor’s performance at lease commencement (that is, making the underlying asset available for the lessee’s use) creates an unconditional right to receive lease payments (that is, a lease receivable), the Board decided not to propose the

recognition of a lease receivable for all leases, thereby rejecting a single lessor accounting model along the lines of the derecognition approach in the 2010 Exposure Draft. Although some stakeholders had suggested applying the derecognition approach to all leases, the Board rejected that approach, mainly for most property leases (that is, leases of land or buildings), for a number of reasons:

- a. When a lessee is not expected to consume a significant portion of the underlying asset (for example, in many property leases), an approach that requires a lessor to continue to recognize the underlying asset and separately recognize rental income would generally provide more useful information to users.
- b. A single model based on the recognition of a lease receivable and derecognition of the underlying asset would not appropriately reflect the business model of many lessors, principally those that lease longer lived assets (such as property).
- c. It would be extremely complicated to apply the approach to leases of portions of a larger asset (that is, when a lessor leases portions of a single asset to multiple parties concurrently, such as one floor of a building).

BC89. While some stakeholders continued to support making changes to lessor accounting, after evaluating the Board's proposals in the 2010 and 2013 Exposure Drafts, a majority of the Board's stakeholders, including both preparers and users, said that lessor accounting should not be fundamentally changed from that in previous GAAP. Many stakeholders communicated that the changes proposed to lessor accounting in either of the Exposure Drafts would be costly to implement, including the need for many lessors to implement new accounting systems and processes. Meanwhile, outreach with financial statement users confirmed that, in contrast with lessees' financial statements, users do not typically adjust lessors' financial statements, which indicates that the lessor accounting model in previous GAAP substantially fulfills users' needs. Many users, and others, said that the proposed model would reduce, rather than improve, the quality of financial reporting.

BC90. On the basis of this and other feedback received on the lessor accounting proposals in the 2010 and 2013 Exposure Drafts, the Board decided that the lessor accounting model in previous GAAP did not need comprehensive improvements and, therefore, changing that model in a significant way would not produce benefits (and would perhaps reduce the usefulness of lessors' financial reporting) significant enough to justify the costs of doing so. In reaching that conclusion, the Board considered whether the lessee and lessor accounting models should result in symmetrical accounting. In Topic 842, the accounting by lessees and lessors is broadly symmetrical in the statements of comprehensive income and cash flows (and also with respect to lease classification), but not so in the statement of financial position. The Board acknowledged that there are good conceptual arguments to support requiring the recognition of a lease receivable for all leases for which the lessee will record a lease liability. This also would necessitate separate asset recognition of the rights retained in the underlying asset by the

lessor (that is, a residual asset). Nonetheless, having considered all of the feedback received throughout the project, including that from financial statement users, the Board concluded that achieving symmetry between the statements of financial position of lessees and lessors was not a paramount objective of Topic 842. Instead, the Board decided lessors should continue to recognize all of the economic benefits inherent to the underlying asset in a single unit of account (that is, as a net investment in the lease for sales-type and direct financing leases or by continuing to recognize the underlying asset for operating leases). The Board's decision not to significantly change the lessor accounting model from previous GAAP in Topic 842 is consistent with the original objectives for the leases project, which initially set out only to improve lessee accounting.

BC91. While the Board decided not to significantly change the lessor accounting model in previous GAAP, the Board concluded that the previous lessor accounting model should not be retained in its entirety in Topic 842. For one, the Board decided that the scope, the definition of a lease, and some other aspects of the new leases guidance should be aligned between lessees and lessors, in particular because of subleasing, but also because the Board acknowledges that some of these areas should remain consistent between lessees and lessors and that doing so would not involve substantial costs for lessors, but that having different guidance applicable to lessees and lessors might involve significant costs for entities engaged in subleasing.

BC92. In addition, the Board decided that some updates were needed to the lessor accounting model as a result of the Board's issuance of the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which supersedes all other previous GAAP on revenue recognition. The Board decided that some updates to the lessor accounting guidance consistent with provisions in Topic 606 were warranted. First, that is because leasing is, fundamentally, a revenue-generating activity for lessors. Therefore, the Board decided there should be cohesion between the revenue recognition (and related cost) guidance applicable to sellers of tangible goods and the guidance applicable to lessors of those same assets, just as there was in previous GAAP. Second, aligning some aspects of the revenue recognition and the lessor accounting guidance should eliminate opportunities for arbitrage that might otherwise exist (for example, an opportunity to arbitrage the difference between a lessor model in previous GAAP based on the transfer of risks and rewards from a seller's perspective and a new revenue model based on the transfer of control from the customer's perspective or an opportunity to recognize revenue and profit from the sale of an asset to a low-credit-quality customer by structuring the sale as a sales-type lease). And third, Topic 606 supersedes previous GAAP on revenue recognition that formed the basis for some aspects of the previous lessor accounting model (for example, previous guidance on accounting for sales of real estate heavily influenced the guidance in previous GAAP about when a lease of real estate could be classified as a sales-type lease).

The lessor accounting model in Topic 842

BC93. The lessor accounting model in Topic 842, consistent with previous GAAP, distinguishes between sales-type, direct financing, and operating leases. Lease classification for lessors is based on the same lease classification approach as that for lessees. A lease that meets any one of the criteria in paragraph 842-10-25-2 is a sales-type lease because the lessor, in effect, transfers control of the underlying asset to the lessee. Even though, other than in cases in which either of the first two lease classification criteria in paragraph 842-10-25-2 is met, the lessor has the right to reacquire the underlying asset at the end of the lease term, when any of the final three criteria in paragraph 842-10-25-2 are met, the lessee has the ability to direct the use of and obtain *substantially* all the remaining benefits from the underlying asset. Even though a sales-type lease is not necessarily identical to a sale, the transactions are economically similar (for example, because sales-type lessors often use leasing as an alternative means to sell their assets and have no intention of reusing or re-leasing assets leased under a sales-type lease). Therefore, recognizing selling profit at lease commencement is consistent with the principle of a sale in Topics 606 and 610.

BC94. In addition to recognizing selling profit on a sales-type lease, a lessor's accounting for a sales-type lease in accordance with Topic 842 includes derecognizing the underlying asset (which is consistent with the view that the lessor has effectively transferred control of that asset to the lessee) and recognizing a net investment in the lease. The lessor's net investment comprises its lease receivable—that is, the lessor's right to receive lease payments plus any residual value of the underlying asset that is guaranteed by the lessee or any other third party unrelated to the lessor) and the unguaranteed residual value of the underlying asset. These two components of the lessor's net investment must be disclosed separately. The unguaranteed residual value of the underlying asset is that portion of the estimated residual value not guaranteed by the lessee or any other third party unrelated to the lessor.

BC95. The Board decided that when the lessee does not, in effect, obtain the ability to direct the use of, and obtain substantially all the remaining benefits from, the underlying asset as a result of the lease, it would be inconsistent with the principle of a sale in Topics 606 and 610 for the lessor to recognize selling profit or to recognize product or sales revenue on the lease. Therefore, a lease that does not meet any of the criteria in paragraph 842-10-25-2 is either a direct financing lease or an operating lease. A lease is an operating lease unless both of the following criteria are met:

- a. The present value of the sum of all of the following amounts to substantially all of the fair value of the underlying asset:
 1. The lease payments
 2. Any residual value of the underlying asset guaranteed by the lessee
 3. Any residual value of the underlying asset guaranteed by a third party unrelated to the lessor (other than the lessee)

- b. It is probable that the lessor will collect the lease payments (see paragraphs BC100–BC109 for a discussion of the Board’s consideration of collectibility and the lessor accounting model).

BC96. When a lease is not a sales-type lease but meets the criteria to be classified as a direct financing lease, the lease transaction effectively converts the lessor’s risk arising from ownership of the underlying asset (that is, asset risk) into credit risk. Consequently, the most faithful representation of a lessor’s involvement in a lease that transfers substantially all the risks and rewards incidental to ownership of the underlying asset to one or more third parties is to recognize the lessor’s financial net investment in the lease and financial (interest) income on that net investment.

BC97. If a direct financing lease gives rise to selling profit (which the Board understands to be infrequent), a lessor does not recognize the selling profit at lease commencement, reducing the lessor’s net investment in the lease. A lessor then recognizes the profit over the lease term in such a manner so as to produce, when combined with the interest income on the remainder of the net investment (that is, the lease receivable and the unguaranteed residual asset), a constant periodic rate of return on the lease. A direct financing lessor recognizes selling profit in this manner over the lease term because that accounting reflects that the lessor generally prices the lease to achieve a reasonable return on its investment in the underlying asset and would not position itself to incur a loss on disposition of the residual asset after the end of the lease. If a direct financing lessor were to defer the selling profit in its entirety until the asset is sold at the end of the lease term, the lessor might frequently recognize a loss on the sale of the residual asset. The Board decided that would not be a faithful representation of the economics for those leases.

BC98. The Board decided that a lessor should recognize any selling loss on a direct financing lease. This is because if the lessor considers other applicable GAAP (such as the impairment guidance in Topic 330, Inventory, or in Topic 360, Property, Plant, and Equipment), that consideration will generally result in the recognition of any loss on the underlying asset on or before lease commencement. For example, the pricing in the lease will likely serve as evidence that the cash flows to be derived from the underlying asset will be less than its carrying amount, resulting in the recognition of an impairment.

BC99. Unlike previous GAAP, the lessor accounting model in Topic 842 does not include any differences in accounting for leases of real estate and leases of other assets other than the requirement to account for the right to use land as a separate lease component unless the accounting effect of doing so will be immaterial (see paragraphs BC145–BC147 for the discussion of separating lease components). Previous GAAP included different lessor requirements for leases of real estate (for example, a lease of real estate could only be a sales-type lease if it transferred title to the real estate to the lessee by the end of the lease term) because the revenue requirements in previous GAAP for the sale of real estate

differed from the revenue requirements in previous GAAP applicable to the sale of other assets. The creation of Topic 606 eliminated those different revenue accounting requirements; therefore, there is no longer a reason for the accounting for leases of real estate to differ from the accounting for leases of other assets.

Collectibility and unreimbursable costs

BC100. The 2013 Exposure Draft did not include any explicit guidance that would require a lessor to assess the collectibility of the lease payments (or other payments not included in the definition of lease payments, such as variable lease payments) to recognize lease revenue. The 2013 Exposure Draft did, however, stipulate that a lessor would recognize impairment losses on lease receivables using the impairment guidance applicable for other financial instruments in Topic 310, Receivables.

BC101. Collectibility of the lease payments was not factored into the lessor accounting model in the 2013 Exposure Draft because:

- a. The tentative decisions in the 2013 Exposure Draft were completely converged with the IASB's tentative decisions, and previous FRSS (that is, IAS 17) did not include any consideration of collectibility in lessor accounting like previous GAAP did.
- b. The Boards' November 2011 joint revised Exposure Draft, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers* (2011 Exposure Draft), did not include a collectibility threshold. The effects of a customer's credit risk did not affect the timing or the measurement of revenue. Instead, those effects were recognized as bad-debt expense presented in a line-item "adjacent to revenue" (in effect, as "contra-revenue"). It was not until shortly before issuance of the amendments in Update 2014-09 (which codified Topic 606) that the Boards introduced a collectibility threshold.

BC102. As discussed throughout this basis for conclusions, after the issuance of the 2013 Exposure Draft, the Board:

- a. Decided to mostly retain the lessor accounting model in previous GAAP, except to the extent necessary to update the lessor accounting guidance for:
 1. Changes to the lessee accounting guidance (that is, to realign those aspects of the leases guidance that the Board decided should be consistent between lessees and lessors)
 2. Changes to the revenue recognition guidance in GAAP resulting from the codification of Topic 606 (that is, to realign certain aspects of the lessor accounting guidance with the revenue recognition guidance where such alignment existed in previous GAAP on leases and revenue).

- b. Incorporated a collectibility threshold into the revenue recognition guidance in Topic 606.

BC103. Therefore, the Board decided that collectibility should be considered by lessors in accounting for their leases. The Board decided that collectibility should affect a lessor's accounting differently depending on whether the lease would otherwise be classified as a sales-type lease, a direct-financing lease, or an operating lease.

BC104. The Board decided that a lessor should classify a lease as a sales-type lease only when the lease is similar to the purchase of a nonfinancial asset by the lessee because the lease, in effect, transfers control of the underlying asset to the lessee. This was, in large part, to ensure that sellers could not structure a sale as a sales-type lease to circumvent the guidance on satisfying performance obligations in Topic 606. Similarly, the Board decided that significant concerns about collectibility should affect the accounting for sales-type leases in the same way they affect the accounting for sales accounted for in accordance with Topic 606. Therefore, the collectibility guidance in Topic 842 applicable to sales-type leases results in generally consistent outcomes with the collectibility guidance in Topic 606, including the guidance about how to account for consideration received from a lessee when collectibility of the lease payments plus any amount necessary to satisfy a residual value guarantee provided by the lessee is not probable.

BC105. Direct financing leases and operating leases are not similar to sales of a nonfinancial asset. Consequently, the Board decided that the collectibility guidance that should apply to direct financing leases and operating leases does not need to align with the collectibility guidance in Topic 606, because leases are outside the scope of Topic 606 and those two types of leases are not similar to a sale. For direct financing and operating leases, the Board decided that the guidance in Topic 842 should be mostly consistent with the collectibility guidance applicable to leases in previous GAAP. Therefore, any lease that is not a sales-type lease is classified as an operating lease if collectibility of the lease payments and any amount necessary to satisfy a residual value guarantee (whether provided by the lessee or another third party) is not probable at lease commencement. In addition, cumulative lease income (that is, cumulative lease revenue) is limited for those leases to the lesser of the income that would be recognized in accordance with the operating lease guidance in Subtopic 842-30 and lease payments received. In addition to this guidance generally being consistent with previous GAAP, the Board decided that precluding classification of a lease as a direct financing lease when collectibility of both the lease payments and any amount necessary to satisfy a residual value guarantee is not probable is consistent with the Board's rationale for when a lease should be classified as a direct financing lease (see paragraph BC96). The Board decided that when collectibility of the lease payments and any amount necessary to satisfy a residual value guarantee is not probable, the lessor's conversion of its risk in the underlying asset to credit risk is nonsubstantive. Thus, the lessor should continue to recognize the underlying asset and account for the lease as an operating lease.

BC106. Consistent with the Board's overall decisions on lease classification, a lessor should not reassess lease classification if the assessment of collectibility of the lease payments changes after the commencement date for reasons other than a modification of the contract.

BC107. The Board decided that a lessor should not reassess collectibility for a sales-type lease or a direct financing lease if collectibility of the lease payments and any amount necessary to satisfy a residual value guarantee is deemed probable at lease commencement. In reaching this decision, the Board considered that the lessor's net investment in the lease would be subject to the financial instruments impairment guidance in Topic 310 and, therefore, any deterioration in the credit quality of the lessee should be captured through an impairment of the net investment in the lease.

BC108. Because a lessor does not recognize a net investment in the lease for an operating lease, the Board decided that additional guidance was necessary (included in paragraph 842-30-25-13). Upon a change in the assessment of collectibility, a lessor should recognize any difference between the lease income that would have been recognized in accordance with the recognition guidance in Subtopic 842-30 and the lease payments, including variable lease payments, that have been received from the lessee as an adjustment of the period in which the collectibility assessment changes.

BC109. The lessor accounting model in Topic 842 does not include a requirement that no important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease to account for a lease as a sales-type lease or a direct financing lease. Previous GAAP stated that important uncertainties might include commitments by the lessor to guarantee performance of the underlying asset in a manner more extensive than the typical product warranty or to effectively protect the lessee from obsolescence of the underlying asset. The Board did not carry forward this criterion because it is not relevant to determining whether the lessee, in effect, obtains control of the underlying asset (that is, whether the lessee has the ability to direct the use of and obtain substantially all the remaining benefits from the underlying asset) as a result of the lease. Rather, this criterion was included in previous GAAP because important uncertainties about unreimbursable costs yet to be incurred by the lessor under the lease indicated that the lessor had not transferred substantially all the risks and benefits of asset ownership. Topic 842 does, however, include guidance instructing lessors to consider the warranties implementation guidance in Topic 606 to determine whether a lessor commitment to guarantee performance of the underlying asset in a manner more extensive than the typical product warranty or to effectively protect the lessee from obsolescence of the underlying asset is an additional service to the lessee in addition to the lease (that is, a nonlease component).

Scope

BC110. The Board decided that, consistent with previous GAAP, only leases of property, plant, and equipment (that is, land and/or depreciable assets) are within the scope of Topic 842. Consequently, none of the items in the list that follows, which is not intended to be an all-inclusive list, are in the scope of Topic 842. In addition to the fact that none of these assets are depreciable assets, the Board observed the following with respect to each:

- a. Leases of intangible assets. The Board acknowledged that there was no conceptual basis for excluding leases of intangible assets from the scope of Topic 842 and that many intangible assets are amortized (rather than depreciated); however, the Board concluded that a separate and comprehensive review of the accounting for intangible assets should be performed before requiring leases of intangible assets to be accounted for within the scope of the leasing guidance.
- b. Leases to explore for or use natural resources, such as minerals, oil, and natural gas. That is because accounting practices for assets relating to exploration and evaluation are diverse and differ from the accounting for other types of assets. Furthermore, the accounting for assets related to the exploration and use of natural resources is specified in Topics 930, Extractive Activities—Mining, and 932, Extractive Activities—Oil and Gas. Leases to explore for or use natural resources also were excluded from previous GAAP. However, the determination of whether certain ancillary items were leases was less important in previous GAAP than in Topic 842 because the operating leases and services were accounted for similarly. Some stakeholders asked whether this scope exception referred solely to the intangible right to explore for these natural resources. The Board observed that this scope exception refers to that as well as to the rights to use the land in which those natural resources are contained. However, leases of equipment used to explore for natural resources (for example, drilling equipment) are not part of this scope exception.
- c. Leases of biological assets (including plants and living animals). The Board wanted to ensure that requirements relating to biological assets are found in a single Topic (Topic 905, Agriculture). Leases of timber are specifically excluded from Topic 842 to be consistent with the scope exclusion that existed in previous GAAP.
- d. Leases of inventory. While the conceptual basis for excluding leases of inventory from the scope of Topic 842 is questionable, the Board observed that few arrangements conveying the right to use inventory would likely meet the definition of a lease. That is because a lessee is unlikely to be able to hold an asset that it leases (and that is owned by another party) for sale in the ordinary course of business or for consumption in the process of production for sale in the ordinary course of business. Consequently, the cost of requiring entities to evaluate whether arrangements conveying the right to use inventory would meet

the definition of a lease, which would be a change from the scope of the previous leases guidance, would not be justified by the benefits of potentially recognizing those few arrangements that would likely meet the definition of a lease.

- e. Leases of assets under construction (construction in process). As in (d) above, the Board observed that there is not necessarily a clear conceptual basis for excluding leases of construction in process from the scope of Topic 842. However, the Board observed that the guidance in Subtopic 842-40 requires a lessee to recognize the construction in process (that is, the underlying asset that is under construction) if it controls that asset during the construction period before the commencement date of the lease (see paragraphs BC398–BC401) and apply the sale and leaseback transaction guidance to the contract. Stakeholders provided feedback that there was likely to be significant overlap between an evaluation of whether the lessee controls the construction in process before the commencement date and an evaluation of whether the lessee controls *the use of* the construction in process before the commencement date. Therefore, the Board excluded leases of construction in process from the scope of Topic 842 primarily for pragmatic reasons including cost-benefit reasons. The cost and complexity of the evaluation that entities would be required to undertake would not yield sufficiently different results in financial reporting to justify the undertaking of those efforts.

Noncore Assets

BC111. Assets that are not essential to the operations of an entity are sometimes of less importance to users of financial statements because those assets often are less material to the entity. Accordingly, the benefits to users of recognizing and measuring the assets and liabilities arising from leases of noncore assets might not justify the costs to preparers of doing so. For example, information about assets and liabilities arising from the lease of a delivery van is important to assess the operations of a delivery company, but it may not be important in assessing the operations of a financial institution, which uses the van to deliver stationery to its retail banking locations. Consequently, the Board considered whether to exclude leases of noncore assets from Topic 842.

BC112. Ultimately, the Board decided not to exclude leases of noncore assets from the scope of Topic 842 (or provide an exemption to their recognition and measurement). In reaching this decision, the Board noted the following difficulties with excluding leases of noncore assets from the scope of the proposals:

- a. Defining core and noncore would be extremely difficult. For example, would office buildings used by a financial institution be a core asset, and would the conclusion be different if the financial institution has retail banking operations? Would an entity consider some offices or cars to be core assets and others noncore assets? If core assets were defined as

those essential or crucial to the operations of an entity, it could be argued that every lease would be a lease of a core asset. Otherwise, why would an entity enter into the lease?

- b. Different entities might interpret the meaning of noncore assets differently, thereby reducing comparability for users of financial statements.
- c. GAAP does not distinguish between core and noncore purchased assets for the purposes of recognition. Because of that, it would be difficult to justify distinguishing a right-of-use asset relating to a core asset from one that relates to a noncore asset.

Long-Term Leases of Land

BC113. A long-term lease of land is sometimes regarded as being economically similar to the purchase or sale of the land, and, therefore, some suggested that such leases should be excluded from the scope of Topic 842. However, the Board decided to not specifically exclude long-term leases of land from the scope of Topic 842 because:

- a. There is no conceptual basis for differentiating long-term leases of land from other leases. If the contract does not transfer control of the land to the lessee, but gives the lessee the right to control the use of the land throughout the lease term, the contract is a lease and should be accounted for as such.
- b. Inevitably, any definition of a long-term lease of land would be arbitrary.
- c. A very long term lease of land (for example, a 99-year lease or 999-year lease) could be classified as a finance (or sales-type) lease because the present value of the lease payments (plus the present value of any lessee residual value guarantee) could represent substantially all of the fair value of the land. In that case, the accounting applied by the lessee and lessor will be similar to accounting for a purchase or sale of the land.

Subleases

BC114. In the Board's view, leases of right-of-use assets (that is, subleases) should be accounted for in the same way as other leases. Accordingly, subleases are within the scope of Topic 842.

BC115. In addition, the Board decided that an entity should account for a head lease and a sublease as two separate contracts unless those contracts meet the contract combinations guidance. Even if entered into at close to the same date, each contract is generally negotiated separately, with the counterparty to the sublease being a different entity from the counterparty to the head lease. Because of this, the obligations that arise from the head lease for the lessee are generally not extinguished by the terms and conditions of the sublease. Therefore, it is appropriate to account for a head lease and sublease separately, and the head lease right-of-use asset is not considered to be held for sale.

BC116. The Board decided that when classifying a sublease, an entity (that is, the intermediate lessor) should evaluate the sublease with reference to the underlying asset rather than the right-of-use asset arising from the head lease. The lessee in a sublease may not know the terms and conditions of the head lease, and, accordingly, referring to the item of property, plant, and equipment that is subject to the lease should be easier to apply than referring to the right-of-use asset arising from the head lease. In addition, the Board noted that it may be difficult to understand and explain why a lessor would account for similar leases differently. That could occur if an entity were required to refer to the right-of-use asset when classifying a sublease. For example, if subleases were classified with reference to the right-of-use asset, a lessor that leases two similar assets on similar terms for five years could account for those leases differently if the lessor owned one of the two assets and leased the other.

Onerous Contracts

BC117. The Board decided that if a lease is onerous (for example, because the lease payments exceed the expected benefits to be derived from use of the asset for a lessee) between the date of inception and the commencement date, an entity should account for it in accordance with Topic 450, Contingencies. The Board decided not to include any particular exclusion for such onerous contracts in Topic 842 because it could potentially be misleading. The guidance includes a requirement to disclose information about leases before the commencement date if they create significant rights and obligations for the lessee. In addition, the Board noted that an entity should apply the requirements in other Topics in any event, without the need to state it specifically in Topic 842.

Embedded Derivatives

BC118. The Board considered whether an entity should be required to account for embedded derivatives within a lease separately, as it does in accordance with Topic 815, Derivatives and Hedging. The Board noted that some variable lease payments that depend on an index or a rate could meet the definition of an embedded derivative.

BC119. Topic 842 does not, in and of itself, require variable lease payments that depend on an index or a rate to be measured at fair value. If the Board did not retain the current requirements to account for embedded derivatives separately, unrelated derivative contracts could be bundled with leases to avoid measuring such embedded derivatives at fair value. Consequently, the Board decided to retain, unchanged, the existing GAAP requirement to assess leases for embedded derivatives and, if they exist, to require the embedded derivatives to be separated from the lease and accounted for in accordance with Topic 815.

Applying Topic 842 at a Portfolio Level

BC120. Topic 842 specifies the accounting required for an individual lease. Many entities have a large number of leases, and, as a result, some respondents noted practical challenges in applying the model on a lease-by-lease basis. These respondents questioned whether it would always be necessary to apply Topic 842 on a lease-by-lease basis. The Board observed that the way in which an entity applies the model to its leases is not a matter for which the Board should provide specific guidance. Nonetheless, in light of the feedback, the Board decided to explicitly state that lessees and lessors are permitted to apply the leases guidance at a portfolio level. The Board acknowledged that an entity would need to apply judgment in selecting the size and composition of the portfolio in such a way that the entity reasonably expects that the application of the leases model to the portfolio would not differ materially from the application of the leases model to the individual leases in that portfolio. In the discussion, the Board indicated that it did not intend for an entity to quantitatively evaluate each outcome but, instead, that the entity should be able to take a reasonable approach to determine the portfolios that would be appropriate for its types of leases.

BC121. The Board observed that the cost relief offered by applying the leases guidance at a portfolio level need not be limited to simply grouping contracts together. The cost relief also could be particularly high for certain aspects of the leases guidance for which entities need to make judgments and estimates, such as determining the discount rate or determining and reassessing the lease term. For example, rather than establishing a specific discount rate for a single leased asset, an entity might conclude that it can establish a single discount rate applied to all leases in a portfolio because using that discount rate would not result in a materially different answer than using a discount rate determined for each individual lease. The implementation guidance in Subtopic 842-20 includes an example of one way a lessee might apply a portfolio approach in determining the discount rate for its leases.

Utilizing Recognition (Capitalization) Thresholds

BC122. The Board observed that, in addition to accounting for some leases at a portfolio level, entities will likely be able to adopt reasonable capitalization thresholds below which lease assets and lease liabilities are not recognized, which should reduce the costs of applying the guidance. An entity's practice in this regard may be consistent with many entities' accounting policies in other areas of GAAP (for example, in capitalizing purchases of property, plant, and equipment).

Identifying a Lease

Definition of a Lease

BC123. Topic 842 defines a lease on the basis of whether a customer controls the use of identified property, plant, or equipment (that is, an identified asset) for a period of time, which may be described in terms of the amount of use of the identified asset (for example, the number of production units that an item of equipment will be used to produce). If the customer controls the use of an identified asset for a period of time, then the contract contains a lease. That will be the case if the customer can make the important decisions about the use of the asset in a similar way to that in which it makes decisions about owned assets that it uses. In such cases, the customer (the lessee) has obtained the right to use an asset (the right-of-use asset) that it should recognize on its balance sheet (subject to the recognition and measurement exemption for short-term leases). In contrast, in a service contract, the supplier controls the use of any assets used to deliver the service.

BC124. The 2010 Exposure Draft essentially retained the definition of a lease and the accompanying requirements in previous GAAP. Many respondents expressed concerns about the population of contracts that would be captured by the proposed requirements (and in particular that some contracts that they viewed as service contracts would be captured). Respondents also identified practice issues in previous GAAP, such as determining when the price that the customer will pay for the output from the asset is contractually fixed per unit of output or equal to the current market price per unit of output, and questioned why the control criteria used in previous GAAP to define a lease were different from the control proposals that were then being developed within the context of revenue recognition and the control principle in Topic 810 on consolidation.

BC125. Accordingly, in the 2013 Exposure Draft, the Board proposed changes to the guidance on the definition of a lease to address those concerns. The 2013 Exposure Draft proposed using a control principle as the means of distinguishing between a service and a lease and to align the principle with that used in other Topics. Respondents generally supported those changes. However, many respondents stressed the increased importance of the definition of a lease, noting that the assessment of whether a contract contains a lease would generally determine whether a customer would recognize lease assets and lease liabilities. Those respondents said that the Board had not provided adequate guidance to support consistent application of the proposed definition to more complicated scenarios.

BC126. Accordingly, Topic 842 generally retains the approach to the definition of a lease that was proposed in the 2013 Exposure Draft, but makes a number of changes to clarify the Board's intentions and reduce the risk of inconsistent application.

BC127. The Board noted that, in most cases, the assessment of whether a contract contains a lease should be straightforward. A contract either will fail to meet the definition of a lease by failing to meet many of the requirements or will clearly meet the requirements to be a lease without requiring a significant amount of judgment. However, the Board added guidance to make it easier for entities to make the lease assessment for more complicated scenarios.

Identified Asset

BC128. The first requirement for a contract to meet the definition of a lease in Topic 842 is that a customer should control the use of identified property, plant, and equipment (an identified asset). The requirement that there be an identified asset is substantially the same as the requirement in previous GAAP that a lease depends on the use of a specified asset. It is important to know what the asset is to assess whether the customer has the right to control the use of that asset and, for example, to determine which asset to derecognize for lessors with sales-type or direct financing leases. Nonetheless, when assessing whether there is an identified asset, an entity does not need to be able to identify the particular asset that will be used to fulfill the contract to conclude that there is an identified asset. Instead, the entity simply needs to know whether an asset is needed to fulfill the contract from commencement. If that is the case, an asset is implicitly specified. Topic 842 clarifies that if a supplier has a substantive right to substitute the asset throughout the period of use, there is not an identified asset and the contract does not contain a lease. That is because the supplier (and not the customer) controls the use of the asset if it can substitute that asset throughout the period of use, thereby deciding for what purpose the asset is used.

BC129. The Board has included guidance to help determine the circumstances in which substitution rights are substantive. This guidance focuses on whether the supplier has the practical ability to substitute the asset and would benefit economically from doing so. The Board's intention in including this guidance is to differentiate between the following:

- a. Substitution rights that result in there being no identified asset because the supplier, rather than the customer, controls the use of an asset
- b. Substitution rights that do not change the substance or character of the contract because it is either not practically or economically feasible for the supplier to exercise those rights or not likely the supplier will be able to exercise those rights.

BC130. If a substitution clause is not substantive because it does not change the substance of the contract, that substitution clause should not affect an entity's assessment of whether a contract contains a lease. The Board noted that, in many cases, it will be clear that the supplier will not benefit from the exercise of a substitution right because of the costs associated with substituting an asset.

BC131. Substitution rights may not be substantive (that is, for purposes of determining whether there is an identified asset) for various reasons. Some substitution rights are not substantive because the contract restricts when a supplier can substitute the asset. For example, if a contract states that a supplier can substitute the asset only on or after a specified future date or after the occurrence of a specified event, that substitution right is not substantive because it does not give the supplier the practical ability to substitute the asset *throughout the period of use*. Other substitution rights are not substantive even if the supplier contractually has the right to substitute the asset at any time. For example, if a supplier has the right or obligation to substitute an asset for the purpose of repair or maintenance, or if a supplier would benefit from substitution only in circumstances that are not likely to arise, those substitution rights also are not substantive regardless of whether those circumstances are specified in the contract.

BC132. Stakeholders raised concerns that in some cases it would be difficult, if not impossible, for a customer to determine whether a supplier's substitution right is substantive. Difficulties may arise because the customer often does not have information about the costs of substitution that would be incurred by the supplier. On the basis of that feedback, the Board decided to add guidance stating that if a customer cannot readily determine whether a supplier has a substantive substitution right, the customer should presume that any substitution right is not substantive. It is intended that a customer should assess whether substitution rights are substantive if it is reasonably able to do so; if substitution rights are substantive, the Board noted that this should be relatively clear from the facts and circumstances. However, the requirement also is intended to clarify that a customer is not expected to exert undue effort to provide evidence that a substitution right is not substantive.

BC133. Topic 842 also clarifies that an asset must be physically distinct to be an identified asset. The Board concluded that a customer is unlikely to have the right to control the use of a capacity portion of a larger asset if that portion is not physically distinct (for example, if it is a 20 percent capacity portion of a pipeline). The customer is unlikely to have the right to control the use of its portion because decisions about the use of the asset are typically made at the larger asset level. Widening the notion of an identified asset to possibly capture portions of a larger asset that are not physically distinct might have forced entities to consider whether they lease assets used to fulfill any contract for services, only to conclude that they do not. Consequently, the Board concluded that widening the definition to include capacity portions of a larger asset would increase complexity for little benefit.

Contract Conveys the Right to Control the Use of an Identified Asset

BC134. Topic 842 contains application guidance on what it means to have “the right to control the use of an identified asset.” This guidance is consistent in many

respects with the concept of control in Topics 606 and 810. In previous leases guidance, a customer could have the right to control the use of an asset solely on the basis of obtaining substantially all of the output from that asset, assuming that the contract is priced in a particular way. This defined *control* on the basis of only a “benefits” element. Topics 606 and 810, however, define control to require both a “power” element and a “benefits” element. The Board decided that, to control the use of an asset, a customer is required to have not only the right to obtain substantially all of the economic benefits from use of an asset throughout the period of use (a “benefits” element), but also the ability to direct the use of that asset (a “power” element). That is, a customer must have decision-making rights over the use of the asset that give it the ability to influence the economic benefits derived from use of the asset throughout the period of use. Without any such decision-making rights, the customer would have no more control over the use of the asset than any customer purchasing supplies or services. If that were the case, the customer would not control the use of the asset.

Right to obtain substantially all of the economic benefits from use of the identified asset

BC135. Topic 842 clarifies that only the economic benefits arising from use of an asset rather than the economic benefits arising from ownership of that asset should be considered when assessing whether a customer has the right to obtain the benefits from use of an asset. A lease does not convey ownership of an underlying asset; it conveys only the right to use that underlying asset (even in the case of a finance lease or a sales-type lease that transfers title to the lessee at the end of the lease, ownership is only conveyed at the end of the lease term). Accordingly, the Board concluded that, when considering whether a contract contains a lease, a customer should not consider economic benefits relating to ownership of an asset (for example, tax benefits as a result of owning an asset). However, a customer should consider benefits relating to the use of the asset (for example, renewable energy credits received from the use of an asset or by-products resulting from the use of an asset).

Right to direct the use of the identified asset

BC136. Topic 842 includes guidance on when a customer has the right to direct the use of an asset if it has the right to direct *how and for what purpose* the asset is used during the period of use. If the supplier has that right, the supplier directs the use of the asset and, thus, no lease exists.

BC137. In the Board’s view, the decisions about how and for what purpose an asset is used are more important in determining control of the use of an asset than other decisions to be made about use, including decisions about operating and maintaining the asset. That is because decisions about how and for what purpose an asset is used determine how and what economic benefits are derived from use. How and for what purpose an asset is used is a single concept; that is, “how” an

asset is used is not assessed separately from “for what purpose” an asset is used. Decisions about operating an asset are generally about implementing the decisions about how and for what purpose an asset is used and are dependent on (and subordinate to) those decisions. For example, a supplier’s operational decisions would have no effect on the economic benefits derived from use of an asset if the customer decides that the asset should not be used. The Board observed that considering decisions about how and for what purpose an asset is used can be viewed as similar to considering the decisions made by a board of directors when assessing control of an entity. Decisions made by a board of directors about the operating and financing activities of an entity are generally the decisions that matter in that control assessment, rather than the actions of individuals in implementing those decisions.

BC138. Nonetheless, decisions about how and for what purpose an asset is used can be predetermined. In that case, those decisions cannot be made by either the customer or the supplier during the period of use. This could happen if, for example, in negotiating the contract, the customer and supplier agree on all the relevant decisions about how and for what purpose an asset is used and those decisions cannot be changed after the commencement date or are, in effect, predetermined by the design of the asset. The Board noted that it would expect decisions about how and for what purpose an asset is used to be predetermined in relatively few cases.

BC139. The approach to determining whether a customer has the right to direct the use of an identified asset changes if the decisions about how and for what purpose an asset is used are predetermined. Topic 842 clarifies that if decisions about how and for what purpose an asset is used are predetermined, a customer can still direct the use of an asset if it has the right to operate the asset, or if it designed the asset in a way that predetermines how and for what purpose the asset will be used. In either of these cases, the customer controls rights of use that extend beyond the rights of a customer in a typical supply or service contract (that is, the customer has rights that extend beyond solely ordering and receiving output from the asset). In those cases, the customer has the right to make (or has made in the case of design) decisions that affect the economic benefits to be derived from use of the asset throughout the period of use. Although the Board concluded that each of those cases represents a scenario in which the customer directs the use of an asset, it expects that, for most leases, the assessment of whether a customer directs the use of an asset will be based on identifying the party that decides how and for what purpose an asset is used.

BC140. Topic 842 clarifies that only decisions made *during* the period of use (and not before the period of use) should be considered in the control assessment, unless the customer designed the asset in a way that predetermines how and for what purpose the asset will be used. In the Board’s view, if a customer specifies the output from an asset at or before the beginning of the period of use (for example, within the terms of the contract) and cannot change those specifications during the period of use, it generally does not control the use of an asset. In that

case, it would have no more decision-making rights than any customer in a typical supply or service contract.

BC141. In addition, Topic 842 provides guidance about protective rights—that is, terms and conditions included in the contract to protect the supplier's interest (or investment) in the underlying asset or other assets, to protect its personnel, or to ensure the supplier's compliance with applicable laws and regulations. In the Board's view, such protective rights define the scope of the rights obtained by a customer without preventing a customer from having the right to direct the use of that asset. Accordingly, protective rights may affect the price paid for the lease (for example, a lessee may pay less for the use of the asset if it is more restricted in its use of that asset). However, protective rights generally will not affect the existence of the customer's right to direct the use of the asset.

Other Approaches Considered for Definition of a Lease

BC142. In developing Topic 842, the Board considered other alternatives suggested by stakeholders on the definition of a lease. The main alternatives considered are as follows:

- a. *Financing component.* The Board considered requiring a lease to be a financing arrangement for the right to use an asset. In other words, there would have to be a clearly identifiable financing component for a contract to contain a lease. However, the Board did not adopt this approach because:
 1. In the Board's view, it is appropriate to focus on whether the customer has obtained control of a right-of-use asset to determine whether a contract contains a lease. The right-of-use asset gives rise to a corresponding lease liability if payments are made over time, but exists even if there is no lease liability (for example, when lease payments are fully prepaid). If an entity obtains the right to use an asset for a period of time, the contract contains a lease, regardless of the timing of payments for that right of use. Whether the contract contains a financing element does not affect whether a lease creates an asset and a liability for the lessee. The focus on the asset obtained in a lease also distinguishes leases from other contracts, such as service or supply arrangements.
 2. Many of the suggested indicators of "financing arrangements" focus on the form of the payments and on those payments being similar to payments within a loan agreement. The Board was concerned that focusing on the form of an arrangement rather than its substance could result in the following:
 - i. Many existing leases, including many existing finance leases and property leases, would no longer meet the definition of a lease, even when it is clear that the customer has obtained a right of use at contract commencement.

- ii. It would be relatively easy to structure a contract to fail to meet the definition of a lease by, for example, changing the payment structure, while not changing the customer's right to use an asset.
- b. *Topic 606*. The Board considered whether to link the guidance on the definition of a lease more closely to the requirements in Topic 606, in particular the requirements on whether a good or service is "distinct." Under this approach, the concept of "distinct" could have been used to distinguish between contracts that contain distinct lease and service components (that an entity should unbundle and account for separately) and those that do not contain distinct lease and service components (and therefore should be accounted for entirely as a contract for services). The Board did not adopt this approach because:
1. The "distinct" guidance in Topic 606 was developed to address a different objective from that of identifying a lease. It was developed to identify the nature of an entity's promises in a contract with a customer to ensure the most appropriate allocation and recognition of revenue. In contrast, the lease definition guidance aims to identify whether a customer has obtained the right to use an asset and, therefore, should recognize the assets and liabilities associated with that transaction. Because it was developed for a different purpose, applying the "distinct" guidance in Topic 606 might have resulted in customers failing to recognize assets and liabilities that meet the conceptual definition. The Board concluded that control is a more appropriate basis on which to make this determination.
 2. The Board was concerned that a requirement to determine whether lease and service components were distinct would add unnecessary complexity to the guidance. That is because such an approach was expected to result in little difference in outcomes, and yet would have included an additional requirement that could have been complicated to interpret and apply within the context of leases.
 3. This approach would have required an additional step in identifying a lease as compared with the approach in Topic 842 *if* an entity were to conclude that it first has to identify a lease before determining whether it would be appropriate to separate that lease from other goods or services within the contract.
- c. *Standalone utility*. The Board considered whether to specify that a customer controls the use of an underlying asset only if that asset has standalone utility to the customer; that is, only if the customer has the ability to derive the economic benefits from use of an asset, either on its own or together with other resources that could be sourced in a reasonable period of time. The Board decided not to add this requirement because:
1. The control principle in Topic 842 is sufficient, without this additional requirement to appropriately determine whether a customer controls the use of an identified asset. Such an approach is not used

- elsewhere in GAAP when assessing control of an asset, such as with the purchase of an item of property, plant, and equipment.
2. Entities might reach different conclusions for contracts that contain the same rights of use, depending on differences in customers' resources or suppliers' business models.
 3. Assessing this requirement would have been subjective and required judgment beyond that required to apply the definition of a lease in Topic 842. It also may have had unintended consequences. In addition, the Board did not identify any existing scenarios for which the inclusion of such a requirement would have been expected to change the lease conclusion. Consequently, the Board concluded that the costs of including such a requirement would not be justified by any possible benefits.
 - d. *Substantial services.* The Board considered whether to require an entity to account for a contract with lease and service components entirely as a service if the service components are substantial and are the predominant portion of the overall contract. The Board decided not to include this requirement. Again, in the Board's view, if a contract conveys to the customer the right to use an asset, the contract contains a lease. The presence of services, no matter how substantial, does not change the rights of use that a lessee obtains. The Board was concerned that similar rights of use could be accounted for differently because services of a more significant value had been bundled together with some right-of-use assets and not with others.

Separating Components and Consideration in a Contract

Lease and Nonlease Components

BC143. Many contracts contain both lease and nonlease (generally, but not always, service) components, such as a contract for a lease of equipment that includes maintenance services. In addition, there are contracts that contain multiple lease components, such as a lease of a port that can incorporate the lease of land, buildings, and equipment.

BC144. Previous GAAP provided limited guidance on how to separate lease components and nonlease components of a contract, even though it required that separation. Because Topic 842 results in lease components of a contract being accounted for differently from nonlease components (for all leases except short-term leases for which a lessee elects the recognition and measurement exemption), the Board decided to provide expanded guidance on how entities should account for contracts that contain both lease components and nonlease components.

Separate Lease Components

BC145. Topic 842 includes guidance on determining whether rights to use two or more underlying assets in a single contract should be accounted for as a single lease component or multiple lease components. The guidance is applicable to lessees and lessors and is included principally because:

- a. Different accounting answers can result from how the unit of account to which the leases guidance applies is determined. In particular, the unit of account that is identified can affect lease classification and the allocation of contract consideration to the components (lease and nonlease) in the contract. 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.
- b. Previous GAAP did not contain specific guidance on how to identify the appropriate unit of account for leases. However, the Board understands that practice developed such that entities often considered multiple pieces of equipment together for purposes of lease classification when, as a result of their functional interdependence, they were part of an overall process or facility. In the Board's view, the fact that practice developed interpretive guidance specifically in this respect demonstrates that including separate lease components guidance in Topic 842 will represent an improvement to GAAP.

BC146. The separate lease components guidance in paragraph 842-10-15-28 is similar to the guidance on identifying performance obligations in Topic 606, and, therefore, the Board expects that it will be applied in a similar manner. The Board notes that the identification of separate lease components in a lease contract is similar to the identification of separate performance obligations in a revenue contract—in both circumstances, an entity is trying to identify whether a customer (or a lessee) is contracting for a number of separate outputs (rights of use in the case of leases) or, instead, contracting for a single output that incorporates a number of different inputs. Accordingly, rather than developing entirely separate requirements addressing how to identify separate lease components, the Board decided that it is logical to provide requirements similar to those in Topic 606 on the identification of performance obligations to determine whether a lessee is contracting for the right to use multiple underlying assets (for example, five vehicles) or for the right to use a single solution that is comprised of multiple assets (for example, many data centers or manufacturing facilities).

BC147. Topic 842 also requires an entity to account for a right to use land as a separate lease component, even if the separating lease components criteria are not met, unless the accounting effect of doing so would be insignificant. The Board decided that land, by virtue of its indefinite economic life and nondepreciable nature, is different from other assets, such that it should be assessed separately from other assets regardless of whether the separating lease components criteria are met. Previous GAAP included a series of rules for when land would be assessed separately from other elements, and those rules differed depending on whether the other element was a building (or integral equipment) or something else. The Board provided two examples of when the accounting effect of separation would be immaterial in paragraph 842-10-15-29; however, there may be additional circumstances in which the accounting effect of separately accounting for a right to use land would be immaterial.

Separating Lease from Nonlease Components

BC148. Topic 842 requires that lessors separate lease from nonlease components in a contract. However, lessees may elect, as an accounting policy election by class of underlying asset, not to separate nonlease components from the lease component(s) to which they relate. The Board decided that the leases guidance in Topic 842 should apply only to the lease components of a contract. In addition, for lessors, the Board considered that most nonlease goods or services that are included in a contract with a lease will be subject to the revenue recognition guidance in Topic 606. While some lessors, in response to previous proposals in this area, said that they would prefer not to separate lease and nonlease components in a contract with some wanting to account for the entire contract as a lease and others wanting to account for the entire contract as a service contract), accounting for lease components in accordance with Topic 842 and the nonlease components in accordance with, typically, Topic 606 is consistent with the corresponding guidance on scope that is included in Topic 606. In addition, this decision is consistent with some of the Board's other decisions—the rationale for which was that a nonlease component should not, in general, be subject to different accounting requirements solely because it is included in a contract that contains a lease.

BC149. The Board also decided that lessees should account for lease and nonlease (typically, service) components separately (unless they elect the practical expedient). Board members observed that to do otherwise could result in different accounting for services solely depending on whether the service is included together with a lease. Consistent with the view in paragraph BC148 for lessors, the Board decided that the accounting for services should be the same, regardless of whether the contract that includes the services also includes a lease. In addition, for some Board members, this decision is based on their view that leases are different from service contracts (see paragraphs BC40–BC43). In their view, requiring lessees to capitalize service components in some cases would result in lessees overstating their assets and liabilities.

BC150. The practical expedient to account for a lease component and its related nonlease components as a single lease component was provided by the Board on the basis that the costs and administrative burden of allocating consideration to separate lease and nonlease components may not be justified by the benefit of more precisely reflecting the right-of-use asset and the lease liability. The availability of the practical expedient to a lessee is not affected by the relative size of the lease and the nonlease components. However, given that the result of electing this practical expedient is to record additional lease liabilities, the Board concluded that lessees will, in general, only elect this expedient in arrangements with less significant service components. Therefore, comparability should not be significantly affected as a result of providing this practical expedient. The practical expedient does not permit entities to circumvent the guidance on embedded derivatives.

BC151. The Board previously considered two other alternatives on separating lease components from nonlease components in a contract. The feedback received on those previous proposals significantly influenced the separation guidance included in Topic 842. The following details the proposals and the feedback received:

- a. The guidance in the 2010 Exposure Draft put forth that an entity (lessee or lessor) should separately account for nonlease components of a contract if those components are distinct and the entity is able to separate those components. An entity would allocate consideration to lease and nonlease components in accordance with the amendments in the 2010 proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*. That proposed Update included guidance to help determine when the nonlease components of a contract would be distinct. Almost all respondents agreed that an entity should separate lease components of a contract from nonlease components, noting that the Board's proposals should be applied only to the lease components of a contract. However, many of those respondents found the proposals confusing, or they disagreed with some aspects of those proposals, in particular, the proposal to account for the entire contract as a lease if nonlease components were not distinct.
- b. The 2013 Exposure Draft contained guidance for lessors consistent with that in Topic 842. However, lessees would not always have been permitted to separate nonlease components from lease components in the proposals. If the lessee did not have observable standalone prices for one or more nonlease components in a contract and also did not have observable standalone prices for one or more lease components, the nonlease components and lease components for which the lessee did not have observable standalone prices would be accounted for as a single lease component. Many respondents to the 2013 Exposure Draft (including lessees and lessors) expressed concern about the lessee proposals. A number of entities said that including nonlease components

within a single lease component would not be appropriate, regardless of whether the lessee had observable standalone prices for the components of the contract. Lessors additionally commented that the proposed guidance would result in them having to communicate proprietary information to customers about how they price contracts so that their lessees would be able to separate lease and nonlease components.

Allocating Consideration in the Contract

BC152. Topic 842 requires a lessor to allocate the consideration in the contract to the separate lease components and the nonlease components on the basis of the revenue recognition transaction price allocation guidance in paragraphs 606-10-32-28 through 32-41. In addition, largely in response to feedback from stakeholders on earlier proposals, and to ensure that the guidance is clear, Topic 842 further specifies that a lessor should:

- a. Reallocate the consideration in the contract at the effective date of a contract modification that is not accounted for as a separate contract
- b. Allocate changes in the consideration in the contract in accordance with the revenue recognition changes in the transaction price guidance (paragraphs 606-10-32-42 through 32-45)
- c. Allocate consideration in the contract only to those items that transfer a good or service to the lessee and, therefore, are components (see paragraphs BC143 and BC144).

BC153. In reaching those decisions, the Board decided that lessors should allocate the consideration in the contract in accordance with the relevant revenue recognition guidance in Topic 606. In the Board's view, leasing transactions are fundamentally a revenue-generating activity (even if the principal revenue stream is interest income) in which the item that a lessor transfers to the customer is the right to use the underlying asset. Accordingly, it is appropriate for a lessor to allocate consideration to the lease and nonlease components as a seller allocates the transaction price (and changes in the transaction price) to performance obligations in a revenue contract and does not allocate consideration to activities or costs that do not transfer a good or service to the lessee. In reaching its decisions on lessor allocation, the Board noted that the basis for conclusions in Update 2014-09 states that an entity is not precluded from accounting for concurrently delivered goods or services that have the same pattern of transfer to the customer as if they were a single performance obligation, even if they are distinct from each other, because the outcome would be the same as accounting for the goods and services separately. Therefore, it similarly would be reasonable for lessors to account for multiple components of a contract as a single component if the outcome from doing so would be the same as accounting for the components separately (for example, a lessor may be able to conclude that accounting for an operating lease and a related service element as a single component results in the same accounting as treating those two elements as separate components). The

previous sentence notwithstanding, a lessor may need to separately consider presentation and disclosure in accordance with other Topics.

BC154. In addition, the Board considered that in any contract that contains both lease components and nonlease components, the entity transferring goods and/or services is likely to be both a lessor (relating to the lease components) and a seller (relating to the nonlease components). The Board's decision to allocate consideration to lease and nonlease components in accordance with the revenue recognition guidance in Topic 606 is intended to result in mostly consistent accounting for entities that are both a lessor and a seller of goods or services in the same contract.

BC155. The lessee allocation requirements in Topic 842 follow:

- a. A lessee shall determine the standalone price of lease and nonlease components on the basis of observable standalone prices. The lessee shall estimate the standalone price of lease and nonlease components (maximizing the use of observable information) if observable standalone prices are not available. That may include use of a residual approach to estimate a standalone price if the standalone price of the component is highly variable or uncertain.
- b. A lessee shall allocate consideration in the contract only to those items that transfer a good or service to the lessee, and, therefore, are components (see paragraphs BC143 and BC144).
- c. A lessee shall allocate changes in the contract consideration on the same basis as at contract inception.
- d. A lessee shall reallocate the consideration in the contract either:
 1. On remeasurement of the lease liability (for example, a remeasurement resulting from a change in the lease term or a change in the assessment of whether a lessee is or is not reasonably certain to exercise an option to purchase the underlying asset)
 2. At the effective date of a contract modification that is not accounted for as a separate contract.

BC156. The allocation guidance for lessees in Topic 842 does not reference other Topics; the Board decided that it will be less complex and more intuitive for lessees to include the allocation guidance within the leases Topic. The Board also decided that having lessees apply the revenue recognition guidance in Topic 606 (as is the case for lessors) does not make conceptual sense because a lessee is the customer in a lease rather than the supplier. However, the allocation guidance for lessees is similar to that for lessors and also is broadly consistent with that in previous GAAP, although some additional rigor has been added to the process for determining the standalone price of a lease or nonlease component. That is, the Board decided that in determining the standalone price of lease and nonlease components of the contract, a lessee is required to use observable standalone prices, if available, before using an estimated standalone price. Furthermore, a lessee should maximize the use of observable inputs and apply estimation

methods consistently in similar circumstances when estimating a standalone price. The Board decided that the ability to estimate standalone prices should include the ability to use a residual approach to estimate the standalone price, subject to the requirement to maximize the use of observable inputs in estimating the standalone price.

Activities (or Costs) That Do Not Transfer a Good or Service to the Lessee

BC157. The 2010 and 2013 Exposure Drafts did not provide guidance on what activities (or costs) constitute a *component* in a contract that is or contains a lease and, therefore, that should receive an allocation of the consideration in the contract. Therefore, after both Exposure Drafts were issued, some stakeholders commented that although it is clear that some activities, such as providing maintenance services, would be nonlease components, it was unclear whether other costs that are sometimes separately stated in a contract, such as taxes and insurance, would be considered components. Those stakeholders noted that executory costs were specifically excluded from the definition of *minimum lease payments* in previous GAAP. Those stakeholders further commented that in some leases, it is common practice for one party to the contract to pay certain costs directly to a third party, although the counterparty to the contract is principally liable to make those payments (for example, a lessee may make property tax payments directly to the taxing authority although the lessor is principally liable for those payments).

BC158. In response to those concerns, the Board decided to provide guidance in Topic 842 on what constitutes a component in a contract and to clarify that only components get an allocation of the consideration in the contract. The Board decided that activities (or costs of the lessor) that do not transfer a good or service to the lessee are not components in a contract. For example, an entity would not account for a portion of the consideration in the contract that is attributable to paying the lessor's property taxes (or its hazard insurance) as a component if the lessor is the primary obligor for those taxes (or insurance) and the amounts paid are not for a service (for example, maintenance or operations services) provided by the lessor to the lessee.

BC159. The guidance in Topic 842 in this respect is consistent with the revenue recognition guidance in Topic 606, which states that promised goods or services do not include set up or other activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to the customer. Those activities, therefore, do not get an allocation of the transaction price.

BC160. The Board further noted that, beyond items like property taxes and hazard insurance, a lessee's payments are almost always reimbursing costs of the lessor, all the way down to the profit margin. Therefore, the Board decided that guidance of this nature was necessary to ensure that entities only allocated the consideration

in the contract to those items or activities that actually provide a good or service to the lessee.

Consideration in the Contract

BC161. The guidance in the 2013 Exposure Draft stipulated how an entity should allocate the consideration in the contract but did not define consideration in the contract; therefore, some stakeholders questioned whether and, if so, when that included variable consideration. That is because, although the Board decided that an entity would not include variable lease payments other than those that depend on an index or a rate (or are in substance fixed payments) in lease payments, the revenue recognition guidance in Topic 606 requires an entity to estimate variable consideration in determining the transaction price.

BC162. In response to this feedback, the Board included the following guidance in Topic 842:

- a. First, lessees should not include variable consideration in determining the consideration in the contract other than variable consideration that depends on an index or a rate. This aligns the accounting for variable payments for nonlease components with the Board's decision on the accounting for variable lease payments (see paragraphs BC205–BC212 for the Board's rationale on its variable lease payment decisions). The Board further considered that it would be costly and complex to require lessees to estimate variable payments for nonlease components included in a contract that contains a lease and that entities generally are not required to estimate variable payments for similar nonlease components that do not include a lease.
- b. Second, lessors should determine whether the terms of a variable payment relate specifically to a lease component or a nonlease component, and:
 1. If the terms of the variable payment (other than those that depend on an index or a rate or are in substance fixed) relate specifically or partially to a lease component, then the entity should recognize those payments as income in profit or loss in the period in which the changes in facts and circumstances on which the variable payment is based occur, and, therefore, should not estimate those payments or include any amounts related to the variable payment in the consideration in the contract. When recognized, the income resulting from those variable payments should be allocated to the separate lease components and nonlease components of the contract on the same basis as the allocation of the consideration in the contract.
 2. If the terms of the variable payment relate specifically to a nonlease component (that is, the terms of the variable payment relate specifically to the entity's efforts to transfer the good or service or to a specific outcome from transferring the good or service), the entity should include in the consideration in the contract the amount of

those expected payments that would be included in the transaction price in accordance with the revenue recognition variable consideration guidance in paragraphs 606-10-32-5 through 32-13. A lessor should allocate the variable consideration in this case entirely to the nonlease component(s) to which it relates if doing so would be consistent with the transaction price allocation objective in paragraph 606-10-32-28. Otherwise, the variable consideration included in the consideration in the contract is allocated in the same manner as any other consideration in the contract (that is, to the separate lease components and nonlease components of the contract).

BC163. The Board decided that providing guidance on consideration in the contract was necessary to ensure consistent application of the allocation guidance in Topic 842, particularly for lessors because of the differences between how the Board decided a lessor should account for variable lease payments and how an entity accounts for variable consideration in Topic 606. The Board concluded that accounting for a variable payment that relates partially to a lease component (for example, a performance bonus that relates to the leased asset and the lessor's operation of that asset) in the same manner as a variable lease payment (that is, with respect to recognition and measurement) will be less costly and complex than accounting for that variable payment in accordance with the variable consideration guidance in Topic 606. In addition, the Board decided that a lessor should not account for a single variable payment in accordance with two accounting models (for example, partially as a variable lease payment and partially as variable consideration in the scope of Topic 606).

BC164. Allocating variable consideration that is included in the consideration in the contract entirely to the nonlease component(s) to which the variable consideration relates only when doing so would be consistent with the allocation objective in paragraph 606-10-32-28, which is consistent with the Board's objectives of:

- a. Aligning the lessor allocation guidance to that applicable to sellers of goods or services in Topic 606
- b. Accounting for nonlease components in a manner generally consistent with how they would be accounted for if not included in a contract that contains a lease.

Contract Combinations

BC165. The Board included guidance in Topic 842 for when an entity should combine two or more contracts and account for them as a single contract. Although it is usually appropriate to account for a contract individually, an entity should assess the combined effect of contracts that are interdependent. An entity may enter into multiple contracts in contemplation of another such that the contracts, in substance, form a single arrangement that achieves an overall commercial effect. The financial reporting effect of recognizing those contracts separately may be

different from the financial reporting effect of recognizing those contracts on a combined basis. In those situations, accounting for the contracts independently might not result in a faithful representation of the combined transaction. This accounting has been acknowledged throughout GAAP, and guidance similar to that in Topic 842 was included in Topic 606.

BC166. The Board decided that entering into contracts at or near the same time is a necessary condition for contracts to be combined. That decision is consistent with the objective of identifying the contract that is to be accounted for as the unit of account because that assessment also is performed at contract inception.

BC167. The Board decided that in addition to contracts being entered into at or near the same time, the contracts should satisfy one or more specified criteria for the contracts to be combined. The Board observed that when either criterion (a) or (b) in paragraph 842-10-25-19 is met, the relationship between the consideration in the contracts (that is, the price interdependence) is such that if those contracts were not combined, the amount of consideration allocated to the components in each contract might not faithfully depict the value of the goods (including rights of use) or services transferred to the customer. The Boards decided to include the criterion in paragraph 842-10-25-19(c) to avoid the possibility that an entity could effectively bypass the guidance for separating components depending on how the entity structures its contracts.

BC168. The Board clarified that, for two or more contracts to be combined, they should be with the same counterparty. However, the Board acknowledged that in some situations, contracts with related parties (as defined in Topic 850, Related Party Disclosures) should be combined if there are interdependencies between the separate contracts with those related parties. Thus, in those situations, combining the contracts with related parties results in a more appropriate depiction of the arrangement.

Lease Modifications

BC169. The guidance on lease modifications in Topic 842 was developed principally with the following in mind:

- a. The accounting for lease modifications in previous GAAP was generally considered to be very complex (often explained only by flowchart). In the Board's view, the lease modifications guidance in Topic 842 is less complex and more intuitive to apply than the previous guidance.
- b. Contracts that contain leases frequently contain nonlease components (that is, other goods or services). This was particularly important to the Board's considerations about lease modification accounting for lessors because Topic 606 contains a robust framework for accounting for modifications of contracts with customers to provide nonlease goods and services (for example, supplies for use with leased equipment or services such as maintenance or operation of the underlying asset).

- c. From a lessee perspective, right-of-use assets and lease liabilities will be recognized for all leases (other than short-term leases) and the lease liability is, in effect, the cost of the right-of-use asset. Therefore, a lease modification that results in a change in the scope of, or the consideration for, the lease affects both the lease liability and the right-of-use asset (not always in the same way).

Modifications Accounted for as Separate Contracts

BC170. The Board decided that some modifications to existing contracts that are leases or contain leases should not affect the accounting for a lease in the original contract. The Board decided that if a modification grants the lessee additional rights of use (for example, the right to use an additional asset) and the lease payments increase commensurate with the standalone price for those additional rights, that lease should be accounted for as a separate contract (that is, separate from the original contract).

BC171. In those circumstances, the Board decided that accounting for the modification (or amendment) separate from the original contract is appropriate because the new lease does not affect the original contract. It does not change the scope or the consideration allocable to the lease and nonlease components in the original contract. The Board also concluded that accounting for modifications of this nature as separate contracts reduces complexity because it does not require an entity to adjust its established accounting for the original contract.

BC172. In contrast, a modification that does not meet the criteria to be accounted for as a separate contract changes the terms and conditions of the existing lease(s) between the parties. This includes a modification that grants the lessee additional rights of use but the increase in the lease payments is not commensurate with the standalone price for those additional rights. In that case, the modification changes the terms and conditions of the existing lease by changing the lease payments (after reallocation of the consideration in the contract).

Lessee Accounting for Lease Modifications

BC173. When a modification does not meet the criteria to be accounted for as a separate contract, the lessee remeasures the lease liability for the modified, existing lease as of the effective date of the modification as if the modified lease were a new lease that commences on that date. Because the Board decided that a modified lease is accounted for as if it were a new lease at the effective date of the modification, the lessee reassesses the classification of the lease and remeasures the right-of-use asset and the lease liability based on the changed terms and conditions of the modified contract (including the changed lease payments).

BC174. The lessee's accounting for the modification depends on the nature of the modification. The guidance in Topic 842 differentiates between the following types of modifications:

- a. Those that (1) grant the lessee additional rights not included in the original lease, (2) extend or reduce the term of an existing lease, or (3) solely change the consideration in the contract
- b. Those that fully or partially terminate an existing lease by reducing the assets subject to lease.

BC175. The Board concluded that for the types of modifications in paragraph BC174(a), a lessee should not recognize a gain or loss from the modification because there has been no termination, fully or partially, of the original lease. Instead, the modification solely changes the cost of the right-of-use asset resulting from the original lease. Consequently, the amount of the remeasurement of the lease liability for the modified lease is recorded as an adjustment to the right-of-use asset and, no amount is recognized in profit or loss. In deliberating this guidance, the Board noted that a lease may be modified even if the stated terms of the modification do not change the stated terms of the lease. For example, a stated change in the consideration to be paid for a nonlease component may change the remaining lease payments because the lessee must allocate that change in consideration on the same basis as the original consideration in the contract was allocated.

BC176. The Board also preserved the following regarding modifications of the nature in paragraph BC174(a):

- a. The right to use an additional underlying asset (for example, an additional floor of a building or an additional piece of equipment) will generally be a separate lease component, even if the modification granting that additional right of use is not a separate contract in accordance with paragraph 842-10-25-8. Consequently, after a modification of the type in paragraph BC174(a)(1), a lessee will typically have additional separate lease components than before the modification. Example 17 in Topic 842 demonstrates the effect of this conclusion.
- b. A modification of the type in paragraph BC174(a)(2) does not grant an additional right of use. Rather, it merely changes an attribute of the lessee's existing right to use the underlying asset that it already controls. That is because the duration of the lessee's right of use (for example, 2, 5, or 10 years) is merely an attribute of that right of use in the same way that the specifications of a piece of equipment (for example, its color or functioning speed) are attributes of that tangible asset. That is why a lessee recognizes a lease liability for the full duration of the lease at lease commencement, regardless of the lease term.

BC177. For a modification that fully or partially terminates an existing lease by reducing the assets subject to lease, the Board decided that in some cases, a gain

or loss should result. That would be the case whenever the right-of-use asset does not equal the lease liability immediately before the effective date of the modification (for example, in a finance lease or in an operating lease in which the lease payments are not even throughout the lease term). The Board concluded that recognizing the difference between the change in the lease liability and the proportionate adjustment to the right-of-use asset in profit or loss is consistent with the accounting in other Topics that address terminations or extinguishments. Example 18 in Topic 842 illustrates two ways that a lessee might account for a modification of this nature, either of which would be acceptable to the Board.

Lessor Accounting for Lease Modifications

BC178. In Topic 842, a modification is accounted for prospectively by a lessor from the effective date of the modification (that is, no profit or loss is recognized) unless the modification, in effect, results in the sale of the underlying asset by transferring control of the asset to the lessee. This occurs when an operating lease or direct financing lease is modified and the modified lease is classified as a sales-type lease. Topic 842 provides guidance, including illustrative examples, on how to effect the prospective accounting (for example, specifying the effect of any prepaid or accrued rentals on the accounting for the modified lease and how to calculate the postmodification net investment in the lease for sales-type and direct-financing leases). This includes guidance for scenarios in which the lease classification changes as a result of the modification (for example, from operating lease to sales-type lease or from direct financing lease to operating lease). The Board decided to provide relatively detailed guidance and examples to ensure the guidance is understandable and can be applied in a consistent manner.

BC179. In deciding on the lease modification requirements for lessors applicable to operating leases, the Board considered that, based on the lessor accounting model (which is not symmetrical to the lessee accounting model), each period to which the right of use applies (for example, each day, month, or year) should be considered distinct from each other period. That is, based on the decision to substantially retain previous GAAP lessor accounting in Topic 842, which accounts for operating leases in the same manner as service contracts, a lessee generally benefits from its right to use the underlying asset each period it has those rights, and its ability to benefit from the right of use in one period is generally unaffected by its right-to-use the asset in any other period. As a result, prospective accounting for a modified lease that does not, in effect, sell the underlying asset is consistent with the revenue recognition guidance in Topic 606 for contract modifications in which the remaining goods or services to be provided after the modification are distinct from those provided before the modification. The Board decided that having a model for lease modifications that is generally consistent with that for contract modifications both (a) is appropriate on a conceptual basis given that leasing is fundamentally a revenue-generating activity for lessors and (b) will reduce complexity for lessors that regularly provide nonlease goods or services to their customers in conjunction with their leasing activities.

BC180. The Board considered but rejected approaches that would have either relied on or been based on the financial instruments guidance elsewhere in GAAP in accounting for modifications to sales-type and direct financing leases. The Board considered those alternative approaches principally because the lessor's lease receivable is a financial asset. However, the Board rejected those approaches because they would have been more complex than the approach in Topic 842 (that is, those approaches would have required additional steps to determine the significance of the modification) and because the Board decided that it is more important to align the modifications guidance to that in Topic 606, particularly for lessors that regularly provide nonlease goods or services. In addition, some stakeholders informed the Board that relying solely on the financial instruments guidance elsewhere in GAAP would not provide guidance on how to account for the nonfinancial unguaranteed residual asset in a modification. The Board's decision to align the lease modifications guidance with the contract modifications guidance in Topic 606 is conceptually consistent with the Board's decisions elsewhere in Topic 842 to align the lessor accounting guidance with the revenue recognition guidance where it is reasonable to do so.

Recognition and the Date of Initial Measurement

Inception versus Commencement of a Lease

BC181. Topic 842 requires that lessees and lessors recognize and measure lease assets and lease liabilities at the commencement date of the lease. The requirement in Topic 842 to recognize and measure the assets and liabilities arising from a lease at the commencement date is consistent with the Board's proposals in the 2013 Exposure Draft.

BC182. The Board concluded that recognizing assets and liabilities arising from a lease at the commencement date is consistent with the overall right-of-use model in which a lessee recognizes an asset representing its right to use an underlying asset for the period of the lease and a liability representing its obligation to make lease payments. A lessee does not obtain and control its right to use the underlying asset until the commencement date, that is, the date on which the lessor makes the underlying asset available for the lessee's use. Before that date, the lessor has not yet performed under the contract. Although a lessee may have an obligation to stand ready to make lease payments if the lessor performs under the contract, the lessee is unlikely to have an obligation to make lease payments before the asset is made available for its use. Similarly, from the lessor's perspective, although the lessor may have an obligation to stand ready to deliver the right to use the underlying asset from the date of inception, the lessor is unlikely to have a right to receive lease payments before the asset is made available for the lessee's use. Nonetheless, if the costs of meeting an obligation under the lease exceed the economic benefits expected from the lease, an entity should consider the guidance

in Topic 450 on contingencies to determine whether the entity has a liability before the commencement date.

BC183. Having concluded that the commencement date is the appropriate date for an entity to recognize assets and liabilities arising from a lease, the Board decided that aligning the date of initial measurement with the recognition date has the following benefits:

- a. It clarifies that, other than any gain or loss to be recognized by a lessor with sales-type leases, a gain or loss should not arise on initial recognition of lease assets and lease liabilities by a lessee or a lessor.
- b. It removes the need to add requirements (and, thus, potentially reduces complexity) on how to account for changes to the terms and conditions of a lease or assumptions used in measuring lease assets and lease liabilities between the date of inception and the commencement date. Any changes to a lease that occur after the date of inception are taken into account when initially measuring the asset and liability at the commencement date.
- c. It clarifies that an entity should capitalize initial direct costs incurred before the commencement date. Some respondents to the 2010 Exposure Draft had noted that the previous proposals on initial measurement implied that an entity would not be permitted to capitalize any initial direct costs incurred after the date of inception.
- d. It is more consistent with the measurement date for other transactions, such as business combinations and the acquisition of property, plant, and equipment.

BC184. In deciding on the date of initial recognition and measurement, the Board noted that for some leases, the rights and obligations that arise from entering into a lease could be significant. Without any disclosure, a user of financial statements would have no information about those rights and obligations before the commencement date (assuming that the entity did not recognize a liability in accordance with Topic 450). Accordingly, Topic 842 requires that a lessee disclose information about leases that create significant rights and obligations between the date of inception and the commencement date. Those disclosures will inform users of financial statements of significant cash commitments made relating to leases for which assets and liabilities will be recognized by the lessee in future periods. This recognition and disclosure requirement is consistent with that proposed in the 2013 Exposure Draft.

BC185. The 2010 Exposure Draft proposed that a lessee and a lessor recognize lease assets and lease liabilities at the commencement date of a lease but initially *measure* those assets and liabilities at the date of inception of the lease. Respondents to the 2010 Exposure Draft generally agreed that the commencement date is the appropriate date on which to recognize lease assets and lease liabilities but questioned whether an entity should measure the lease as of contract inception. Although for most leases the time between the date of

inception and the commencement date is usually short, some respondents noted that there are contracts for which that is not the case (for example, some leases are signed before the underlying asset is constructed). When that is the case, the proposals raised a number of questions:

- a. How should an entity account for any changes to the terms and conditions of the lease between the date of inception and the commencement date?
- b. Should an entity account for the time value of money, changes in indexes, and changes in the fair value of the underlying asset between the date of inception and the commencement date? If so, how?

BC186. The Board noted that its intention in proposing to initially measure lease assets and lease liabilities at inception was that the measurement would reflect the nature of the transaction and the terms and conditions of the lease. The Board concluded that this would require an entity to look to the terms and conditions agreed to in the contract at the date of inception. However, the Board had not intended that an entity would recognize a gain or loss relating to changes between the dates of inception and commencement when recognizing lease assets and lease liabilities at the commencement date.

Measurement: Lessee

Measurement Bases of the Lease Liability and Right-of-Use Asset

BC187. The Board decided on a cost measurement basis for the lease liability and right-of-use asset, with cost measured at the present value of the lease payments. The Board concluded that this would provide useful information to users of financial statements while minimizing costs as compared with other approaches.

BC188. The Board considered whether to refer to existing GAAP rather than specify in the lease proposals the initial and subsequent measurement of the lease liability and right-of-use asset. The Board rejected that approach for a number of reasons:

- a. The approach would be inconsistent with the Board's decision not to apply a components approach to lease accounting. For example, existing requirements on financial instruments would require separate accounting for options in a lease.
- b. Leases often have unique features compared with other financial liabilities and nonfinancial assets and, therefore, should have accounting that reflects those unique features.
- c. The approach would be more complex to apply, particularly when a lease contains features such as options, variable lease payments, and residual value guarantees.

- d. Previous leases guidance specified how to measure capital lease assets and capital lease obligations initially and throughout the lease term such that users of GAAP are accustomed to having the measurement guidance contained in the leases Topic.

Initial Measurement of the Lease Liability

Lease Term: Options to Extend or Terminate a Lease

BC189. Leases often grant the lessee a right to extend a lease beyond the initial noncancellable period or to terminate a lease before the end of the lease period. Depending on the terms and conditions of the option, a three-year lease with an option to extend for two years may or may not be economically similar to a three-year noncancellable lease or a five-year noncancellable lease. However, a lease with options would never be exactly the same as a lease without any options.

BC190. There are a number of different ways that a lessee and lessor could reflect options that exist in leases:

- a. *A components approach*, in which options in a lease are recognized and measured as separate components of the lease. The Board rejected a components approach to lease accounting because such an approach would be complex, would ignore the interrelationship between the term of a lease and the exercise of options, and would be difficult to apply because options may be difficult to measure reliably.
- b. *A disclosure approach*, in which an entity recognizes a lease liability or lease receivable for the noncancellable period and discloses the existence of any options to extend the term. Although simple to apply, the Board rejected this approach because, as compared with previous GAAP, it would provide less useful information to users of financial statements. The measurement of lease assets and lease liabilities would ignore the existence of options, including those that are reasonably certain of being exercised and, thus, would potentially misrepresent the assets and liabilities arising from a lease.
- c. *A measurement approach*, in which options in a lease are included in the measurement of lease assets and lease liabilities using a particular method. That method could be, for example:
 1. A probability-weighted measurement method (in which the measurement of lease assets and lease liabilities reflects the probability of each possible lease term)
 2. A probability threshold method (in which an entity includes optional periods in the lease term if the exercise of the options meets a specified threshold, for example, reasonably certain, virtually certain, or more likely than not)

3. An economic incentive method (in which an entity includes optional periods in the lease term if an entity has an economic incentive to exercise the option).

BC191. The Discussion Paper and the 2010 Exposure Draft proposed determining the lease term on the basis of a *most likely* measurement approach; that is, the lease term would be the longest possible term that is more likely than not to occur. That is because the Board thought that the lease term should reflect an entity's reasonable expectation of what the term would be. The 2010 Exposure Draft also proposed that, at each reporting date, the lessee or lessor should reassess which outcome it considered to be most likely to occur on the basis of any new facts or circumstances that indicate that there would be a significant change in the recognized lease liability or lease receivable since the previous reporting period.

BC192. Many respondents to the Discussion Paper and the 2010 Exposure Draft disagreed with the proposals because:

- a. Some said that determining the present value of lease payments on the basis of the most likely lease term would result in the recognition of a liability (for the lessee) and an asset (for the lessor) that does not meet the definition of a liability or an asset in Concepts Statement 6. That is because the lessee is not obliged to make lease payments and the lessor does not have a right to receive lease payments beyond the initial noncancellable period until the lessee has exercised the option.
- b. Some disagreed because the approach would not distinguish between a five-year noncancellable lease and a three-year lease with an option to extend for two years that is likely to be exercised. In their view, an entity is in a different economic position when it has entered into a five-year noncancellable lease rather than a three-year lease with an option to extend that it may or may not exercise, and that difference should be reflected in the measurement of lease assets and lease liabilities.
- c. Some suggested increasing the threshold at which an entity would include options to extend in the measurement of lease assets and lease liabilities. They suggested thresholds such as "reasonably assured" (used in existing GAAP), "reasonably certain" (used in existing IFRS), and "virtually certain" (which would be a higher threshold that would almost equate to including only contractual minimum lease payments in the measurement of lease assets and lease liabilities).
- d. Others suggested including options in the measurement of lease assets and lease liabilities only when a lease includes economic incentives for an entity to exercise an option.
- e. Most preparers highlighted the cost and complexity of not only determining the lease term at the commencement date but also reassessing the lease term at each reporting date. Preparers reiterated this message at workshops held in 2010 to discuss the proposals.

BC193. On reconsideration, the guidance in the 2013 Exposure Draft affirmed the view that the lease term should reflect an entity's reasonable expectation of what the term would be. However, the basis of that expectation was linked to a lessee having a "significant economic incentive" to exercise an option. The Board considered that applying the concept of significant economic incentive would provide a threshold similar to the concepts of "reasonably assured" in previous GAAP and "reasonably certain" in IFRS. However, the proposals would have emphasized that there needed to be a significant *economic* incentive for the lessee to exercise the option to include optional periods in the lease term. An expectation of exercise alone (and without a significant economic incentive to do so) would not be sufficient. The Board concluded that requiring an economic incentive would provide a threshold that could be applied more objectively than a threshold based solely on management's estimates or intent.

BC194. Most respondents to the 2013 Exposure Draft, including most financial statement users that did not like the uncertainty of management estimates based only on a "more likely than not" threshold that could change frequently, understood that "significant economic incentive" was a high threshold and said that the proposals were an improvement to those in the Discussion Paper and in the 2010 Exposure Draft. Some respondents continued to express a variety of opinions on whether *any* options should be included in determining the lease term and whether or how management intent should be considered in evaluating options to extend a lease. However, the most prevalent feedback from many respondents was that if the Board intended for the significant economic incentive threshold to be applied in a similar manner to the "reasonably assured" threshold in previous GAAP, the Board should retain the "reasonably assured" threshold in the final leases guidance. Those respondents stated that retaining the previous threshold rather than rearticulating it in a different manner, if it was the Board's intention that it should be applied similarly, would reduce the costs of implementing and applying a new leases standard.

BC195. Therefore, on the basis of the feedback received and because it was the Board's intention that "significant economic incentive" should result in similar lease term conclusions as the "reasonably assured" guidance in previous GAAP, the Board decided that the lease term should include only optional periods to extend the lease if either (a) the lessee is *reasonably certain* to exercise that option or (b) exercise of the option is controlled by the lessor. The Board decided to use the term *reasonably certain* rather than *reasonably assured* to remain converged in this respect with IFRS. The Board was informed that the guidance on lease term in previous GAAP and IFRS, which use the terms *reasonably assured* and *reasonably certain*, respectively, are applied consistently in practice. Therefore, the Board views *reasonably certain* and *reasonably assured* as synonyms that should be applied in the same way. There is little in leasing guidance in previous GAAP (or IFRS) on the application of either of these terms; therefore, the Board decided it will be useful to continue, as in the 2013 Exposure Draft, to provide some implementation guidance in the form of factors for entities to consider in applying

the reasonably certain threshold. The Board considered which factors should be considered when determining the lease term at the commencement date. The Board affirmed that at the commencement date, an entity should take into account all relevant *economic* factors (contractual, asset, entity, and market-based factors) when assessing whether an entity is reasonably certain to exercise an option to extend a lease. The factors to consider when reassessing the lease term are discussed in paragraphs BC227–BC232.

BC196. Consistent with the 2013 Exposure Draft, the Board also affirmed that options to extend a lease and options to terminate a lease should be accounted for in the same way. Accordingly, payments to be made during the period after which a lessee can terminate a lease are included when measuring lease assets and lease liabilities if the lessee is reasonably certain not to exercise the option to terminate the lease.

BC197. Some Board members agree with those respondents (as discussed in paragraph BC192(a)) that indicated that recognizing renewal options as a liability by a lessee or an asset by the lessor results in recognizing liabilities and assets that separately do not meet the conceptual definitions of assets and liabilities. However, those Board members acknowledge that renewal options create an asset for the lessee and a liability for the lessor. Those Board members observe that either including or not including renewal options in the measure of assets and liabilities will be inconsistent in one way or another with the conceptual definitions of assets and liabilities and, therefore, accept the approach in Topic 842. That approach accounts for renewal options only when it is reasonably certain that they will be exercised or when exercise is outside the control of the entity (such as when a lessor controls a lessee's exercise of a renewal option or a termination option). Those Board members view the approach in Topic 842 as a practical way, consistent with that in previous GAAP, to account for renewal options where the form is optional, but it is clear that there is economically little or no choice but to extend or not to terminate the lease.

Discount Rate

BC198. The 2010 and 2013 Exposure Drafts proposed that a lessee should discount the lease liability using the rate the lessor charges the lessee (which would often be the rate implicit in the lease), if that rate can be readily determined. If the rate the lessor charges the lessee cannot be readily determined, the lessee would use its incremental borrowing rate, which would take into account the credit standing of the lessee, the length of the lease, the nature and quality of the security provided, and the economic environment in which the transaction occurs.

BC199. There was broad support among those stakeholders that provided feedback on the discount rate for a lessee to use its incremental borrowing rate in the absence of information about the rate the lessor charges the lessee. Stakeholders also generally supported this approach because it is similar to the discount rate requirements for capital leases in previous GAAP.

BC200. Therefore, in Topic 842, the Board, in general, affirms the previous proposals about the discount rate to be used by the lessee at initial measurement. However, in affirming the previous proposals, the Board decided to eliminate the use of the phrase *rate the lessor charges the lessee*. In the 2010 and 2013 Exposure Drafts, the rate the lessor charges the lessee included possible discount rates other than the rate implicit in the lease (for example, a property yield). In redeliberating the proposals in the 2013 Exposure Draft, the Board decided that the rate the lessor charges the lessee should always be the rate implicit in the lease and, therefore, that the final leases guidance should simply refer to the *rate implicit in the lease*.

BC201. As discussed in paragraphs BC120 and BC121, the Board noted that it may be acceptable to apply the leases guidance at a portfolio level by lessees and lessors in some circumstances. In redeliberating the discount rate proposals in the 2013 Exposure Draft, the Board noted that this decision would include the ability to use a portfolio approach to determine the discount rate for a lessee's leases. The Board considered that this would substantially address the concerns of those stakeholders that commented that calculating the incremental borrowing rate for individual leases would impose a significant administrative burden on their organizations. The Board also considered that, in some cases, it might be reasonable for a subsidiary to use a parent entity or group's incremental borrowing rate as the discount rate. Depending on the terms and conditions of the lease and the corresponding negotiations, the parent entity's incremental borrowing rate may be the most appropriate rate to use as a practical means of reflecting the interest rate in the contract, assuming the implicit rate is not readily determinable. For example, this might be appropriate when the subsidiary does not have its own treasury function (all funding for the group is managed centrally by the parent entity) and, consequently, the negotiations with the lessor result in the parent entity providing a guarantee of the lease payments to the lessor. Therefore, the pricing of the lease is more significantly influenced by the credit standing of the parent than that of the subsidiary.

BC202. The Board also considered and rejected the view that the "cost of money" would be an appropriate discount rate for lessees that are required to comply with the Cost Accounting Standards and the Federal Acquisition Regulation to use in applying the guidance in this Update. The "cost-of-money" rate used to reimburse those entities is not necessarily linked to the rate the lessor considers in pricing the lease, and it is not necessarily linked to the lessee's incremental borrowing rate. Consequently, it is not an appropriate proxy for the interest rate in the contract.

Lease Payments

In Substance Fixed Payments

BC203. The guidance in the 2013 Exposure Draft stipulated that lease payments include in substance fixed payments. In substance fixed lease payments are payments that may, in form, appear to contain variability but are, in effect, fixed and unavoidable. The Board decided to include in substance fixed payments in the measurement of lease assets and lease liabilities because those payments are unavoidable and, thus, are economically indistinguishable from fixed lease payments. The majority of those that participated in outreach on the 2013 Exposure Draft (which included preparers, users, accounting firms, and others) supported including in substance fixed payments in the definition of lease payments. Accounting firms and regulators noted the importance of defining and providing examples of in substance fixed payments to ensure consistent application and comparability between entities.

BC204. In response to this feedback, the Board affirmed in Topic 842 that in substance fixed lease payments are included in the measurement of lease assets and lease liabilities. The Board discussed whether to leave this as a principle or provide further requirements. The Board concluded that providing a principle rather than an extensive list of possible scenarios, which could never capture every situation, was generally sufficient, however, it included some additional implementation guidance in Subtopic 842-10 as compared with the 2013 Exposure Draft to assist in identifying in substance fixed payments. In affirming its decisions reached in the 2013 Exposure Draft, the Board also considered that the concept of in substance fixed payments existed in practice in previous GAAP, and, in the Board's view, the guidance on in substance fixed payments included in this Update is substantially similar to the interpretive guidance that existed in previous GAAP. Consequently, the examples that exist in practice and that are included in various pieces of interpretive guidance provide useful information on how the Board intends this concept to apply in Topic 842. The Board also noted that the concept of capturing items that are in substance fixed payments because they are readily determinable exists elsewhere in existing guidance (for example, on the determination of whether a notional amount exists in accounting for derivatives in Topic 815).

Variable Lease Payments

BC205. Some or all of the lease payments for the right to use an asset can be variable. That variability can arise because lease payments are linked to:

- a. Price changes due to changes in an external market rate or the value of an index. For example, lease payments might be adjusted for changes in a benchmark interest rate or the Consumer Price Index.

- b. The lessee's performance derived from the underlying asset. For example, a lease of retail property may specify that lease payments are based on a specified percentage of sales made from that property.
- c. The use of the underlying asset. For example, a car lease may require the lessee to make additional lease payments if the lessee exceeds a specified mileage.

BC206. There are various views on whether variable payments linked to future performance or use of an asset meet the definition of a liability. Some are of the view that a lessee's liability to make and a lessor's right to receive variable lease payments do not exist until the future event requiring the payment occurs (that is, when the underlying asset is used or a sale is made). Accordingly, some are of the view that entities should only provide disclosure about variable lease payments linked to performance or use and should not include those payments in the measurement of lease assets and lease liabilities.

BC207. However, some note that a lessee's obligation to make and a lessor's right to receive variable lease payments exist at the commencement date by virtue of the lease contract. Consequently, they are of the view that all variable lease payments meet the definition of a liability for the lessee and an asset for the lessor. It is the amount of the liability or asset that is uncertain, rather than the existence of the liability or asset. Accordingly, some would suggest that lessees and lessors should estimate variable lease payments and include that estimate in the measurement of lease assets and lease liabilities.

BC208. The 2010 Exposure Draft proposed a probability-weighted estimation approach in which a lessee and lessor would include estimated variable lease payments in the measurement of lease assets and lease liabilities at the commencement date. Those proposed amendments also would have required the reassessment of estimates if there was a significant change in the measurement of the lease liability. Many respondents to that Exposure Draft disagreed with those proposals. Preparers stated and demonstrated at workshops why this approach would be extremely costly to apply, especially for longer term leases with payments linked to the lessee's performance or use of the underlying asset (for example, a 25-year retail store lease). They noted that the reason that they often enter into leases with variable lease payments based on performance or use is because of the uncertainty associated with that future performance or use; that is, they wish to share the risks of the uncertainty about the economic benefits to be derived from using an underlying asset with the lessor and also, often, to incentivize the lessor to perform (for example, to incentivize a mall owner to bring entertainment to the mall that will attract additional shoppers). Accordingly, it often would be difficult for a lessee to estimate variable lease payments reliably. Similarly, it often would be difficult for the lessor to estimate the future performance from or use of an asset with precision when it has little or no control over that use. Consequently, respondents, including some users of financial statements, questioned the relevance of the information that would be included in the measurement of lease assets and lease liabilities.

BC209. On the basis of that feedback, the Board agreed that the cost and complexity of estimating and measuring all variable lease payments could not be justified by the benefit. The 2013 Exposure Draft, therefore, proposed to include in the measurement of lease assets and lease liabilities only those variable lease payments that depend on an index or a rate. For some Board members, the decision about variable lease payments linked to future performance or use was made solely for cost-benefit reasons, that is, they are of the view that all variable lease payments meet the definition of an asset (for the lessor) and a liability (for the lessee). However, those Board members were convinced by the responses to the 2010 Exposure Draft that the benefits of those proposals would not justify the costs, particularly because of the concerns expressed about the precision of the measurement that would result from the proposals. Other Board members concluded that variable lease payments linked to future performance or use do not meet the definition of an asset (for the lessor) or a liability (for the lessee) until the performance or use occurs. They consider those payments to be avoidable by the lessee and, accordingly, would conclude that the lessee does not have a present obligation to make those payments. In addition, variable lease payments linked to future performance or use could be viewed as a means by which the lessee and lessor can share future profits to be derived from the use of the asset. Accordingly, the 2013 Exposure Draft proposed that those variable lease payments would not be included in the measurement of lease assets and lease liabilities.

BC210. The Board affirmed its decision to include only those variable lease payments that depend on an index or a rate in the measurement of lease assets and lease liabilities. The Board's reasoning remains consistent with that underlying its decision in the 2013 Exposure Draft. The Board also considered that most respondents to the 2013 Exposure Draft, including most users with whom outreach was conducted, agreed with the proposals about the accounting for variable lease payments. Those respondents generally said that variable payments contingent on future events (for example, performance or use) do not represent a present obligation of the lessee or a right of the lessor and, therefore, do not meet the definition of an asset or a liability. Many stakeholders, including most users with whom outreach was conducted, said that they would not want subjective estimates about variable lease payments reflected in the measurement of lease assets and lease liabilities.

BC211. For reasons similar to those for including in substance fixed payments in the measurement of lease assets and lease liabilities, the Board also decided to include variable lease payments that depend on an index or a rate in the measurement of lease assets and lease liabilities. Those payments meet the definition of assets (for the lessor) and liabilities (for the lessee) because they are unavoidable (that is, a lessee has a present obligation to make, and the lessor has a present right to receive, those lease payments). Any uncertainty, therefore, relates to the measurement of the asset or liability that arises from those payments and not to the existence of the asset or liability.

BC212. In the Board's view, in principle, forecasting techniques should be used to determine the effect of changes in an index or a rate on the measurement of lease assets and liabilities. However, forecasting changes in an index or a rate requires macroeconomic information that entities may not have readily available, and forecasts often can be imprecise. In the Board's view, the usefulness of the additional information obtained using such a forecast would not justify the costs of obtaining it. The 2010 Exposure Draft proposed using forward rates when measuring lease assets and lease liabilities if they are readily available. However, respondents to that Exposure Draft commented that this would reduce comparability between those using forward rates and those not doing so and that determining whether a rate would be "readily available" requires judgment. In response to this feedback, in the 2013 Exposure Draft, the Board decided to require an entity to determine payments that depend on an index or a rate using the index or rate that exists at the commencement date. Most respondents to that Exposure Draft agreed with the Board's proposal and, consequently, the Board affirmed that decision in Topic 842. Subsequent measurement of variable lease payments that depend on an index or a rate is discussed in paragraphs BC234–BC237.

Residual Value Guarantees

BC213. The 2010 and 2013 Exposure Drafts proposed that a lessee should estimate the amount payable to the lessor under residual value guarantees and account for that amount as a lease payment. Many respondents supported those proposals, noting that the amounts payable under residual value guarantees should be included in the measurement of lease assets and lease liabilities because they are unconditional and meet the definition of a liability.

BC214. Similarly, Topic 842 requires that a lessee include the amount probable of being owed under residual value guarantees in the measurement of the lease liability (and the right-of-use asset). In the Board's view, payments probable of being owed under residual value guarantees meet the definition of a liability and are part of the cost of the right-of-use asset and, thus, should be recognized and measured as part of the lease liability and the right-of-use asset. That is because those payments cannot be avoided by the lessee—the lessee has an unconditional obligation to pay the lessor if the market price of the underlying asset moves in a particular way. Accordingly, any uncertainty does not relate to whether the lessee has an obligation. Instead, it relates to the amount that the lessee may have to pay, which can vary on the basis of movements in the market price for the underlying asset. In that respect, residual value guarantees are similar to variable lease payments that depend on an index or a rate for the lessee.

BC215. The Board considered whether a lessee should account for residual value guarantees separately because they are linked to the value of the underlying asset and may meet the definition of a derivative. However, the Board notes that residual value guarantees are often so interlinked with other terms and conditions in a lease

that it could be misleading and potentially costly to recognize such guarantees separately. That also is consistent with the Board's decision not to adopt a components approach to lease accounting.

Options to Purchase the Underlying Asset

BC216. The Board considered whether a purchase option is:

- a. The ultimate renewal option and, thus, should be accounted for similar to other options to extend or terminate a lease. This approach would include the exercise price of a purchase option in the determination of lease payments on a basis similar to the inclusion of lease payments to be made during optional periods.
- b. A means of terminating the lease that should be accounted for only when it is exercised as a sale or purchase of the underlying asset. This approach would exclude the price of a purchase option from the determination of lease payments.

BC217. The guidance in the 2010 Exposure Draft would have viewed a purchase option as a means of terminating the lease and, thus, proposed that the price of a purchase option is not a lease payment. Respondents had mixed views about the proposal to account for purchase options only when they are exercised. Some respondents agreed with the proposals, but others proposed that the accounting for purchase options should be consistent with the accounting for options to extend or terminate a lease.

BC218. On reconsideration, in issuing the 2013 Exposure Draft, the Board decided that purchase options should be accounted for in the same way as options to extend the term of a lease (that is, the exercise price of a purchase option would be included in the measurement of lease assets and lease liabilities if the lessee had a significant economic incentive to exercise that option). Topic 842 affirms that decision but, instead, consistent with the Board's decision about options to extend (or not to terminate) a lease, refers to whether the lessee is reasonably certain to exercise the purchase option on the basis of an evaluation of relevant economic factors. The Board concluded that a purchase option is the ultimate option to extend the lease term. A lessee that has an option to extend a lease for all of the remaining economic life of the underlying asset is, economically, in a similar position to a lessee that has an option to purchase the underlying asset. Accordingly, the Board decided that those two options should be accounted for in the same way.

Initial Measurement of the Right-of-Use Asset

BC219. Consistent with the 2010 and 2013 Exposure Drafts, Topic 842 requires a lessee to initially measure the right-of-use asset at cost, the calculation of which is included in paragraph 842-20-30-5.

BC220. The Board considered whether a lessee should initially measure the right-of-use asset at fair value because some note that it may provide more relevant information about the economic benefits to be derived from the use of the underlying asset. However, initial measurement of a right-of-use asset at cost is consistent with the measurement of most other nonfinancial assets, such as assets within the scope of Topics 360 and 350, Intangibles—Goodwill and Other. Initially measuring right-of-use assets on a basis similar to that of the underlying asset would increase comparability of leased and owned assets and, thus, improve the information provided to users of financial statements. Furthermore, initial measurement of the right-of-use asset at cost is less complex and less costly for entities to apply than fair value measurement because there is rarely an active market for right-of-use assets. For many leases, a cost measurement basis also will provide a reasonable approximation of the fair value of the right-of-use asset at the commencement date.

Initial Direct Costs

BC221. In the 2010 and 2013 Exposure Drafts, the Board decided that initial direct costs for a lessee should include costs that are directly attributable to negotiating and arranging a lease that would not have been incurred without entering into the lease. A lessee would capitalize initial direct costs by adding them to the carrying amount of the right-of-use asset. The Board concluded that capitalizing initial direct costs would be consistent with the treatment of costs associated with acquiring other nonfinancial assets (for example, property, plant, and equipment and intangible assets). Maintaining consistency in the accounting for leased and owned assets increases comparability, thereby providing better information for users of financial statements.

BC222. Topic 842 affirms the Board's decision to capitalize initial direct costs by treating them as part of the cost of the applicable right-of-use asset. Topic 842 also states that initial direct costs should be allocated to the separate lease components on a relative standalone price basis. To be consistent with the Board's decision on lessor accounting, which is explained in paragraphs BC304–BC307, the Board decided that initial direct costs for a lessee also should include only incremental costs that an entity would not have incurred if the lease had not been obtained (that is, executed). Initial direct costs should, therefore, generally include commissions or payments made to existing tenants to obtain a lease but should not include costs that are not incremental (for example, lessee payroll costs that would have been incurred regardless of the lease) or incremental costs that would have been incurred regardless of whether the parties execute the lease (for example, external legal costs to draft or negotiate a lease).

Subsequent Measurement of the Lease Liability

BC223. The Board concluded that the lease liability should at all points during the lease (whether a finance lease or an operating lease) reflect the present value of the remaining lease payments. In this way, the lessee measures lease liabilities in

a similar manner to other similar financial liabilities (that is, on an amortized cost basis).

BC224. A lessee remeasures the lease liability to reflect changes to the lease payments resulting from a change in any one of the following:

- a. The lease term (see paragraphs BC227–BC232).
- b. The assessment of an option to purchase the underlying asset (see paragraphs BC227–BC232).
- c. The resolution of a contingency upon which some or all of the variable lease payments that will be paid over the remainder of the lease term are based such that those payments now meet the definition of lease payments. For example, an event occurs that results in variable lease payments that were linked to the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.
- d. The amount probable of being owed under a residual value guarantee (see paragraph BC239).

BC225. A lessee recognizes the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. Although entities recognize changes in most other liabilities in profit or loss, Topic 842 stipulates that a lessee should adjust the carrying amount of the right-of-use asset to reflect changes in the measurement of the related lease liability arising unless the carrying amount of the right-of-use asset is reduced to zero, in which case the lessee should recognize any remaining amount of the remeasurement in profit or loss. That is because:

- a. A change in one or more of items (a), (b), or (d) in paragraph BC224 reflects the lessee's expectation that it has acquired more or less of the right to use the underlying asset. Regarding items (a) and (b) in paragraph BC224, the lessee expects to acquire either (1) the right to use the underlying asset for more or less time or (2) the underlying asset in its entirety. Regarding item (d) in paragraph BC224, a change in the amount probable of being owed under a residual value guarantee will often reflect the lessee's expectation of the remaining benefits of the underlying asset that it will consume (for example, a lessee's expectation of a lower residual value may be directly related to its decision about how it will use that asset during the remainder of the lease term).
- b. In the Board's view, the adjustments are made to measure the total cost of the asset accurately.

In concept, a right-of-use asset previously reduced to zero could be remeasured at an amount greater than zero in the event of a reassessment of the lease term (if the lease term increases) or a lessee purchase option that increases the lease liability. However, the Board observed that a right-of-use asset will only measure at zero before the end of the lease term if it has been fully impaired. It would, therefore, be highly unlikely that a lessee would reassess upward the lease term

or conclude that it is reasonably certain to exercise an option to purchase the underlying asset when it has previously impaired the right-of-use asset. However, in that unlikely event, the right-of-use asset would only be increased above zero if the lessee is expected to realize future economic benefits from the lease as a result of the revised expectation.

BC226. The Board decided that a lessee should not be required or permitted to measure lease liabilities at fair value after initial measurement because that would be:

- a. Inconsistent with the subsequent measurement of many other nonderivative financial liabilities, thus decreasing comparability for users of financial statements
- b. More complex and costly for entities to apply than a cost-based approach because it requires the use of both current expected cash flows and current interest rates
- c. Inconsistent with the proposal that the initial measurement of assets and liabilities arising from a lease should not be at fair value.

Reassessment of Options to Extend or Terminate a Lease or to Purchase the Underlying Asset

BC227. In principle, the Board is of the view that users of financial statements receive more relevant information when entities reassess options on a regular basis because reassessment reflects current economic conditions. For example, using a lease term established at lease commencement throughout the lease could be misleading if there has been a change in facts or circumstances from those that existed at lease commencement.

BC228. However, requiring reassessment at each reporting date would be costly for a lessee with many leases. To address that concern, the 2010 Exposure Draft proposed that a lessee would be required to reassess the lease term only when there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability.

BC229. Respondents to the 2010 Exposure Draft expressed concern about the costs associated with such reassessment. They noted that it could be difficult to interpret when a change would be significant. Many interpreted the proposals as requiring an entity to demonstrate that there had not been a change in facts and circumstances that would indicate a significant change in the lease asset or lease liability to avoid having to reassess options. The costs of demonstrating that any change would not be significant could be as costly as reassessing options at each reporting date.

BC230. The proposals in the 2013 Exposure Draft attempted to address concerns about the cost of the reassessment proposals in the 2010 Exposure Draft, while still retaining the principle that a lessee should reassess options for changes in circumstances or economic conditions. The 2013 Exposure Draft would have

required an entity to reassess options only when a lessee has or no longer has a significant economic incentive to exercise an option. The “significant economic incentive” threshold for including the effect of an option in the measurement of the lease liability was higher than the “more likely than not” threshold in the 2010 Exposure Draft. Therefore, the Board concluded that a lessee should be required to remeasure lease assets and lease liabilities as a result of changes relating to options relatively infrequently, thus reducing costs associated with reassessment from the 2010 proposals. In addition, the Board decided that a change in market conditions alone (for example, an option moving in or out of the money) should not trigger reassessment because of concerns about the possibility of frequent changes to the lease term as market prices increased or decreased. The Board concluded that such an outcome would add unnecessary complexity and cost to the accounting and may not provide useful information to users of financial statements.

BC231. Even with the change to the reassessment proposals in the 2013 Exposure Draft, many respondents expressed concerns about the proposal to reassess extension, termination, and purchase options. Many of those respondents stated that they understood the Board’s objective in requiring reassessment but that the cost of applying the reassessment proposals would exceed any benefit. They stated that reassessment would be costly because of:

- a. *The frequency of reassessment.* Some respondents were concerned that an entity would have to continually assess and monitor relevant factors that may give rise to a significant economic incentive even though there may be no change in those factors or a change in one or more of those factors might not result in a change in the lease term or the assessment of a purchase option. They noted that a lessee often makes a decision on the exercise of an option close to the end of the lease term or at the time its business strategy changes. Therefore, a lessee might incur significant costs to continually monitor relevant factors or reassess the options, although a change in the entity’s assessment of an option might occur only at the end of the initial noncancellable period or when the lessee’s business strategy changes. In situations in which a lessee determines that remeasurement of the lease assets and lease liabilities is not necessary, those respondents also mentioned that there would be costs involved in demonstrating to their auditors that assumptions on a significant economic incentive have not changed.
- b. *The volatility of lease assets and lease liabilities in the financial statements.* Some of those stakeholders expressed concern that the factors referred to in the 2013 Exposure Draft (that is, contract-based, asset-based, market-based, and entity-based factors) potentially could change multiple times within a given reporting period resulting in continuous reassessment of a lease liability.
- c. *The administrative challenge to track the data to assess whether the lessee has a significant economic incentive.* Because of the subjective

nature of the proposed reassessment criteria, some stakeholders noted that it might not be possible to apply the proposed reassessment requirements within their information technology systems. Rather, they fear that reassessment would have to be computed manually. Also, because lease administration often would be decentralized, the new guidance would require involvement from various departments such as real estate, contract management, legal, treasury, tax, and internal audit.

BC232. The Board considered the feedback from respondents to the 2013 Exposure Draft, in particular, those concerns about the cost of reassessing options and whether there are substantial benefits to reassessment. In redeliberations of the proposals in the 2013 Exposure Draft, the Board decided that Topic 842 should include a reassessment requirement. In the Board's view, not requiring a reassessment of options under *any* circumstances could reduce the usefulness and relevance of the financial information provided to users and could invite structuring to avoid recognition of options at initial measurement. However, the Board decided to reduce the costs of reassessment as compared with earlier proposals by further clarifying the reassessment provisions and limiting how often they would need to be applied. Therefore, Topic 842 requires a lessee to reassess an option to extend or terminate a lease or an option to purchase the underlying asset only (a) upon the occurrence of a significant event or a significant change in circumstances that both is within the control of the lessee and directly affects whether the lessee is reasonably certain to exercise or not to exercise the option or (b) upon the occurrence of an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease. In the Board's view, this reassessment guidance should not require a lessee to reassess the lease term on a continual basis. Instead, the lessee's ongoing efforts should consist solely of monitoring for significant events or changes in circumstances ("triggering events") of which it should be aware (because those events or changes in circumstances are within the lessee's control) or for specified events that are explicit in the contract, and only then should it reassess an option. As such, this approach can be applied at a reasonable cost to preparers. Changes in market-based factors will not, in isolation, trigger the reassessment of an option because market-based factors (for example, a change in the real estate market) are not, in general, within the control of the lessee. In addition to reducing the costs of applying the requirements in Topic 842, for some Board members, the decision to limit the circumstances in which reassessment will be required is consistent with their view that options, such as those to purchase the underlying asset or to extend a lease, generally do not result in obligations for the option holder unless the option holder has little or no choice economically but to exercise the option. Consequently, in those Board members' view, generally, a significant event or a significant change in circumstances or an event that contractually obligates the lessee to exercise (or not to exercise) an option should be required to change the assessment of a lessee option.

Exercise of an Option to Purchase the Underlying Asset

BC233. Previous GAAP stipulated that if the lessee purchases the underlying asset subject to a capital lease, any difference between the purchase price and the carrying amount of the capital lease liability immediately before the purchase should be recorded by the lessee as an adjustment of the carrying amount of the asset. The Board decided to carry forward this guidance to Topic 842 as well as to specify that this guidance would apply to finance and operating leases. The Board concluded that the previous guidance was still relevant and resulted in the appropriate accounting but that it also should apply to operating leases now that there will be lease liabilities recognized for those leases.

Reassessment of Variable Lease Payments That Depend on an Index or a Rate

BC234. Paragraphs BC209–BC212 describe the Board's reasons for requiring both lessees and lessors to include variable lease payments that depend on an index or a rate in the measurement of lease assets and liabilities.

BC235. Both the 2010 and 2013 Exposure Drafts proposed that an entity should reassess the measurement of lease assets and lease liabilities to reflect changes in the index or rate that is used to determine variable lease payments that depend on an index or a rate. In issuing that proposal, the Board decided that reassessment was necessary to provide relevant information to users of financial statements about a lessee's lease liabilities at the reporting date. For example, if lease liabilities are not remeasured for changes in an index or a rate, measuring the lease liability for a 20-year property lease, for which lease payments are linked to a price index, may not provide users of financial statements with useful information about the entity's future cash outflows relating to that lease throughout the lease term.

BC236. Feedback from stakeholders on the reassessment proposals in both Exposure Drafts indicated concerns about the cost of performing reassessments and questioned whether the benefits for users of financial statements would justify the costs for preparers. For example, some stakeholders noted that the total lease-related expenses recognized in profit or loss by a lessee would be the same for operating leases and substantially the same for finance leases, regardless of whether the lessee remeasures the lease liability for changes to an index or a rate. In contrast, stakeholders acknowledge that the measurement of the lease liability and the right-of-use asset with or without reassessment of these variable lease payments may differ significantly.

BC237. On balance, the Board decided that the benefits of what would effectively be solely a gross-up to the balance sheet (that is, because the increase in the lease liability for increases in the reference index or rate would result in a corresponding increase to the right-of-use asset) do not justify the costs to preparers of doing so. The Board further concluded that users should be able to

reasonably assess the effect of future rent increases dependent on an index or a rate on the basis of the disclosures that a lessee will provide about (a) its variable lease expense each period and (b) the terms and conditions of its variable lease payment arrangements. However, Topic 842 does contain one exception to this decision. The Board decided that a lessee *should* remeasure variable lease payments that depend on an index or a rate when the lessee remeasures the lease liability for another reason. For example, if a lessee remeasures the lease liability for an updated lease term, the lessee will measure the remaining lease payments on the basis of the index or the rate as of the remeasurement date and not on the basis of the rate or the index as of the lease commencement date. The Board concluded that it would be illogical to remeasure the lease liability in those circumstances using an outdated index or rate.

Resolution of a Contingency upon Which Future Lease Payments Are Based

BC238. The Board decided to specify that a lessee should remeasure its lease liability if a contingency upon which some or all of the variable lease payments that will be paid over the remainder of the lease term are based is resolved such that those payments now meet the definition of lease payments. In deciding to enact this requirement, the Board considered scenarios whereby entities might attempt to circumvent the lessee right-of-use asset and lease liability recognition and measurement requirements by initially structuring the lease payments at only a nominal amount (for example, \$30 for Year 1 of a 10-year lease) and then making those payments fixed (or partially fixed) after Year 1 for the remainder of the lease term based on, for example, a percentage of Year 1 sales using a leased building or based on Year 1 production using a piece of leased equipment. Absent this requirement, some stakeholders suggested that the guidance would not require the lessee to reassess the lease payments and update its lease liability and right-of-use asset in those scenarios, meaning the lessee might not recognize a meaningful right-of-use asset or lease liability throughout the lease term even though the terms of the lease would require fixed payments after resolution of the contingency. Therefore, the Board decided to specify that if variability in some or all of the remaining lease payments is resolved (such as in the examples above, in which, after Year 1, some or all of the lease payments become fixed for the remainder of the lease term), those amounts now meet the definition of lease payments and should be reflected, from that point forward, in the right-of-use asset and the lease liability.

Reassessment of Amounts Payable under Residual Value Guarantees

BC239. The Board decided that lessees should reassess the amounts probable of being owed under residual value guarantees because that provides more

relevant information to users of financial statements and reflects current economic conditions. The Board noted that this is similar to the requirements in previous GAAP for leases classified as operating leases. In accordance with previous GAAP on operating leases, a lessee did not consider payments expected to be made to satisfy a residual value guarantee in determining its lease expense until it became probable that there would be a deficiency in the residual value of the underlying asset at the end of the lease term. At that time, the lessee also would record a liability for the amount of the expected payment. Therefore, an operating lessee was required to reassess payments expected to be made to satisfy a residual value guarantee based on changes in facts or circumstances. Capital lessees in previous GAAP already included the full amount of any residual value guarantee in the capital lease obligation.

Reassessment of the Discount Rate

BC240. The Board decided that the discount rate used to measure the remaining lease payments at present value is the discount rate established at lease commencement unless the lease liability is remeasured as a result of a change in the lease term or a change in the assessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset. The lessee updates the discount rate at the date of the remeasurement of the lease liability on the basis of the remaining lease term and the remaining lease payments.

BC241. The Board decided that in most cases a lessee should not reassess the discount rate during the lease term. That is generally consistent with amortized cost accounting for other, similar financial liabilities. In other GAAP in which the discount rate is required to be reassessed, it is usually because the liability to which the discount rate relates is measured on a current measurement basis.

BC242. Nonetheless, the Board concluded that there are limited circumstances in which a lessee should update the discount rate. These circumstances occur when there is either a change in the lease term or a change in the assessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset. In the Board's view, in those circumstances, the economics of the lease have changed and those changes should be reflected in the discount rate. For example, if a lessee previously accounted for a lease on the basis that it has a remaining term of 5 years and that remaining lease term changes to 10 years, it would be appropriate to reassess the discount rate to be consistent with the change in the lease payments included in the measurement of lease assets and lease liabilities and the change in the rate of interest that the lessee would likely incur to borrow the funds necessary to obtain the right-of-use asset for that period of time. However, the Board decided that such a change to the discount rate should be required only if the lessee had not taken into account the optionality in the contract when determining the discount rate at the commencement date. It is not necessary to update the discount rate if that rate already reflects that the

lessee has an option to extend or terminate the lease or to purchase the underlying asset.

BC243. Because a lessee will, in general, reassess the lease term and purchase options only infrequently—that is, only when a significant event or significant change in circumstances within the control of the lessee results in a change to the lease term or the assessment of a purchase option—the Board noted that a lessee should be required to reassess the discount rate only infrequently.

BC244. The Board decided that a lessee should only remeasure variable lease payments that depend on an index or a rate when the lease liability is remeasured for another reason (see paragraph BC237). The Board also decided that a lessee should not update the discount rate whenever the reference interest rate on which the variable lease payments are determined changes (as was proposed in the 2013 Exposure Draft). Because the change in the variable lease payments does not affect the lease liability, that change should not affect the rate used to discount that lease liability.

Foreign Currency Exchange

BC245. The 2010 Exposure Draft did not provide specific requirements on how an entity should account for the effects of foreign currency exchange differences relating to a lessee's lease liabilities (for a lessee) or a lessor's lease receivable that are denominated in a foreign currency.

BC246. Some respondents to the 2010 Exposure Draft suggested that an entity should recognize any foreign currency exchange differences as an adjustment to the carrying amount of the right-of-use asset. This approach would treat translation adjustments as a correction of or update to the cost of the right-of-use asset, which is initially measured on the basis of the initial measurement of the lease liability. Those respondents were of the view that lease payments denominated in a foreign currency are, in effect, another form of variable lease payments and should be accounted for in a similar manner to variable lease payments that are determined using an index. Those respondents also questioned whether useful information would be provided as a result of the profit or loss volatility created by recognizing foreign currency exchange differences on a lessee's lease liability in profit or loss (profit or loss volatility might arise because any foreign-currency-denominated lease liability is remeasured to reflect the rate of exchange at the end of each reporting period, whereas the carrying amount of the right-of-use asset, being a nonmonetary asset, is not remeasured to reflect movements in exchange rates).

BC247. A lessee's lease liability and a lessor's net investment in the lease are monetary items (as defined in GAAP) that, therefore, in accordance with Topic 830, Foreign Currency Matters, are required to be remeasured using exchange rates at the end of each reporting period if denominated in a foreign currency. Consequently, any foreign currency exchange gains and losses relating to lease liabilities (for the lessee) and a lessor's net investment in the lease denominated in a foreign currency should be recognized in profit or loss, consistent with existing

requirements on foreign currency exchange differences. A lessee's right-of-use asset is a nonmonetary asset as defined in GAAP. Therefore, subsequent changes to a foreign exchange rate should not have any effect on the cost of the right-of-use asset, and, thus, it would be inappropriate under existing requirements on foreign currency exchange differences to include such changes in the remeasurement of the right-of-use asset. Although the approach could result in volatility in profit or loss from the recognition of foreign currency exchange differences, those changes would be disclosed separately as foreign currency exchange gains or losses. Accordingly, it would be clear to users of financial statements that the gain or loss results solely from movements in exchange rates. Because that is consistent with the existing requirements for foreign currency exchange in accordance with other Topics, the Board concluded that it was unnecessary to include any specific requirements in Topic 842.

Subsequent Measurement of the Right-of-Use Asset

BC248. The Board decided that a lessee should not be permitted to measure a right-of-use asset at fair value after initial measurement because that will be:

- a. Inconsistent with the subsequent measurement of many other nonfinancial assets.
- b. More complex and costly for entities to apply than a cost-based approach because it requires the use of both current expected cash flows and current interest rates. There is rarely an active market for right-of-use assets, which would add to the complexity.
- c. Inconsistent with the proposal that initial measurement of assets and liabilities arising from a lease should not be at fair value.

The Right-of-Use Asset in a Finance Lease

BC249. Paragraphs BC32–BC74 include a detailed discussion of the feedback received on the lessee accounting model and the basis for the Board's decisions on lessee accounting, including that, in the Board's view, finance leases are economically similar to the acquisition of other nonfinancial assets. Consequently, the Board decided that a lessee should amortize the right-of-use asset resulting from a finance lease on a straight-line basis from the commencement date to the end of the lease term unless another systematic basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits, consistent with the depreciation and amortization of other nonfinancial assets.

BC250. Subtopic 842-20 also specifies that if the lease transfers ownership of the underlying asset to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, the lessee should amortize the right-of-use asset to the end of the useful life of the underlying asset.

BC251. Therefore, after lease commencement, a lessee will measure the right-of-use asset resulting from a finance lease at cost less accumulated amortization and impairment (see paragraphs BC255–BC259).

The Right-of-Use Asset in an Operating Lease

BC252. Subtopic 842-20 sets out that the right-of-use asset in an operating lease is measured after lease commencement at the amount of the lease liability and is adjusted for the following, unless the right-of-use asset has been previously impaired, in which case the right-of-use asset is measured as described in paragraphs BC255–BC259 after the date of the impairment:

- a. Prepaid or accrued lease payments
- b. The remaining balance of any lease incentives received, which is the amount of the gross lease incentives received net of amounts recognized previously as part of the single lease cost
- c. Unamortized initial direct costs
- d. Impairment of the right-of-use asset (see paragraphs BC255–BC259). This item (d) refers to measurement of the right-of-use asset at the time of impairment. That is, at the point in time an impairment is recognized, the corresponding adjustment to the carrying amount of the right-of-use asset is the amount of the impairment. After recognizing an impairment, the lessee will measure the right-of-use asset based on alternative guidance (see paragraph 842-20-35-10).

BC253. In Topic 842, operating leases are not equivalent to other purchases of nonfinancial assets; they grant different rights and impose different obligations on the lessee. Operating leases grant the lessee a right to use the lessor's asset over the lease term, such that the total cost of the lease payments should be recognized on the basis of the pattern in which the benefits conveyed by the lease are consumed, which is generally (but not always) on an equal basis over the lease term. In theory, the carrying amount of the right-of-use asset in an operating lease determined in this manner would represent and approximate the present value of the remaining benefits to the lessee at each measurement date.

BC254. The Board received a substantial amount of feedback from stakeholders about the subsequent measurement of operating (or "Type B") right-of-use assets after the issuance of the 2013 Exposure Draft. Many stakeholders said that measurement of operating lease right-of-use assets with reference to the associated lease liability (as per the guidance in Subtopic 842-20) would alleviate many of the systems and process concerns those stakeholders saw in the Type B accounting proposals in the 2013 Exposure Draft. Those stakeholders said that most of the data necessary to calculate the lease liability (for example, scheduling of future lease payments), as well as information on prepaid or accrued lease payments and initial direct costs, were accumulated and maintained to do the accounting and prepare the required disclosures in previous GAAP on leases. Consequently, measuring operating lease right-of-use assets in this manner would

not require lessees to implement new systems or processes to account for those assets. In addition to the views expressed in paragraph BC253, the Board's decisions on the subsequent measurement of operating lease right-of-use assets, and on the lessee accounting model more broadly, were significantly influenced by this feedback. The Board concluded that measuring the right-of-use assets resulting from operating leases in this manner should significantly reduce the costs to preparers of enacting the primary improvement resulting from Topic 842 (that is, the recognition of lease assets and lease liabilities for all leases other than short-term leases).

Impairment of the Right-of-Use Asset

BC255. Consistent with the proposals in the 2010 and 2013 Exposure Drafts, Topic 842 requires that lessees apply the impairment requirements of Topic 360 to the lessee's right-of-use assets. The right-of-use asset is a long-lived, nonfinancial asset and, therefore, should be within the scope of the Impairment or Disposal of Long-Lived Assets Subsection of Topic 360. In the Board's view, it would be inappropriate to continue to recognize a right-of-use asset from which the lessee does not expect to derive future economic benefits (for example, a right to use a building that the lessee has abandoned) or to recognize that asset at an amount the lessee does not expect to recover. Furthermore, the Board noted that the Topic 360 model is the appropriate impairment model to apply to a lessee's right-of-use assets because there are substantial benefits for users of financial statements in having comparability in the accounting for all of an entity's long-lived nonfinancial assets (that is, because a right-of-use asset is a long-lived nonfinancial asset, there is no compelling reason that it should not be assessed for impairment consistent with the model for other long-lived nonfinancial assets).

BC256. Respondents to the 2010 and 2013 Exposure Drafts generally agreed with the Board's proposal. Some respondents to the Exposure Drafts noted that it could be difficult for lessees to implement an impairment model for right-of-use assets that is different from other nonfinancial assets, particularly if a lessee's owned assets and right-of-use assets have significantly interrelated and interdependent cash flows.

BC257. The guidance in Subtopic 842-20 as it pertains to impairment of the right-of-use asset and subsequent accounting for a finance lease is generally consistent with the requirements in previous GAAP for capital leases. In addition, Subtopic 842-20 includes specific guidance for operating leases on:

- a. Calculating the single lease cost each period after the right-of-use asset is impaired (paragraph 842-20-25-6)
- b. Measuring the right-of-use asset after an impairment (paragraph 842-20-35-10).

The Board decided that this specific guidance is necessary to ensure that entities can calculate the periodic lease cost and determine the carrying amount of the

right-of-use asset for an operating lease after an impairment of the right-of-use asset and that those amounts are calculated in a consistent manner.

BC258. The single lease cost that will be recognized each period after an impairment of an operating lease right-of-use asset equals the combined sum of (a) the amortization of the right-of-use asset for the period on a generally straight-line basis and (b) accretion of the lease liability in accordance with the interest method. The right-of-use asset will be measured at its carrying amount immediately after the impairment less accumulated amortization at each reporting date.

BC259. The guidance on how to recognize lease cost and measure the right-of-use asset for an operating lease after an impairment of the right-of-use asset reflects a combination of the following:

- a. First, a conclusion by the Board that the link that many perceive between the economic benefits to be derived from the lease and the lease payments, and reference in support of a single, generally straight-line lease cost for operating leases, is effectively “broken” after the right-of-use asset is impaired because the lessee will no longer obtain future economic benefits from the lease equal to (or greater than) the payments it is required to make to the lessor. In other words, the lease payments no longer have any direct correlation to the economic benefits the lessee is able to derive from the lease but, instead, represent a liability reflective of a past expectation of economic benefits that could be derived from the lease.
- b. Second, consideration that operating lease cost was not recognized on a straight-line basis in previous GAAP after a lessee recognized a liability related to an operating lease in accordance with Topic 420, Exit or Disposal Cost Obligations. In those cases, the lease cost each period of the remaining lease term reflected a combination of the (1) straight-line recognition of the remaining economic benefits to be derived from the lease (for example, \$75,000 each year if the lease payments were \$100,000 annually, but the lessee expected to be able to obtain only \$75,000 from a sublessee) and (2) interest method accretion of the discounted Topic 420 liability. In that way, the guidance in Topic 842, which recognizes a single lease cost that combines (i) recognition of the remaining economic benefits to be realized from the lease and (ii) accretion of the discounted lease liability, is similar to the guidance in previous GAAP and results in a similar pattern of profit and loss. In addition, the net effect of the difference between the lease liability and the impaired right-of-use asset on the statement of financial position in accordance with Topic 842 is similar to the effect a Topic 420 operating-lease-related liability had on the statement of financial position in previous GAAP.

Presentation: Lessee

BC260. Paragraphs BC44 and BC45 discuss the Board's decisions and rationale for the lessee accounting model in Topic 842. Those decisions and rationale are integral to the Board's decisions on how a lessee should present items in the financial statements.

Statement of Financial Position

BC261. The Board decided that a lessee should either present as separate line items in the statement of financial position or disclose in the notes to the financial statements each of the following:

- a. Finance lease assets
- b. Operating lease assets
- c. Finance lease liabilities
- d. Operating lease liabilities.

If a lessee discloses those amounts in the notes, it also should disclose in which line items the amounts are included in the statement of financial position.

BC262. The Board decided that it did not want to mandate separate presentation of each of those amounts. However, the Board noted that there are differences between a right-of-use (lease) asset and other, owned nonfinancial assets and that users of financial statements may benefit from disclosure of the carrying amount of a lessee's right-of-use assets. For example, right-of-use assets may be viewed as being (a) less risky than owned assets because a right-of-use asset may not embed residual asset risk or (b) more risky than owned assets because the lessee may need to replace the right-of-use asset at the end of the lease term but may not be able to secure a favorable rate for the replacement lease. Accordingly, Topic 842 requires that a lessee provide information about the carrying amount of right-of-use assets separately, either in the statement of financial position or in the notes. Similarly, a lease liability is a unique class of liability that is linked to a corresponding asset and may have features, such as options and variable lease payments, that differ from those in other liabilities. Therefore, presenting the carrying amount of the lessee's lease liabilities separately from other financial liabilities either in the statement of financial position or in the notes provides users of financial statements with information that is important to understanding the extent to which an entity uses lease arrangements and highlights the relationship between the lessee's lease liabilities and its right-of-use assets.

BC263. The Board concluded that separate presentation or disclosure of right-of-use assets resulting from finance leases and right-of-use assets resulting from operating leases will be useful because those right-of-use assets are measured in a different way after the commencement date and arise from what are, in the Board's view, economically different transactions. Similarly, the Board decided to require the presentation or disclosure of lease liabilities arising from finance leases

separately from lease liabilities arising from operating leases. Although all lease liabilities are measured in the same way, the Board concluded that separate presentation or disclosure should help a user to understand the liability balance to which the lessee's lease costs, which differ in terms of recognition and presentation for finance and operating leases, relate.

BC264. The Board further decided that to the extent a lessee does not present items (a)–(d) in paragraph BC261 as separate line items in the statement of financial position, it should not include:

- a. Finance lease assets in the same line item as operating lease assets (for example, if finance lease assets are included within the property, plant, and equipment line item, operating lease assets must be presented in a different line item)
- b. Finance lease liabilities in the same line item as operating lease liabilities.

In reaching this decision, the Board concluded that presenting the assets and liabilities that result from these two different types of transactions in the same line item in the statement of financial position would be misleading; it would convey an economic similarity that, in the Board's view, does not exist. For example, because of how operating lease obligations are generally treated in lessee bankruptcy, which is generally different from how finance lease obligations are treated in lessee bankruptcy, the Board concluded that it would be inappropriate to present those two different types of liabilities in the same line on the statement of financial position. While both types of lease liabilities are financial liabilities, finance lease liabilities are the equivalent of debt, and operating lease liabilities are not "debt like" but, rather, operating in nature.

BC265. The presentation guidance in the 2013 Exposure Draft would have required a lessee to present right-of-use assets not presented separately in the statement of financial position within the same line item as if the corresponding underlying assets were owned. The Board did not include this requirement in Topic 842. The Board decided that it was unnecessary to prescribe where right-of-use assets must be presented (if not presented separately) because the notes would provide that information. In addition, some Board members said that presenting operating lease assets together with owned property, plant, and equipment may be inappropriate given the Board's conclusion that operating leases convey rights and carry risks substantially different from those of owned property, plant, and equipment.

Statement of Comprehensive Income

BC266. Topic 842 requires that for operating leases, a lessee recognize a single lease cost. That cost should, to the extent it is not capitalized as part of the cost of another asset, be included in the lessee's income from continuing operations, in a manner generally consistent with such presentation in previous GAAP.

BC267. In contrast, for finance leases, a lessee should present amortization of the right-of-use asset and the interest on the lease liability in separate line items, in a manner consistent with how the entity presents depreciation or amortization of similar assets and other interest expense.

BC268. The Board's decisions on presentation of lease cost in the statement of comprehensive income are directly linked to the Board's rationale for the lessee accounting model. Paragraphs BC59–BC65 provide information on the Board's basis for (a) recognizing a single lease cost for operating leases that is operating in nature and (b) recognizing separately calculated amortization and interest for finance leases.

Statement of Cash Flows

BC269. The requirements for presenting cash outflows in the statement of cash flows are linked to the presentation of expenses arising from a lease in the statement of comprehensive income. In the Board's view, it would be inconsistent to present payments in one manner in the statement of comprehensive income and in another manner in the statement of cash flows.

BC270. Consequently, Topic 842 requires a lessee to classify cash repayments of the principal portion of the lease liability for finance leases as financing activities in the statement of cash flows. Cash paid relating to interest should be classified in operating activities in accordance with Topic 230, Statement of Cash Flows. This requirement results in comparability between interest paid for finance leases and interest paid on other financial liabilities.

BC271. In addition, the Board decided that cash flows from operating leases and variable lease payments that are not included in the lease liability should be classified as operating activities because the corresponding lease costs, if recognized in the statement of comprehensive income, will be presented in income from continuing operations. The previous sentence notwithstanding, Topic 842 states that lease payments capitalized as part of the cost of another asset (for example, inventory or a piece of property, plant, or equipment) should be classified in the same manner as other payments for that asset.

Disclosure: Lessee

BC272. In determining the disclosures for leases, the Board considered the disclosure requirements in previous GAAP and the Board's current decisions in the disclosure framework project.

BC273. When selecting the disclosure objective, the Board considered work in other related projects. The Board also considered that including a disclosure objective allows an entity to understand the purpose of the disclosure requirements and the extent to which information about its leases should be disclosed. As a result, the Board proposed that the disclosures about leases should enable users

of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

BC274. In Topic 842, the Board decided to retain the guidance in the 2013 Exposure Draft that an entity should consider the level of detail necessary to satisfy the disclosure objective as well as how much emphasis to place on various requirements. While some respondents to the 2013 Exposure Draft expressed concern that this guidance could introduce diversity in practice and create some challenges for auditors and regulators, the Board concluded that the guidance is merely part of the disclosure objective and that it provides useful information on the Board's view about the level of information that would meet the disclosure objective.

BC275. The Board rejected the idea of including an explicit statement about materiality in the disclosure guidance. In rejecting this idea, the Board noted that recently issued disclosure guidance in Topic 606 includes a similar disclosure objective and a similar statement about the level of detail that would meet that objective without providing any further guidance on materiality; the Board noted that no additional guidance is necessary in Topic 842 as compared with Topic 606 in this regard. The Board reached this conclusion notwithstanding its current decision to propose guidance that would result in the inclusion of an explicit statement about materiality in future standards as a part of its disclosure framework project.

BC276. The Board also rejected including an explicit statement that the disclosure requirements are not required in all circumstances. That is because it is implicit to the overall disclosure objective that the level of detail in the disclosures should equate to the significance of an entity's leasing activity (for example, if leasing is a significant part of an entity's business activities, the disclosures would be more comprehensive than for an entity whose leasing activities are less significant to its business activities).

Qualitative Disclosures

BC277. Topic 842 requires a lessee to provide qualitative information about its leases in the context of the overall disclosure objective. This guidance is substantially unchanged from the qualitative disclosure proposals in the 2013 Exposure Draft. Most respondents to the 2013 Exposure Draft did not comment on the qualitative disclosure proposals. However, some respondents to the 2013 Exposure Draft expressed concerns about the proposals. The principal concerns included the following:

- a. Some preparers stated that the qualitative disclosures might be so generic that they do not provide meaningful information. Therefore, they questioned the application and usefulness of the qualitative disclosures.

- b. Compiling, summarizing, and providing the information would be costly for some entities and may not provide significant additional benefit to users, especially if the disclosures were generic.
- c. Some users expressed concern that the disclosure requirements might result in “boilerplate” statements rather than providing useful, entity-specific information.

BC278. The Board noted that while preparers’ concerns were focused on the perceived cost of producing the disclosures, users’ concerns were principally that the qualitative disclosures would not be detailed or entity-specific enough. This was confirmed in additional outreach with users. The Board decided to include qualitative disclosure requirements in Topic 842 because it views those disclosures as an essential tool to allowing a user to gain an understanding of a lessee’s leasing activities. In the Board’s view, the disclosure objective and level of detail guidance discussed in paragraphs BC272–BC276 should assist entities in determining the appropriate qualitative information to provide.

BC279. The Board considered but rejected requiring lessees to provide qualitative disclosures about the existence and terms and conditions of significant nonlease commitments the lessee has taken on as a result of entering into lease contracts. Similar to its rationale for eliminating the requirement proposed in the 2013 Exposure Draft to disclose a maturity analysis of the entity’s nonlease components included in a contract that contains a lease, the Board decided that a lessee should not be required to provide disclosures about nonlease components solely because they are obtained together with a lease.

Quantitative Disclosures

Lease Cost and Cash Flow Information

BC280. Topic 842 requires a lessee to provide quantitative information about its leasing activities. Paragraph 842-20-50-4 specifies the required information to be disclosed, and Example 6 (paragraph 842-20-55-53) in the implementation guidance to Subtopic 842-20 demonstrates how the disclosure requirements might be fulfilled.

BC281. User outreach conducted throughout the development of Topic 842 confirmed that users have various strategies to evaluate an entity’s leasing activities. Users’ leasing information needs may vary depending on the type of user they are (for example, credit analyst or equity analyst) and the industry in which the entity operates or in which the user principally follows, as well as for other reasons. A single user may conduct multiple analyses of an entity for different purposes. The following is a list of the principal information needs communicated by users and how the items required for disclosure in paragraph 842-20-50-4 meet those needs:

- a. *Information about interest.* Many users treat all leases as finance leases in their analyses because they want to compare an entity that leases its assets with one that purchases those same assets (for example, an airline that leases its airplanes and an airline that purchases its airplanes). Presently, users make imprecise adjustments in their analyses. The disclosure requirements in paragraph 842-20-50-4 will provide those users with significantly improved information for their analyses by providing separate interest and amortization information for finance leases, the beginning (end of prior reporting period) and ending balances of the lessee's operating lease liabilities, and the weighted-average discount rate for the entity's operating leases as of the beginning and the end of the reporting period.
- b. *Information about cash paid for leases.* Users have communicated that they want information about a lessee's cash payments during a period for leases but that this information is often not presented or disclosed separately in the financial statements. The disclosures required by paragraph 842-20-50-4 will provide users with information about cash paid for leases during each reporting period presented. Specific cash flow information is provided for cash payments to settle amounts included in the lessee's lease liability, broken out between financing and operating activities. This cash flow information, together with the required disclosures of short-term lease costs and variable lease costs (for which cash flows should approximate those costs), will provide improved information to users from what they received under previous GAAP.
- c. *Alternative measurement information.* Some users will continue to adjust the reported right-of-use assets and lease liabilities (for example, to produce a "whole asset" view of the entity). In previous GAAP, users often made adjustments on the basis of the reported operating lease expense, capitalizing a multiple of that operating lease expense. The disclosure requirements in paragraph 842-20-50-4 include more detailed lease cost information (which, unlike operating lease expense information disclosed in previous GAAP, will include lease costs capitalized as part of the cost of other assets) for those users that may still make adjustments on the basis of lease cost, as well as information on the weighted-average remaining lease term for the lessee's finance and operating leases. The Board decided to include weighted-average remaining lease term information to provide users with a better understanding of both (1) the period of time the lessee's capitalized lease obligations would allow the lessee to continue its current operations and (2) the lessee's renewal risk. A user will be able to adjust the reported lease obligations depending on how it wants to analyze the entity.
- d. *New leasing activity during the reporting period.* One of the disclosure requirements in paragraph 842-20-50-4 is to disclose the right-of-use assets obtained during the period in exchange for lease liabilities. A similar disclosure was required in previous GAAP on capital leases, but the disclosure requirement in paragraph 842-20-50-4 will address all

leases (other than short-term leases for which the lessee elects the recognition and measurement exemption).

BC282. In addition to considering the information needs of users, the Board considered the cost of obtaining and reporting the information. Integral to the Board's decisions on the lessee accounting model included in Topic 842 was the information provided by stakeholders that this lessee accounting model would achieve what many said to be the primary improvement to the lessee accounting guidance (that is, recognizing lease assets and lease liabilities for all leases other than short-term leases) without requiring entities to implement significant new systems or processes. Similarly, the Board noted that the costs to produce the disclosures required in paragraph 842-20-50-4 will not be excessive because each of the items is either (or both):

- a. Already being disclosed in accordance with previous GAAP on leases.
- b. Can be produced or obtained using existing systems or processes (for example, by adding a column or a calculation to the schedule a lessee maintains to produce the maturity analysis disclosure required in previous GAAP). It was already necessary in previous GAAP, for example, to track cash payments made for leases (that are not variable lease payments), to:
 1. Properly recognize the required straight-line operating lease expense
 2. Properly recognize any prepaid or accrued rent in the balance sheet
 3. Prepare the required maturity analysis disclosure.

Reconciliation of Opening and Closing Balances

BC283. The 2010 and 2013 Exposure Drafts both included a proposed requirement for lessees to produce and disclose a reconciliation of the opening and closing balance of the lessee's lease liabilities. That reconciliation would inform users of financial statements about changes to the lessee's lease liabilities during the reporting period. Users indicated that such a reconciliation would provide them with information that is useful to their analyses. The 2010 Exposure Draft also proposed that this reconciliation should be provided by class of underlying asset, while the 2013 Exposure Draft did not. The elimination of the class of underlying asset requirement between the 2010 and 2013 Exposure Drafts was principally for cost-benefit reasons.

BC284. The proposal to require a reconciliation of lease liabilities was the most pervasive disclosure concern expressed by respondents to both Exposure Drafts. In response to the 2013 Exposure Draft, preparers said that this reconciliation would be especially onerous to create and costly to implement, particularly if there is a need to make substantial investments in more robust information technology systems. Some of those preparers indicated that new system capabilities would be required to meet the proposed lease liabilities' reconciliation disclosure requirement that would otherwise not be required.

BC285. In contrast, many users supported the proposal for a lessee to provide a reconciliation of the opening and closing balances of its lease liabilities. In their view, this disclosure would provide valuable information when analyzing the changes that occurred during the period in the related account. However, users typically focused on certain amounts that would be disclosed rather than on the reconciliation as a whole. Users were generally interested in the liabilities created because of leases commencing or being extended in the section of the reconciliation, which would depict new leases entered into during the reporting period. They also were interested in the cash paid amount that would be included in the lease liabilities reconciliation, because this information would assist in analyzing an entity's cash flows related to its leases.

BC286. In deciding not to retain the proposed reconciliation requirement as part of Topic 842, the Board considered that the information users were most interested in obtaining could be provided without requiring a reconciliation and that the information would be provided by the lease cost and cash flow information disclosures required by paragraph 842-20-50-4. The Board also considered that creating and providing reconciliations are generally costly for preparers, particularly when the information required is not available centrally within the department producing the financial statements, which is often the case for leases. Lastly, the Board considered that some of the information that would be required for the reconciliation of lease liabilities would require systems and/or process capabilities that would not be required to apply the lessee accounting model (for example, the ability to calculate, on an effective interest method basis, the periodic unwinding of the discount on the entity's operating lease liabilities), and, therefore, the reconciliation disclosure requirement might negate a significant portion of the cost relief stakeholders have communicated would be achieved as a result of the Board's changes to the lessee accounting model since the 2013 Exposure Draft.

Maturity Analyses

BC287. Topic 842 requires that a lessee disclose a maturity analysis of the contractual lease payments included in its lease liabilities at the reporting date to assist users of financial statements in understanding and evaluating the nature and extent of liquidity risks. A lessee should disclose, at a minimum, the amounts due on an annual basis for each of the first five years after the reporting date, plus a lump sum for the remaining years. Those maturity analyses are similar to the maturity analyses that were required in previous GAAP. This requirement was previously proposed in both the 2010 and 2013 Exposure Drafts. While a few respondents to the Exposure Drafts expressed the view that this disclosure should not be necessary in a final leases standard because of the increased reporting of a lessee's lease obligations in the financial statements, users have generally communicated that information about the maturities of lease payments is useful to users of financial statements and that they support reconciling the undiscounted future lease payments to the lessee's lease liabilities. The Board noted that because a substantially equivalent disclosure was already required in previous

GAAP, there should be minimal, if any, incremental costs to continuing to provide this disclosure in Topic 842.

BC288. The 2013 Exposure Draft also included a proposal to require the disclosure of a maturity analysis of nonlease (for example, service) components of a contract that also contains a lease. The Board included this proposal because it would provide information about the committed future cash flows of the entity based on the total future payments arising from contracts that contain a lease. For example, if an entity has an unconditional obligation to make payments of \$100 each month (\$70 for the lease and \$30 for nonlease components) for the next 5 years, it would be more useful to provide a maturity analysis of all of those payments rather than provide a maturity analysis relating only to the lease payments of \$70 each month.

BC289. The Board did not retain the proposed requirement to include a maturity analysis of nonlease components as part of Topic 842. Consistent with feedback from some stakeholders, the Board concluded there is not a substantive difference between a nonlease component obtained from a lessor and a substantially identical good or service obtained from another supplier. Because entities are not required to produce a maturity analysis for their noncancellable service or supply contracts with parties that are not lessors, the Board decided that a lessee should not be required to do so for substantially similar contracts just because it also has entered into a lease with that supplier. The Board further considered that because entities are not currently required to track future fixed payments associated with nonlease components, it may be costly for those entities to develop a system and a process to prepare this disclosure.

Other Disclosures

BC290. Some users told the Board that they would like to see disclosed a sensitivity analysis of the range of possible cash outflows related to all leases (including short-term leases) aggregated by major class of underlying asset. This sensitivity analysis would take into account management's expectations for renewal options and variable lease payments.

BC291. The Board rejected this proposal on the basis that it would be costly for preparers to provide and would include subjective, forward-looking information that could not easily be prepared or audited. In the Board's view, the historical information that will be disclosed in accordance with Topic 842 for each period presented in the financial statements will provide users with a sufficient base of information from which to make their own projections about possible future cash outflows of the entity for leases.

Measurement: Lessor

Sales-Type and Direct Financing Leases

BC292. In Topic 842, a lessor recognizes a net investment in the lease for any sales-type or direct financing lease. For a sales-type lease, the lessor initially measures the net investment in the lease at the sum of (a) the lease receivable and (b) the unguaranteed residual asset. For a direct financing lease, the net investment in the lease is measured at the sum of (1) the lease receivable and (2) the unguaranteed residual asset, the sum of which is reduced by any deferred selling profit. The *rate implicit in the lease* is defined in such a way that any initial direct costs eligible for deferral in certain sales-type leases or in direct financing leases are included automatically in the net investment in the lease. The initial measurement approach for the net investment in the lease and its components is broadly consistent with the initial measurement guidance in previous GAAP (with the exception of the treatment of selling profit for direct financing leases).

BC293. The lessor measurement guidance in Topic 842 is substantially changed from the lessor measurement guidance that was previously proposed in the 2010 and 2013 Exposure Drafts. The discussion of the lessor measurement guidance in Topic 842 that follows does not recount the previous proposals or the Board's previous basis for those proposals. That is because the changes to the lessor measurement guidance since the previous proposals are explained by the Board's broader decisions on the appropriate lessor accounting model, in particular, its decisions to (a) substantially retain the lessor accounting model in previous GAAP and (b) align certain aspects of the lessor accounting guidance with the related revenue recognition guidance in Topic 606. The Board's decisions on the lessor accounting model are discussed in paragraphs BC75–BC109.

Initial Measurement of the Lease Receivable

BC294. At the commencement date, the lease receivable is measured at the sum of (a) the present value of the *lease payments* not yet received by the lessor and (b) the present value of any portion of the estimated residual value at the end of the lease term that is guaranteed (either by the lessee or any other third party unrelated to the lessor).

Lease Term: Options to Extend or Terminate a Lease

BC295. The Board decided that a lessor should determine the lease term in the same way that the lessee does. Although the assessment of whether the lessee is reasonably certain to exercise an option to extend a lease or is reasonably certain not to exercise an option to terminate the lease may be more difficult for the lessor (because the decision to extend or terminate is made by the lessee), the Board decided that it would complicate the final leases guidance to add different requirements for lessees and lessors in this respect. In addition, the Board

considered that because the assessment of whether the lessee is or is not reasonably certain to exercise an option is based on relevant *economic* factors, the lease term guidance would not inappropriately require a lessor to consider noneconomic factors such as the lessee's intent. The reasons for the Board's decisions on the lease term are set out in paragraphs BC189–BC197.

Options to Purchase the Underlying Asset

BC296. The Board decided that a lessor should account for options provided to the lessee to purchase the underlying asset by applying the same requirements that are applied by a lessee when accounting for those options. The reasons for the Board's decisions on how to account for options to purchase the underlying asset are set out in paragraphs BC216–BC218.

Discount Rate

BC297. Topic 842 requires that a lessor use the rate implicit in the lease (that is, the rate of interest that, at a given date, causes the present value of the net investment in the lease to equal the sum of the fair value of the underlying asset and any capitalized initial direct costs of the lessor) when discounting its lease assets and when assessing lease classification (that is, in determining the present value of the lease payments and the present value of any guaranteed residual value). Consistent with the rationale in previous GAAP, the Board concluded that the rate implicit in the lease is the most appropriate discount rate for lessors to use because it most directly affects, in most cases, the lessor's pricing of the lease. In contrast to lessees, the Board decided that the rate implicit in the lease should always be available to lessors.

Lease Payments

BC298. The lease payments for a lease are the same for the lessee and the lessor, except that for a lessee only, lease payments include amounts probable of being owed by the lessee under residual value guarantees. The Board's rationale for what are or are not lease payments for a lessor, other than those about residual value guarantees, is discussed in paragraphs BC203–BC212. Lease payments for the lessor do not include any amounts related to residual value guarantees because under the lessor accounting model, the lease receivable (and, therefore, the net investment in the lease) includes residual value guarantees separately (see paragraphs BC213–BC215).

Variable Lease Payments

BC299. The Board decided that a lessor should apply the same requirements when determining which variable lease payments to include in the measurement of the lease receivable (and, therefore, the net investment in the lease) as a lessee does when measuring its lease liability. Accordingly, a lessor should include in the measurement of the lease receivable only those variable lease payments that

depend on an index or a rate. Although estimating variable lease payments to be paid in the future may be easier or more difficult for the lessor than the lessee in particular situations, the Board decided that it would complicate the guidance to propose different lessee and lessor accounting for variable lease payments; that is, it would be difficult to understand why variable lease payments would represent a liability for the lessee and not an asset for the lessor or vice versa. In addition, the feedback received on previous proposals in the 2010 and 2013 Exposure Drafts about variable lease payments was similar for both lessees and lessors. The reasons for the Board's decisions on variable lease payments are set out in paragraphs BC205–BC212.

Residual Value Guarantees

BC300. Consistent with previous GAAP, the lessor's lease receivable (and, therefore, the lessor's net investment in a sales-type or direct financing lease) includes the present value of any residual value guarantee, whether provided by the lessee or another third party unrelated to the lessor. The Board considered that any guaranteed residual amount is, in effect, a final payment resulting from the lease and, therefore, should be accounted for in a similar manner to the lease payments (that is, as part of the lease receivable, which is a financial asset).

BC301. The Board considered but rejected accounting for residual value guarantees separate from a lease. The Board noted that residual value guarantees are often so interlinked with lease payments, particularly when the guarantor is the lessee, that it could be misleading to recognize such guarantees separately.

Selling Profit or Selling Loss

BC302. Topic 842 defines selling profit or selling loss as the difference between (a) the fair value of the underlying asset or the lease receivable, if lower, and (b) the carrying amount of the underlying asset net of any unguaranteed residual asset, further reduced by any deferred initial direct costs of the lessor. Any initial direct costs eligible for deferral are subtracted from the selling profit that would otherwise be calculated because those costs are automatically included in the measurement of the net investment in the lease (because of how the rate implicit in the lease is defined) and, therefore, would result in overstating the selling profit on the lease. Case C of Example 1 (paragraphs 842-30-55-31 through 55-39) in Subtopic 842-30 demonstrates the determination of selling profit or selling loss when initial direct costs are eligible for deferral.

BC303. The Board's rationale for deferring selling profit (and recognizing selling loss) at lease commencement for direct financing leases is discussed as part of the basis for the lessor accounting model in paragraph BC97.

Initial Direct Costs

BC304. The Board decided that initial direct costs should include only those costs that are incremental to obtaining a lease and that would not have been incurred if the lease had not been obtained (that is, executed). This generally includes costs such as brokers' commissions that are incurred only upon successful execution of the lease and excludes any other costs that would have been incurred even if, at the last minute, the lessee or the lessor failed to execute the lease. Those costs that do not meet the definition of initial direct costs might include legal costs incurred to negotiate or draft the lease agreement if the lessor would have owed fees for those services even if the lessee did not execute the lease. In an arrangement that includes multiple components, lessors should allocate initial direct costs, as well as any other capitalizable costs (for example, contract costs capitalizable in accordance with Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers) to the separate lease components or nonlease components to which those costs relate.

BC305. The Board further decided that initial direct costs should be deferred as part of the net investment in the lease in the case of a direct financing lease or a sales-type lease in which the fair value of the underlying asset is equal to its carrying amount. Initial direct costs are included in the lessor's net investment in the lease by virtue of how the rate implicit in the lease is defined. If a lessor incurs initial direct costs, the rate implicit in the lease is the rate of interest that, at initial measurement, causes the present value of the net investment in the lease to equal the sum of the fair value of the underlying asset and the initial direct costs. Any initial direct costs incurred in connection with a sales-type lease in which the fair value of the underlying asset is different from its carrying amount are expensed as incurred, except to the extent they are allocable to one or more nonlease components.

BC306. The Board's decisions on defining, allocating, and accounting for initial direct costs were intended to align the accounting for initial direct costs by a lessor with the accounting for costs to obtain a contract by a seller of similar goods. The cost deferral guidance in Subtopic 340-40 (a) recognizes as a contract cost asset only those incremental costs of obtaining the contract that an entity incurs that would not have been incurred if that contract had not been obtained, (b) allocates those capitalized costs to the goods and services to which they relate, and (c) recognizes that contract cost asset into income when (or as) the related goods or services are transferred to the customer. The Board concluded that expensing initial direct costs upfront for sales-type leases in which the fair value of the underlying asset is different from its carrying amount (that is, expensing those costs at lease commencement—when the underlying asset is effectively "sold" to the customer) and over the lease term for direct financing leases, operating leases, and sales-type leases in which the fair value of the underlying asset is equal to its carrying amount is consistent with Subtopic 340-40. When a lessor enters into a direct financing lease or a sales-type lease in which the fair value of the underlying asset is equal to its carrying amount, the good or service to which the asset (initial

direct costs) relates is the lessor's service of providing finance to the lessee. In an operating lease, based on the Board's decisions about the lessor accounting model, the good or service to which the initial direct costs relate is the entity's provision of access to the underlying asset, which the lessor satisfies over the lease term. In contrast, in a sales-type lease in which the fair value of the underlying asset is different from its carrying amount, the lessor is generally a manufacturer or a dealer and leasing represents another means for the lessor to sell its products. The good or service to which the initial direct costs relate in those transactions is the underlying asset; control of which is effectively transferred to the lessee at lease commencement.

BC307. The Board concluded that a lessor and a seller of the same good, including an entity that both sells and leases assets, should account for similar costs in the same way. In addition, the Board noted that the guidance on initial direct costs in previous GAAP was aligned with one of the two acceptable methods for accounting for costs to obtain a contract in previous revenue recognition guidance, and, therefore, the Board's decision on initial direct costs in Topic 842 maintains alignment between the leases and revenue recognition guidance for these types of costs.

Initial Measurement of the Unguaranteed Residual Asset

BC308. The unguaranteed residual asset is initially measured at the present value of the portion of the estimated residual value of the underlying asset that is not guaranteed by the lessee or another third party unrelated to the lessor. The discount rate that is used to measure the unguaranteed residual asset is the rate implicit in the lease.

Subsequent Measurement of the Net Investment in the Lease

BC309. A lessor measures its net investment in a sales-type or direct financing lease on an amortized cost basis after initial measurement. That measurement basis is consistent with the subsequent measurement guidance for lessors in previous GAAP and similar to but not exactly the same as the measurement basis applied to other financial assets and hybrid financial assets. For example, there are some differences in (a) the measurement of variable lease payments in Topic 842 and (b) how similar features would be measured for a financial asset measured at amortized cost in accordance with the financial instruments requirements. Nonetheless, this approach would result in accounting for the net investment in a sales-type or direct financing lease on a basis similar to that applied to other similar receivables.

Impairment of the Net Investment in the Lease

BC310. Topic 842 requires assessment of the net investment in a sales-type or a direct financing lease for impairment in accordance with the subsequent measurement guidance in Topic 310 on receivables. The lease receivable is a

financial asset. Even though the unguaranteed residual asset does not meet the definition of a financial asset in GAAP, the Board decided that it would be overly complex and provide little benefit to require entities to separately assess those components of the net investment for impairment (for example, assess the lease receivable only in accordance with Topic 310 and assess the unguaranteed residual asset in accordance with Topic 360).

BC311. The Board concluded that there would likely be little incremental benefit to requiring a separate impairment analysis for the components of the net investment because to be classified as a sales-type or direct financing lease the unguaranteed residual asset must, in general, be minor as compared with the lease receivable. In some cases, for example, when the lease transfers ownership of the asset to the lessee by the end of the lease term or grants the lessee a purchase option it is reasonably certain to exercise, there is no unguaranteed residual asset. Therefore, because most of the net investment in a sales-type or direct financing lease will comprise the financial lease receivable, the Board concluded that assessing impairment of the entire net investment in accordance with the impairment guidance for financial instruments is appropriate. The Board also considered that, in general, lessors entering into sales-type and direct financing leases will not re-lease the asset after the lease term. Those lessors will look to realize any expected residual value from the asset through a sale of the asset to the lessee or another party. Therefore, treating the entire net investment in the lease as a future cash flow stream when evaluating impairment is consistent with how lessors generally view their net investment in that lease.

BC312. The Board concluded that the incremental costs of requiring a lessor to assess the lease receivable and the unguaranteed residual asset for impairment separately would be significant based largely on feedback from respondents to the 2013 Exposure Draft. In the 2010 and 2013 Exposure Drafts, the Board proposed that a lessor should assess the lease receivable for impairment in accordance with Topic 310 and the residual asset (which included the guaranteed and unguaranteed portions) in accordance with Topic 360. Respondents stated that it would be complex to have a "split" impairment assessment of that nature (that is, to assess the lease receivable for impairment in the financial instruments guidance and to assess the residual asset for impairment in Topic 360). Those respondents mostly requested that the Board allow the entire net investment in the lease to be assessed for impairment in accordance with the financial instruments model.

BC313. As noted in paragraphs BC308 and BC309, the measurement basis for a lessor's net investment in a lease is similar to but not exactly the same as the measurement basis applied to other financial assets. Although the measurement of some net investments in a lease would be different from other financial assets measured at amortized cost, the Board previously concluded that this was not a reason to apply a different impairment model. The impairment model being proposed by the Board always would require a lessor to measure all expected losses relating to net investments in leases. Additional information is available in

the basis for conclusions of the December 2012 proposed FASB Accounting Standards Update, *Financial Instruments—Credit Losses* (Subtopic 825-15).

Reassessment of Options, the Discount Rate, and Variable Lease Payments That Depend on an Index or a Rate

BC314. As a consequence of its decision to substantially retain the lessor accounting model in previous GAAP, the Board decided that a lessor should not reassess lessee options to extend or terminate a lease or to purchase the underlying asset. Similarly, a lessor should not reassess either (a) the discount rate in the lease for sales-type or direct financing leases or (b) the lease payments for changes in a reference index or rate on which some or all of the lease payments are determined unless there is a lease modification that does not result in a separate contract. Any changes in payments made to the lessor as a result of the latter are accounted for as variable lease payments within the period earned.

Sale of the Lease Receivable

BC315. The Board considered whether lease receivables held for sale (or securitization) should be measured at fair value. Fair value measurement of those receivables would be similar to the principles in existing financial instruments requirements on the measurement of financial assets held for the purposes of sale. Fair value measurement also would eliminate the recognition of gains or losses upon sale (assuming the transfer occurs at fair value) because the asset being transferred would be recognized at fair value immediately before sale.

BC316. However, the Board decided not to require or permit a lessor to measure lease receivables held for sale at fair value because:

- a. There would be two measurement bases for lease receivables in the final leases guidance, thus, increasing complexity and reducing comparability.
- b. The measurement requirements would need to specify whether a lessor would be required to measure at fair value only the part of the lease receivable being transferred or all of the cash flows included in the lease receivable, including those relating to variable lease payments and options that meet the recognition criteria for those items. That would be relevant, for example, if a lease contains a renewal or extension option that it is reasonably certain to exercise; however, the cash flows to be sold relate only to lease payments to be received during the noncancellable period of the lease. In that case, a part of the lease receivable (that is, the lease payments to be received during the extension period) would not be held for sale. Both alternatives (that is, measuring the entire lease receivable or only the part to be transferred at fair value) would be complicated in this situation. Measuring only the part of the lease receivable to be transferred at fair value would require splitting the lease receivable into two parts with two different measurement bases for the same receivable. Alternatively, measuring all

- of the lease receivable at fair value would result in a lessor measuring lease payments not held for sale at fair value, which would be inconsistent with the Boards' other decisions on the measurement of lease payments.
- c. If the fair value requirement was a "held-for-sale" requirement, it would not be entirely consistent with the financial instruments guidance.
- d. Applying different measurement bases to different parts of a lease receivable also could introduce opportunities for structuring.

BC317. The Board decided that a lessor should apply the derecognition requirements in Topic 860, Transfers and Servicing, to lease receivables. Developing derecognition requirements specifically for lease receivables would add complexity to the lease guidance and reduce comparability between lease receivables and other similar financial assets. The Board did not identify any particular feature of lease receivables that would suggest that the financial instruments derecognition requirements would be inappropriate. In particular, Topic 860 includes requirements that address the sale of only a part of a larger financial asset.

BC318. The Board also decided to retain the guidance in previous GAAP on leases that says if a lessor sells the lease receivable associated with a sales-type or a direct financing lease and retains an interest in the unguaranteed residual asset, the lessor should not continue to accrete the unguaranteed residual asset to its estimated value over the remaining lease term. The lessor should report any remaining unguaranteed residual asset thereafter at its carrying amount at the date of the sale of the lease receivable and apply Topic 360 on property, plant, and equipment to determine whether the unguaranteed residual asset is impaired.

Measurement of the Underlying Asset at the End of the Lease Term or on Termination of a Lease

BC319. The Board decided that if a lessee returns the underlying asset before the end of the lease term (for example, because of a premature termination of the lease), the lessor should account for the returned asset as a reclassification of the net investment in the lease (that is, the lease receivable and the unguaranteed residual asset) and, therefore, measure the returned asset at the carrying amount of the net investment in the lease at that date. In reaching that decision, the Board noted that the net investment in the lease would be required to be assessed for impairment immediately before the underlying asset is returned to the lessor, and that this approach is consistent with how that impairment assessment would be performed. The Board concluded, however, that a lessor should continue to recognize a receivable for any amounts that it expects to receive relating to the lease. Accordingly, a lessor should initially measure the returned asset at the carrying amount of the net investment in the lease (after impairment), excluding any amounts that the lessor expects to receive, which the lessor will continue to recognize as a receivable.

BC320. The Board considered two other alternatives for measuring the returned asset:

- a. *Fair value:* A lessor would derecognize the net investment in the lease and recognize the returned asset at fair value.
- b. *Retrospective measurement:* A lessor would calculate a revised rate implicit in the lease (the rate actually earned on the shortened lease term) on the basis of the fair value of the returned asset at the time the lease terminates prematurely.

BC321. The Board rejected fair value because, in rare circumstances, it could potentially result in a lessor recognizing a gain from a repossession of the underlying asset. The Board noted that it is counterintuitive for a lessor to recognize a gain as a result of what most would view as an unfavorable circumstance (that is, the termination of a lease before the end of the lease term).

BC322. The Board rejected retrospective measurement because:

- a. The approach would be complex to apply. It requires the use of hindsight to recalculate the transaction as if the lessor had known at the commencement date that the lease would be terminated prematurely.
- b. The measurement methodology is not consistent with the way in which a lessor would assess the net investment in the lease for impairment immediately before recognition of the returned asset.
- c. In rare circumstances, it could potentially result in a net gain from a repossession of the underlying asset in situations in which the fair value of the asset has increased over the lease term.

Operating Leases

Initial Measurement

BC323. The Board decided that a lessor should continue to recognize and measure the underlying asset in accordance with other Topics and recognize lease income over the lease term for operating leases. A lessor does not recognize a receivable. That is consistent with a lessor's accounting for operating leases in previous GAAP.

BC324. The Board also decided that lessors should defer initial direct costs as a result of entering into an operating lease. The rationale for the Board's decisions on the deferral and subsequent recognition of initial direct costs are discussed in paragraphs BC304–BC307.

Subsequent Measurement

BC325. The Board decided that a lessor should recognize lease income arising from operating leases on a straight-line basis or another systematic basis if that basis is more representative of the pattern in which income is earned from the

underlying asset. In reaching that decision, the Board considered two other alternatives:

- a. Recognizing lease income on the basis of the contractual cash flows
- b. Recognizing lease income on a straight-line basis exclusively.

BC326. Recognizing lease income on the basis of the contractual cash flows might be an appropriate method of recognizing lease income if the lessor measured the underlying asset at fair value, recognizing changes in fair value through profit or loss. That is because the fair value of the asset would be estimated on the basis of future cash flows, taking into account both the timing and amount of contractual and noncontractual cash flows. However, the Board concluded that recognizing lease income on a contractual cash flow basis would not be appropriate when the underlying asset is measured at cost because, under such an approach, the amount of lease income recognized would be entirely dependent on the contractual timing of lease payments, rather than on the pattern in which the benefit is expected to be derived by the lessee from use of the underlying asset.

BC327. Although in the Board's view, recognizing rental income on a straight-line basis often will reflect the pattern in which income is earned from the underlying asset, it noted, consistent with previous GAAP, that will not always be the case. For example, the Board concluded that it would be simpler and more consistent with its proposals on variable lease payments to recognize lease income arising from variable lease payments for operating leases in the period in which the changes in facts and circumstances on which the payments are based occur, rather than on a straight-line basis. Consequently, the Board decided that a lessor should recognize rental income on a systematic basis that is not straight line if that basis was more representative of the pattern in which income is earned from the underlying asset. Nonetheless, a lessor is expected to recognize uneven fixed lease payments on a straight-line basis when the payments are uneven for reasons other than to reflect or compensate for market rentals or market conditions (for example, when there is significant front loading or back loading of payments or when rent-free periods exist in a lease).

Presentation: Lessor

BC328. As outlined in the discussion of the lessor accounting model in paragraphs BC75–BC109, the Board decided to retain most aspects of the lessor accounting model in previous GAAP. Consequently, lessors' presentation of leases in the statement of financial position, in the statement of comprehensive income, and in the statement of cash flows is substantially the same as in previous GAAP.

Statement of Financial Position

Sales-Type and Direct Financing Leases

BC329. A lessor in a sales-type lease or a direct financing lease should recognize and present in the statement of financial position its net investment in sales-type and direct financing leases. A lessor should also disclose its aggregate amount of lease receivables and unguaranteed residual assets (and for direct financing leases, deferred selling profit, if any).

BC330. In deciding that lessors should present a single net investment in sales-type and direct financing leases in the statement of financial position rather than separately present the components of the net investment (that is, the lessor's lease receivables, unguaranteed residual assets [and for direct financing leases, any deferred selling profit]), the Board principally considered the following:

- a. In the vast majority of sales-type and direct financing leases, the estimated residual value (whether guaranteed or unguaranteed) is realized by a sale or re-lease of the asset, and, for that reason, the residual value should be looked at as a last payment, similar to the lease payments.
- b. Combined presentation of a net investment in the lease helps to explain the rationale for discounting, and then accreting, the unguaranteed residual asset. While the unguaranteed residual asset is defined in GAAP as a nonfinancial asset, it is, in substance, a final cash flow at the end of sales-type and direct financing leases and, therefore, is reasonably accounted for like a financial asset when part of the lessor's net investment in the lease. Conversely, it would generally not be appropriate to present the nonfinancial unguaranteed residual asset with other nonfinancial assets (for example, with property, plant, and equipment), when they are not accounted for in a similar way (that is, unless the unguaranteed residual asset is no longer accreted, which is what occurs after a sale of the lease receivable) and do not share the same economic characteristics (for example, a lessor cannot use or sell—without the lease being attached—an asset while it is the subject of a lease).
- c. This presentation is consistent with the Board's decision to assess impairment of the unguaranteed residual asset in a lease together with impairment of the lease receivable (see paragraphs BC310–BC313).

BC331. While users generally said that the lessor accounting model in previous GAAP provided them with the financial information they needed, many users indicated that they needed more information about the lessor's residual assets and exposure to residual asset risk. The latter (exposure to residual asset risk) is addressed by the lessor disclosure requirements discussed in paragraphs BC339 and BC340. Regarding the former (information about the lessor's residual assets), the Board noted that users will benefit from the disclosure of a lessor's unguaranteed residual assets separate from the lessor's lease receivable. That is

because, although linked, those assets (that is, the unguaranteed residual asset and the lease receivable) have different natures, risks, and liquidity. Separate disclosure of those assets will improve the transparency of information provided to users of financial statements about a lessor's exposure to credit risk (relating to the lease receivable, which includes any guaranteed portion of the underlying asset's estimated residual value) and asset risk (relating to the unguaranteed residual asset).

Operating Leases

BC332. A lessor in an operating lease should present the underlying asset subject to an operating lease in accordance with other Topics (for example, in accordance with Topic 360 if property, plant, or equipment or Topic 330 if inventory).

Statement of Comprehensive Income

BC333. A lessor should present any profit or loss on a sales-type lease that is recognized at the commencement date in a manner that best reflects the lessor's business model(s). Examples of presentation include the following:

- a. If a lessor uses leases as an alternative means of realizing value from the goods that it would otherwise sell, the lessor should present revenue and cost of goods sold relating to its leasing activities in separate line items so that income and expenses from sold and leased items are presented consistently. Revenue recognized is the lesser of the fair value of the underlying asset at the commencement date and the sum of the lease receivable and any lease payments prepaid by the lessee. Cost of goods sold is the carrying amount of the underlying asset at the commencement date minus the unguaranteed residual asset.
- b. If a lessor uses leases for the purposes of providing financing, the lessor should present the profit or loss in a single line item.

BC334. Business models vary among lessors with sales-type and direct financing leases. For example, many financial institution lessors use leasing solely as a means of providing financing to lessees. Other lessors, for example, manufacturer or dealer lessors, use leasing as an alternative means of realizing value from assets that they would otherwise sell, and also provide financing to lessees. Topic 842 permits a lessor to present profit recognized at the commencement date either gross or net to reflect its business model(s) (if the lessor has different leasing businesses). That would enable a lessor to present the effects of leases in a way that is consistent with how the lessor generates its income.

Statement of Cash Flows

BC335. The Board decided that in the statement of cash flows, a lessor should classify lease payments received on all leases within operating activities because leasing is generally part of a lessor's revenue-generating activities.

Disclosure: Lessor

BC336. The lessor disclosure objective is the same as that for lessees. The lessor disclosure guidance also includes the same guidance about the appropriate level of detail for the disclosures. The Board's basis for its decisions to include the disclosure objective and the level of detail guidance are explained in paragraphs BC272–BC276.

Qualitative Disclosures

BC337. The basic qualitative disclosures required by Subtopic 842-30 are the same as those required for lessees. That is, a lessor should disclose:

- a. Information about the nature of its leases
- b. Information about significant assumptions and judgments made in applying the lessor accounting requirements
- c. Lease transactions between related parties.

BC338. The Board's rationale for requiring qualitative lessor disclosures is the same as its rationale for requiring qualitative lessee disclosures, which is explained in paragraphs BC277–BC279.

Residual Asset Risk Disclosures

BC339. Topic 842 requires a lessor to provide information about how it manages its risk associated with the residual value of its leased assets, including its risk management strategy for residual assets, the carrying amount of residual assets covered by residual value guarantees, and any other means by which it reduces its residual asset risk.

BC340. A primary concern of users on the disclosure requirements in previous GAAP is the lack of transparency about how the lessor manages its exposure to residual value risk. While users generally said that the lessor accounting model in previous GAAP provided them with the financial information they needed, many users indicated that additional information was needed about the lessor's residual assets and exposure to residual risk. Uncertainty about the residual value of the underlying asset at the end of the lease is a lessor's primary risk, particularly for a lessor of equipment and vehicles. This is because a decline in the market value of leased equipment and vehicles at a rate greater than the rate the lessor projected (on the basis of its policy on residual value measurement) would adversely affect the profitability of the lease. Residual value realization at the end of the lease term might be affected by several factors (for example, rapid technological or economic obsolescence, unusual wear and tear, excess use, or manufacturer's warranties). Consequently, the Board decided that a lessor should disclose how it manages its residual value risk to enable users to assess the uncertainty of cash flows arising from a lessor's leases and from its leased assets. The Board considered that producing residual risk disclosures will carry an incremental cost to preparers, but

it decided to require the disclosures on the basis that this is an area in which users have consistently requested additional information and told the Board that the financial reporting for lessors in previous GAAP was inadequate for their information needs in many cases.

Information on Underlying Assets

BC341. 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).

Table of Lease Income

BC342. Topic 842 requires a tabular disclosure of lease income, which will provide information about the different components of lease income recognized during the reporting period (for example, profit recognized at the commencement date, interest income on sales-type and directing financing leases, lease income arising from the lease payments for operating leases, and variable lease income). In the Board's view, this disclosure highlights for users the different nature of the components of lease income.

Maturity Analysis

BC343. Topic 842 requires that lessors disclose a maturity analysis of the timing of the future cash flows arising from its leases, separately for sales-type and direct-financing leases and operating leases. In the Board's view, such disclosure helps users of financial statements to assess the expected timing and amount of future cash flows arising from leases. In deciding to require the maturity analyses, the Board considered that the requirements are substantially the same as those that were required in previous GAAP.

Reconciliation of Opening and Closing Balances

BC344. The 2013 Exposure Draft included a proposal that a lessor should provide reconciliations of the lease receivable and residual asset for sales-type and direct

financing leases because those reconciliations inform users of financial statements about changes to those assets during the reporting period. Users of financial statements have informed the Board that such reconciliations are useful in their analyses. However, the Board decided not to include this requirement in Topic 842. The Board's rationale for not including this requirement is generally consistent with its rationale for not including a requirement for lessees to provide a reconciliation of the opening and closing balance of their lease liabilities. Paragraphs BC283–BC286 provide further detail.

BC345. In lieu of the reconciliation requirement, which would have provided quantitative information about the changes in a lessor's lease receivables and residual assets, the Board decided that lessors should provide qualitative information about the change in the balance of their unguaranteed residual assets and deferred selling profit (for direct financing leases) during the reporting period. The Board decided not to require this information for the lease receivable because it would be inconsistent with the disclosure requirements for similar financial assets.

Sale and Leaseback Transactions

BC346. In a sale and leaseback transaction, one entity (the seller-lessee) sells an asset that it owns to another party (the buyer-lessor) and immediately leases back that same asset. Lease accounting requirements in previous GAAP include specific requirements on sale and leaseback transactions involving real estate assets (for example, land, buildings, or integral equipment) to determine whether, when a real estate asset is sold and immediately leased back, an entity should account for the transaction as a sale and leaseback or account for the entire transaction as a financing arrangement. Those requirements were largely derived from guidance specific to sales of real estate in previous GAAP that preceded Topic 606. Previous GAAP did not include specific requirements to determine whether sale and leaseback transactions involving assets other than real estate should be accounted for as sale and leaseback transactions. However, in general, practice developed such that sale and leaseback transactions involving assets other than real estate were accounted for as sale and leaseback transactions unless the arrangement provided the seller-lessee with a bargain option to repurchase the asset.

BC347. Previous GAAP also included specific requirements on recognizing the gain or loss resulting from the sale of the asset in a sale and leaseback transaction. Those requirements were the same for sale and leaseback transactions involving real estate and non-real-estate assets. In general, most gains or losses were deferred at the time of sale of the asset and recognized over the term of the leaseback.

BC348. The requirements in previous GAAP were substantially different from those under IFRS, both regarding whether a sale of the asset occurs (for sale and leaseback transactions involving real estate assets) and how to recognize any gain

or loss on that sale in a sale and leaseback transaction. More transactions were accounted for as sale and leaseback transactions under IFRS than GAAP, while gains and losses (if the transaction was entered into at market terms) were generally recognized at the time of the sale in previous IFRS.

BC349. Topic 842 represents a substantial change from previous GAAP, and the basis for the decisions made on those changes is discussed in paragraphs BC350–BC358.

Determining Whether a Sale Occurs

BC350. Consistent with the 2010 and 2013 Exposure Drafts, a transaction should be accounted for as a sale and leaseback transaction in Topic 842 only if there is a sale of the asset that is the subject of the contract. In determining whether a sale has occurred, Subtopic 842-40 specifies that an entity consider both of the following from Topic 606:

- a. The guidance on identifying the contract
- b. The guidance on when an entity satisfies a performance obligation by transferring control of an asset.

Subtopic 842-40 relies on the guidance in Topic 606 in substantially the same way as the guidance in Topic 610, which applies to sales of nonfinancial assets to parties other than customers.

BC351. Topic 606 requires that for a sale of an asset to occur, a contract must exist between the parties and the buyer must obtain control of the asset from the seller. The Board decided that the presence of the leaseback in a sale and leaseback transaction should not affect those requirements. If no contract exists based on the guidance in Topic 606 or the buyer does not obtain control of the asset as a result of the transaction, no sale has occurred.

BC352. Because the revenue recognition guidance in Topic 606 is different from the guidance on determining whether a sale occurs in a sale and leaseback transaction in previous GAAP, and also because the presence of the leaseback is a unique feature specific to these transactions, the Board decided to provide some additional guidance about how to apply the transfer of control requirements in Topic 606 to a sale and leaseback transaction. Accordingly, Topic 842 includes the following guidance:

- a. *The existence of the leaseback does not, in isolation, prevent the buyer-lessor from obtaining control of the asset.* That is because a lease is different from the purchase or sale of an asset in that a lease does not transfer control of the underlying asset to the lessee; instead, it transfers the right to control the use of the underlying asset for the period of the lease. Consequently, assuming that there are no features in a sale and leaseback transaction that would prevent sale accounting, the buyer-

lessor would be considered to obtain control of the asset and immediately transfer the *right to control the use of* that asset to the lessee for the lease term (the Board's conclusion in this regard also significantly influenced its decision on how to account for the sale; see paragraphs BC359 and BC360). The lease payments received by the buyer-lessor during the lease term, together with the benefits that the buyer-lessor can generate from the residual asset after the lease term, would represent substantially all of the remaining benefits from the asset immediately before the asset is leased to the seller-lessee. Consequently, in such cases, the buyer-lessor obtains control of the asset. The Board further noted that the buyer-lessor in many sale and leaseback transactions is no different from many other lessors in terms of its control of the asset. Many lessors purchase an asset that will be the subject of a lease from a third party only when the terms and conditions of the lease have already been negotiated. The lessor may not receive physical possession of the asset until the end of the lease term (for example, a vehicle could be delivered directly by a manufacturer to the lessee, even though the lessor purchases the vehicle from the manufacturer). In a sale and leaseback transaction, the buyer-lessor also may not receive physical possession of the asset until the end of the lease term. However, in both of those situations, the Board concluded that it is appropriate for the lessor to be deemed to control the asset before the commencement of the lease.

- b. *The buyer-lessor does not obtain control of the asset in accordance with the guidance in Topic 606 if the leaseback would be classified as a finance lease (by the seller-lessee) or a sales-type lease (by the buyer-lessor). The Board has concluded that, in a finance/sales-type lease, the lessee, in effect, obtains the ability to direct the use of, and obtain substantially all the remaining benefits from, the underlying asset. Consequently, if a transaction in which the leaseback would be classified as a finance/sales-type lease were determined to be a sale and a leaseback, one would effectively conclude that the seller-lessee transferred control of the asset to the buyer-lessor and immediately re-obtained control of the asset. The FASB decided that no sale should occur in that scenario because it would be inappropriate for a seller-lessee to account for a concurrent (similar in nature to a "round trip") sale and, in effect, repurchase of the same asset.*
- c. *An option for the seller-lessee to repurchase the asset would preclude accounting for the transfer of the asset as a sale of the asset unless both (1) the exercise price of the option is the fair value of the asset at the time the option is exercised and (2) there are alternative assets, substantially the same as the transferred asset, readily available in the marketplace. Topic 606 states that a customer does not obtain control of an asset if the seller has the obligation or the right to repurchase the asset. Therefore, in general, the presence of a seller-lessee option to repurchase the asset precludes accounting for the transaction as a sale and a leaseback. However, the Board decided to specify that repurchase options that meet*

criteria (1) and (2) do not preclude sale accounting. In the Board's view, a buyer-lessor is not constrained in its ability to direct the use of and obtain substantially all the remaining benefits from the asset if the seller-lessee can only repurchase the asset at its then-prevailing fair market value and the buyer-lessor could use the proceeds from the repurchase to acquire an asset that is substantially the same in the marketplace. This notion was expressed in a similar manner in the basis for conclusions in Update 2014-09. When the Board discussed this provision, 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."

BC353. The Board further noted that there may be substantial judgment involved in determining whether a sale has occurred in some cases. That judgment will depend on the specific facts and circumstances of the contract. For example, in determining when and whether a sale occurs, a seller-lessee may conclude that the buyer-lessor has obtained control of the asset if the buyer-lessor has obtained legal title to the asset, the seller-lessee has a present right to payment for the asset for the sale price, and the buyer-lessor has accepted the significant risks and rewards of ownership. In contrast, an entity may not reach the same conclusion if, for example, the seller-lessee provides a significant residual value guarantee such that the buyer-lessor has not accepted the significant risks and rewards of ownership. If the buyer-lessor has not accepted the significant risks and rewards of ownership and the seller-lessee has not relinquished physical possession of the asset, careful evaluation of the facts and circumstances to determine when and whether a sale occurs in accordance with the principle in Topic 606 may be required.

BC354. The guidance on determining whether a sale has occurred in Subtopic 842-40 is generally consistent with the proposals in the 2013 Exposure Draft. Changes from that proposed guidance were principally along the lines of the following:

- a. Updates to the guidance resulting from changes to the revenue recognition proposals after the issuance of the 2013 Exposure Draft (for example, Topic 606 includes enhanced guidance on identifying the contract that was included in the revenue recognition proposals after the issuance of the 2013 Exposure Draft)
- b. Updates to the guidance resulting from changes to the lessee and lessor accounting proposals in the 2013 Exposure Draft (for example, updating the proposed requirement that a sale does not occur if the seller-lessee obtains substantially all the remaining benefits of the asset with the requirement that a sale has not occurred if the seller-lessee effectively retains control of the underlying asset as a result of the terms of the leaseback—that is, because the leaseback would be classified as a finance/sales-type lease)

- c. Clarifications to address stakeholders' requests for additional guidance on how to consider the transfer of control guidance in Topic 606 in the context of sale and leaseback transactions.

BC355. Most respondents that commented on the Board's sale and leaseback proposals in the 2013 Exposure Draft supported aligning the determination of a sale in a sale and leaseback transaction with the guidance in Topic 606. However, some respondents disagreed with the repurchase options accounting that results, because they noted that only a bargain purchase option should preclude sale accounting that would align with U.S. tax and legal requirements. However, the Board ultimately decided that it was important to determine whether a sale occurs in the context of a sale and leaseback transaction in the same manner as for any other sale transaction, which would be subject to the contract identification and transfer of control guidance in Topic 606.

BC356. The Board previously considered substantially different requirements in the 2010 Exposure Draft, but it ultimately rejected those proposed requirements in favor of the guidance included in Topic 842. The proposal in the 2010 Exposure Draft included a list of conditions that would have typically precluded sale and leaseback accounting. Those conditions would have set a higher threshold in terms of achieving sale accounting than the requirements in Topic 606 (as well as the revenue recognition proposals at that time). Respondents to the 2010 Exposure Draft raised the following concerns about those proposals:

- a. Many questioned why there was a need for a higher threshold in relation to sale and leaseback transactions, especially in light of the proposals in the revenue recognition project to remove the higher threshold that existed in previous GAAP for sales of real estate. Consequently, those respondents questioned why a higher threshold for revenue recognition should be retained only within the context of sale and leaseback transactions.
- b. Many were concerned about whether the sale recognition conditions in the 2010 Exposure Draft were operational. They expected the proposals to be applied very strictly so that almost all sale and leaseback transactions would be treated as financing arrangements.

BC357. The Board ultimately agreed with those respondents and abandoned the proposal in the 2010 Exposure Draft in favor of the requirements in Topic 842, which determine whether a sale has occurred in accordance with the guidance in Topic 606. The Board decided that applying the revenue recognition requirements to sale and leaseback transactions will simplify the sale determination as compared with the proposal in the 2010 Exposure Draft and increase comparability between sales entered into as part of sale and leaseback transactions and all other sales. The Board concluded that this will be beneficial to both preparers and users of financial statements.

BC358. Earlier in the project, the Board also considered whether the transferred asset must be an entire leased asset (a "whole asset" approach) or whether a

bundle of rights and obligations associated with an asset could qualify for sale and leaseback accounting (a "partial asset" approach). For example, under a partial asset approach, in a sale and leaseback of an office building, the lessee would continue to recognize a portion of the building representing the right to use the building during the leaseback period and derecognize that portion of the building relating to the rights transferred to the lessor (for example, ownership rights and the right to use the building after the end of the leaseback period). However, the Board decided not to propose a partial asset approach because it would be complex to apply and would not provide a proportionate benefit in improved information to users of financial statements.

Accounting for a Sale and Leaseback Transaction

BC359. The Board decided that the seller-lessee should account (a) for the sale of the asset, including determining the transaction price for the sale, in accordance with the guidance in Topic 606 if the buyer-lessor is a customer or Topic 610 if the buyer-lessor is not a customer, and (b) for the lease in accordance with the lessee guidance in Topic 842. The Board decided that the buyer-lessor should account for the purchase of the asset in accordance with other Topics (that is, as it would account for the purchase of the asset without the leaseback) and account for the lease in accordance with the lessor guidance in Topic 842.

BC360. The proposals in the 2013 Exposure Draft would have accounted for the sale (purchase) and the leaseback in substantially the same manner as Topic 842. In response to the 2013 Exposure Draft, some stakeholders suggested that the Board should require deferral of the gain on a sale subject to a sale and leaseback transaction (more broadly consistent with previous GAAP). During redeliberations of the 2013 Exposure Draft, the Board considered but ultimately rejected an alternative that would have recognized only the amount of any gain or loss on sale of the asset that relates to the rights retained by the buyer-lessor at the end of the leaseback. In rejecting this alternative, the Board concluded that if an entity determines that a sale and leaseback of a nonfinancial asset has occurred, the accounting for the sale (that is, transfer of control of the underlying asset) and the leaseback (that is, the transfer of a right to use the underlying asset, which is separate and distinct from the underlying asset itself) should not be affected by one another if the transaction is entered into at market terms. For the same reasons, the Board concluded that the buyer-lessor's accounting for its purchase of the asset and for its accounting for the lease of that asset back to the seller-lessee should not be affected by one another.

Off-Market Terms

BC361. The lease payments and the sales price in a sale and leaseback transaction are interdependent because they are negotiated as a package (for example, as part of the same contract or in two or more contracts that will be

combined in accordance with the contract combinations guidance in paragraph 842-10-25-19). That is, the sales price might be more than the fair value of the asset because the leaseback lease payments are above a market rate; conversely, the sales price might be less than the fair value because the leaseback lease payments are below a market rate. That could result in the misstatement of both gains and losses on disposal of the asset for the seller-lessee and the carrying amount of the asset for the buyer-lessor, as well as result in misleading lease expense (for the seller-lessee) or lease income (for the buyer-lessor) related to the leaseback. Consequently, the Board decided that an entity should adjust the sale (purchase) price of the asset if the sale and leaseback occurs at other than a market rate. The entity should account for:

- a. Any adjustment that increases the sale price of the asset, because the sale price paid by the buyer-lessor to the seller-lessee is below fair value, as a prepayment of rent (that is, as an adjustment to the right-of-use asset for the leaseback). The Board decided that a sale price below fair value was no different, in substance, from a prepayment of rent by the seller-lessee.
- b. Any adjustment that reduces the sale price of the asset, because the sale price paid by the buyer-lessor to the seller-lessee is above fair value, as additional financing provided by the buyer-lessor to the seller-lessee. The seller-lessee and the buyer-lessor should account for the additional financing in accordance with other Topics. The Board decided that in cases in which the buyer-lessor in effect, "overpays" for the asset, that overpayment is no different from the buyer-lessor granting the seller-lessee a loan in addition to purchasing the seller-lessee's asset. The seller-lessee and the buyer-lessor should account for that financing in the same manner as any other financing arrangement.

BC362. However, the Board decided that if the transaction is between entities that are related, the lessee and the lessor should not adjust the lease assets or the lease liabilities and should make the appropriate disclosures in accordance with Topic 850. This is consistent in concept with the Board's decision that an entity should account for a related party lease in accordance with the enforceable terms and conditions of that lease, rather than in accordance with a subjective determination of its economic substance.

BC363. An entity determines whether the sale and leaseback is not at a market rate by comparing the difference between either of the following, whichever is more readily determinable:

- a. The sale price of the asset and the fair value of the asset
- b. The present value of the lease payments and the present value of market rental payments.

BC364. The Board noted that an entity should maximize the use of observable prices and observable information in selecting the most appropriate benchmark to

use in determining if the sale and leaseback transaction is at a market rate and in calculating the accounting adjustment for any off-market terms.

BC365. The Board also noted that a sale and leaseback transaction should not be considered off market solely because the sale price or the lease payments include a variable component. In determining whether the sale and leaseback transaction is at fair value, the entity should consider those variable payments it reasonably expects to be entitled to (or to make) on the basis of all of the information (historical, current, and forecast) that is reasonably available to the entity. For a seller-lessee, this includes estimating any variable consideration to which it expects to be entitled in accordance with paragraphs 606-10-32-5 through 32-9. Variable payments are a part of the negotiated exchange between the parties; therefore, it is inappropriate to ignore that part of the negotiated exchange in determining whether the sale and leaseback transaction is at a market rate. Variable payments considered for purposes of this evaluation should not be *recognized* (that is, as part of the transaction price of the sale for the seller-lessee or the cost of the asset to the buyer-lessor, or included in the seller-lessee's measurement of the lease liability) except in accordance with the guidance in Topic 842 or other Topics (for example, Topic 606 or Topic 360).

BC366. The proposals in the 2013 Exposure Draft would have concluded that a sale and leaseback transaction was not at a market rate if either the sale price or the lease payment was not at fair value. Respondents to the 2013 Exposure Draft generally said that it was excessive to have to consider both the fair value of the asset and the market rental payments to make the off-market determination and suggested that the fair value of the asset will typically be more readily determinable. In response to that feedback, the Board decided it could simplify the guidance, without a significant diminution in the benefits that would result, by clarifying that an entity does not necessarily need to determine the fair value of both the underlying asset and the market rental payments. The Board decided that requiring an entity to determine the fair value of both the underlying asset and the market rental payments is likely to be unnecessary given that any overpayment for the underlying asset by the buyer-lessor would often be accompanied by above-market rental payments, and vice versa. In addition, requiring measurement of both the underlying asset and the market rental payments would be inconsistent with guidance in other Topics that generally directs an entity to select the single benchmark measure that is most readily determinable.

Accounting for a Failed Sale and Leaseback Transaction

BC367. If the transfer of the asset is determined not to be a sale:

- a. The seller-lessee should not derecognize the transferred asset and should account for any amounts received as a financial liability in accordance with other Topics.

- b. The buyer-lessor should not recognize the transferred asset and should account for the amounts paid as a receivable in accordance with other Topics.

BC368. These requirements for a failed sale and leaseback transaction are effectively unchanged from the proposals in the 2010 and 2013 Exposure Drafts. The Board decided, in affirming that guidance in Topic 842, that if there is no sale, the seller-lessee should not derecognize the asset (and continue to depreciate the asset) but, instead, should recognize any proceeds from the buyer-lessor as a financial liability. The Board's decision in this regard is consistent with both of the following:

- a. The accounting for a failed sale in Topic 606. For example, if a transaction includes a repurchase option that prevents the customer from obtaining control of the asset, the transaction is accounted for as a financing arrangement.
- b. The accounting for most failed sale and leaseback transactions on lease accounting requirements in previous GAAP.

BC369. As the seller-lessee makes the scheduled payments in the contract, it will allocate those payments between interest expense on the financial liability and repayment of principal on the financial liability. At the end of the "leaseback" period (or at the point in time the buyer-lessor obtains control of the underlying asset), the seller-lessee will recognize any remaining balance of the financial liability as the proceeds on the sale of the asset. The gain or loss recognized at that point will reflect any difference between those proceeds and the carrying amount of the asset.

BC370. The Board further decided that, in accounting for the financing transaction, the seller-lessee should adjust the interest rate on the financial liability as necessary to ensure that both:

- a. Interest on the financial liability is not greater than the principal payments on the financial liability over the shorter of the lease term and the term of the financing. The term of the financing may be shorter than the lease term because the transfer of an asset that does not qualify as a sale initially may qualify as a sale at a point in time before the end of the lease term.
- b. The carrying amount of the asset does not exceed the carrying amount of the financial liability at the earlier of the end of the lease term and the date at which control of the asset will transfer to the buyer-lessor.

The Board concluded that either of the results in (a) or (b) above would be inappropriate, and that inclusion of the guidance requiring adjustment of the seller-lessee interest rate was necessary to prevent those results. The guidance requiring adjustment of the seller-lessee interest rate is generally consistent with practice in previous GAAP.

BC371. In response to feedback from some stakeholders, the Board considered whether the buyer-lessor also should, like the seller-lessee, account for a failed sale and leaseback as a financing transaction. Some stakeholders had suggested that even if the seller-lessee does not recognize a sale, the buyer-lessor should account for the purchase. Those stakeholders said that accounting for the transaction as a financing would obscure the residual risk the buyer-lessor has in the lease because it paid for the asset's fair value but that the leaseback will be for less than that fair value. In addition, previous GAAP did not specify accounting for the buyer-lessor in a failed sale and leaseback transaction such that the failed sale and leaseback accounting for the buyer-lessor required by Subtopic 840-40 may represent a change for some entities. However, the Board decided to affirm its decision that both the seller-lessee and the buyer-lessor should account for a failed sale and leaseback transaction as a financing arrangement. The Board concluded that a buyer-lessor should not recognize an asset it does not control; to do so would be incompatible with the definition of an asset in Concepts Statement 6 and would result in both parties to the transaction recognizing the same underlying asset concurrently.

BC372. The Board observed that the guidance in Topic 606 specifies that if a seller-lessee repurchase option prevents transfer of control of the asset to the buyer-lessor in a sale and leaseback transaction, the seller should account for the contract as a financing arrangement. In making that decision in Topic 606, the Board noted that the application of the guidance on repurchase agreements in Topic 606 for other than sale and leaseback transactions could have required the seller-lessee to account for some sale and leaseback transactions as a lease and leaseback transaction. The Board also noted that applying lease and leaseback accounting in those situations would be complex and difficult to understand and, thus, the cost would not justify the potential benefit.

Sale and Leaseback Disclosures

BC373. The sale and leaseback disclosure requirements in Topic 842 are generally consistent with the sale and leaseback disclosure proposals in the 2010 and 2013 Exposure Drafts. The disclosure requirements in Topic 842 prescribe that lessees should disclose the main terms and conditions of sale and leaseback transactions and the net gain or loss arising from sale and leaseback transactions for each period presented in the financial statements. Those disclosures will inform users of financial statements about transactions that could give rise to significant nonrecurring gains and losses and cause a significant change in the capital structure of the entity.

Related Party Leases

BC374. The Board decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties on the basis of legally enforceable terms and conditions of the arrangement, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, lessees and lessors are required to apply the disclosure requirements for related party transactions in Topic 850. In previous GAAP, entities were required to account for leases with related parties on the basis of the economic substance of the arrangement, which may be difficult when there are no legally enforceable terms and conditions of the arrangement. Examples of difficulties include related party leases that are month to month and related party leases that have payment amounts dependent on cash availability. In these situations, it is difficult and costly for preparers to apply the recognition and measurement requirements. Even when applied, the resulting information often is not useful to users of financial statements.

Short-Term Leases—Lessees

BC375. In the 2010 Exposure Draft, the Board proposed that a lessee and lessor could elect to apply simplified accounting to leases that met the definition of a short-term lease. A lessee would recognize, but would not need to discount, lease assets and lease liabilities arising from short-term leases. A lessor could apply an approach similar to existing operating lease accounting to short-term leases. A short-term lease was defined in the 2010 Exposure Draft as a lease that, at the commencement date, has a maximum possible lease term, including all options to extend, of 12 months or less.

BC376. Respondents to the 2010 Exposure Draft noted that the proposals for short-term leases did not offer much relief for entities because the discount element of short-term leases is often immaterial. In addition, the proposals would still require an entity to track a possibly large volume of leases with little value and to separate nonlease components from lease components for those leases, which could be cumbersome.

BC377. On reconsideration, the Board agreed that applying the full proposals did not justify the costs. Consequently, in the 2013 Exposure Draft, the Board simplified the accounting for short-term leases to offer more relief. The Board proposed that both lessees and lessors need not apply the recognition and measurement requirements to short-term leases. The definition of *short-term lease* was refined from that in the 2010 Exposure Draft such that a lease would not meet the definition of a short-term lease if it included an option for the lessee to purchase the underlying asset (at any exercise price).

BC378. During redeliberations of the proposals in the 2010 Exposure Draft, the Board rejected increasing the short-term lease exemption beyond leases of 12

months because, for example, 2-year leases and 3-year leases are more likely to give rise to material assets and liabilities and the objective of the project was to ensure greater transparency about an entity's leasing activities. Some Board members continue to believe that with the short-term lease exemption, even when limited to leases of 12 months or less, there is the potential for significant assets and liabilities (in aggregate) not to be recognized in the balance sheet and, therefore, do not support the short-term lease exemption despite supporting this Update overall.

BC379. The Board affirmed a recognition and measurement exemption for a lessee's short-term leases in finalizing the guidance in Topic 842. The Board affirmed the short-term lease threshold of 12 months or less that was previously proposed but decided to permit the recognition and measurement exemption to apply to any lease for which the lease term (as defined in Topic 842) is 12 months or less, rather than only to a lease with a maximum possible term of 12 months or less. That decision was largely a consequence of feedback on the 2013 Exposure Draft that suggested that use of a "maximum possible lease term" would not permit the exemption to be applied to "evergreen" leases that may typically only be for a matter of only weeks or even days, because there is no stated maximum lease term (that is, the lease may contain terms that permit the lessee to continue to extend the lease on a day-to-day, week-to-week, or month-to-month basis). The Board also decided that the presence of a lessee option to purchase the underlying asset should not preclude short-term lease designation unless the lessee is reasonably certain to exercise that option. Short-term leases, like all other leases of lessees, are subject to the lease term and purchase option reassessment requirements in Subtopic 842-10.

BC380. Because the Board decided to substantially retain the lessor accounting model in previous GAAP, which accounts for nearly all short-term leases as operating leases, the Board concluded that it was not necessary to include a short-term lease exemption in Topic 842 for lessors.

BC381. The Board considered that leases could be structured to obtain short-term lease accounting. For example, a lease that ultimately extends for 10 years or more could be structured as a 1-year lease with a series of 1-year renewal options, which could result in the lease never being recognized on a lessee's statement of financial position. However, the Board concluded that there are significant economic disincentives to both parties to entering into a series of short-term leases in place of longer-term leases such that there is not a significant structuring risk throughout the system. For example, lessees may have to pay a premium rental price to compensate the lessor for its increased residual asset risk, and some lessors will be unable to enter into short-term leases depending on the terms of the financing they obtained to acquire the underlying asset.

Effective Date

BC382. The Board decided that the amendments in this Update will be effective for public business entities and any not-for-profit entity that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and any employee benefit plan that files or furnishes financial statements with or to the SEC for fiscal years beginning after December 15, 2018, including interim reporting periods within those fiscal years. For all other entities, the amendments in this Update will be effective for fiscal years beginning after December 15, 2019, and for interim reporting periods beginning after December 15, 2020. In addition, the Board decided to allow early application of the amendments in this Update upon issuance.

BC383. In deciding on the effective date of Topic 842, the Board considered a number of factors. The following considerations most significantly influenced the Board's conclusion that an effective date later than that provided would not represent an appropriate balance between costs to preparers and the effect on users of such a significant delay in obtaining the improved, more representationally faithful information they will receive as a result of Topic 842:

- a. Extensive feedback from preparers and industry groups that the amendments in this Update could be implemented without any significant systems or process changes. That is, not to say that no systems or process changes will be necessary but, rather, that those changes are not expected to be extensive or costly.
- b. The Board has provided approximately three-and-a-half years between the issuance of Update 2014-09 and the mandatory effective date of the amendments therein (principally, Topic 606 and Subtopic 340-40). The extent of the accounting changes for most entities that will result from the amendments in this Update are less significant than the extent of the accounting changes for those same entities that will result from adopting the guidance in Topic 606 (and Subtopic 340-40). Consequently, the Board concluded that entities would not, in general, need as much time to implement Topic 842 as they will need to implement Topic 606 (and Subtopic 340-40).
- c. Issues on the effect of Topic 842 on entities' covenants in existing debt/loan agreements are not likely to be significant based on all of the following:
 1. A significant portion of lease agreements contain "frozen GAAP" or "semifrozen GAAP" clauses such that a change in a lessee's financial ratios resulting solely from a GAAP accounting change either would not result in a debt covenant default or would solely require both parties to renegotiate in good faith.
 2. Banks with whom outreach has been conducted state that they are unlikely to dissolve a good customer relationship by "calling a loan" because of a "technical" default of this nature, even if the loan

agreement did not have a “frozen GAAP” or “semifrozen GAAP” provision.

3. The Board’s decision that operating lease liabilities are operating obligations rather than debt. Based on outreach, this decision may substantially alleviate issues for some smaller entities with certain debt covenants.
4. The average life of most commercial and industrial loans, based on data obtained by the staff, is less than the period of time between the issuance of this Update and the first time an entity, especially a private company, will report under Topic 842.

BC384. In contrast, the following considerations most significantly influenced the Board’s decision not to enact an effective date earlier than that provided:

- a. An effective date earlier than that provided would likely have resulted in the beginning of the earliest comparative period presented that is affected by Topic 842 beginning before the issuance of this Update. Even though, because of the simplified requirements in Topic 842 (as compared with earlier proposals), including those as to transition, such an outcome would likely not have been overly burdensome, the Board considered it preferable to enact an effective date that would result in the earliest comparative period presented in the first set of financial statements issued in accordance with Topic 842 beginning after the issuance of this Update.
- b. Most entities will be implementing both Topic 842 and Topic 606 (and Subtopic 340-40) over the next few years such that, given limited resources, staggering the effective dates of those two Topics would permit entities to better assign and allocate resources and perform more effective implementations of each Topic. The Board expressed concern about the availability of appropriate internal and external resources to implement both Topics at the same time. The Board also considered that some entities will be implementing new financial instruments guidance during this timeframe. While this was considered in determining that the effective date for Topic 842 was reasonable, it had less of an effect on the Board’s decision than considerations relative to Topic 606 because the financial instruments standards are expected to significantly affect a much smaller population of entities than Topics 842 and 606.

BC385. The IASB established the same effective date for IFRS 16. Despite some important differences between IFRS 16 and Topic 842, the Board concluded it will significantly assist U.S. entities that have to report under both GAAP and IFRS to be able to adopt both standards concurrently. Both Boards decided to permit some form of early application such that it is generally within the control of each entity whether it wants to adopt IFRS 16 at the same time as it adopts Topic 842.

BC386. The Private Company Decision-Making Framework recommends that amendments in FASB Accounting Standards Updates be effective for private

companies one year after the first fiscal year for which public business entities are required to adopt them and that the amendments be required for the first time only in those entities' *annual* reporting (that is, the entity is not required to adopt the amendments for its interim reporting until the following fiscal year). The Board decided that no additional deferral was necessary for private companies for the following reasons:

- a. Because the Private Company Decision-Making Framework recommendation does not require private companies to adopt a new accounting standard until its first fiscal year following the effective date, private companies generally will not report under Topic 842 until two years after most public business entities first report under Topic 842. Consequently, many calendar-year private companies will not issue financial statements in accordance with Topic 842 until sometime in 2021, more than five years after the issuance of this Update.
- b. Topic 842 will be no more complex for private companies to apply than it will be for public business entities and, in fact, may be simpler for many of those entities to apply because most private companies do not have IFRS reporting obligations (which might require them to account for their leases under the different Topic 842 and IFRS 16 models) and generally have smaller lease portfolios.

BC387. The Board decided to permit early application of Topic 842 on the basis that if entities are willing and can provide users of financial statements with the significantly improved information, Topic 842 will provide sooner than the mandatory effective date they should be permitted to do so. Also of importance, early application permits lessors to adopt Topic 842 at the same time as Topic 606. The Board also concluded that users should not have any significant difficulties with comparability from early application because the financial statements of lessors, as well as the statements of comprehensive income and cash flows of lessees, will be mostly unchanged as a result of adopting Topic 842 and because nearly all users already adjust lessees' statements of financial position for operating leases. The financial statement and disclosure information required by Topic 842 will generally permit users to easily adjust an entity's statement of financial position as necessary to compare an entity that early applies Topic 842 with an entity that does not.

Transition: Modified Retrospective Method

Lessee and Lessor Transition

BC388. The primary improvement in Topic 842, as compared with previous GAAP, is the recognition of lease assets and lease liabilities for all leases. A lessee's accounting for finance leases in Topic 842 will be substantially unchanged from a lessee's accounting for capital leases in previous GAAP. In addition, the accounting effect of operating leases in a lessee's statement of comprehensive

income or statement of cash flows in Topic 842 will be substantially the same as that in previous GAAP. The accounting for lessors is substantially unchanged from previous GAAP, except to align various aspects of the lessor accounting guidance with the guidance in Topic 606 and to certain aspects of the new lessee accounting guidance.

BC389. Consequently, the Board decided to mandate the modified retrospective transition method in Topic 842, with the option to elect a package of practical expedients. The Board decided on this rather than a more onerous transition approach (for example, a full retrospective approach), to reduce the cost of transition for preparers, while still reflecting the primary improvement of the lessee accounting guidance at each reporting date presented in the entity's comparative financial statements.

BC390. The practical effect of the modified retrospective transition method, particularly when combined with the practical expedients that are offered, is that an entity will "run off" those leases existing at the beginning of the earliest comparative period presented in accordance with previous GAAP with the *exception* that, for operating leases, a lessee will present a lease liability in the statement of financial position at each reporting date equal to the present value of the remaining *minimum rental payments* (as that term was applied in previous GAAP) and a right-of-use asset that is derived from the lease liability in the manner described in paragraph 842-20-35-3. Entities will, in effect, "run off" existing leases, as described, *unless* the lease is either modified (and that modification is not accounted for as a separate contract) or, for lessees only, the lease liability is remeasured in accordance with the subsequent measurement guidance in Subtopic 842-30 on or after the effective date. To ensure that the financial statements provide relevant and reliable financial information, lessees and lessors should apply the subsequent measurement guidance in Topic 842 beginning on the effective date. For lessees, this includes the subsequent measurement guidance in Subtopic 842-30 on lease term and purchase option reassessments and assessing impairment of right-of-use assets. For lessors, applying the subsequent measurement guidance in Topic 842 is expected to result in little difference from applying the subsequent measurement guidance in previous GAAP.

BC391. While the Board acknowledges that the accounting result from applying the modified retrospective transition approach will not be the same as that from a full retrospective approach (for example, because of differences between what were *minimum rental payments* or *minimum lease payments* in previous GAAP and what are *lease payments* in Topic 842), the Board noted that the results will be similar such that the benefits of a more precise transition approach would not justify the costs.

BC392. The Board included the following two practical expedients as part of the transition guidance:

- a. An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor) when applying the transition guidance to leases that began before the effective date:
 - 1. An entity need not reassess whether any expired or existing contracts are or contain leases.
 - 2. An entity need not reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as operating leases in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as finance leases).
 - 3. An entity need not reassess initial direct costs for any existing leases.
- b. An entity also may elect a practical expedient, which must be applied consistently by that entity to all of its leases (including those for which the entity is a lessee or a lessor) to use hindsight in determining the lease term (that is, when considering options to extend or terminate the lease and purchase options) and in assessing impairment of the entity's right-of-use assets. This practical expedient may be elected separately or in conjunction with the practical expedients in (a).

BC393. The Board decided to require that the practical expedients in paragraph BC392(a) be elected as a package that will apply to all of the entity's leases (including those for which it is a lessee and those for which it is a lessor) to limit, for users, the potential number of combinations of transition methods entities might elect. That also is why the Board decided not to permit entities to adopt the guidance in Topic 842 on a fully retrospective basis, despite acknowledging that a full retrospective approach would produce the most comparable financial information for users. The following apply to each of the components of the practical expedient in paragraph BC392(a):

- a. The Board decided to permit entities not to reassess whether any expired or existing contracts are or contain leases because the Board expects that, in most cases, entities will reach the same lease/nonlease conclusion in accordance with the guidance in Topic 842 as they did in previous GAAP. Where any difference is expected, the guidance in Topic 842 is likely to result in a nonlease conclusion where previous GAAP would have concluded that the entity has a lease. The Board noted explicitly that this practical expedient grandfathers the guidance on identifying a lease for expired and existing contracts in previous GAAP; this practical expedient does not grandfather an incorrect assessment determined in previous GAAP.
- b. The Board decided to permit entities not to reassess the classification of their leases because the Board expects the vast majority of leases classified as operating leases in previous GAAP also will be classified as

operating leases in Topic 842, and, similarly, the vast majority of leases that would be classified as capital leases in previous GAAP will be classified as finance leases in Topic 842. Therefore, the cost of requiring entities to reassess lease classification will not be justified by the benefit, especially because all leases will be recognized in the statement of financial position.

- c. The Board decided not to require reassessing whether unamortized initial direct costs would have qualified for capitalization in Topic 842. The Board decided that to do so would require entities to incur additional transition costs, while the effect of reassessing those initial direct costs will only be to write off some (or all) of those costs to equity. That means that those costs would never run through the statement of comprehensive income. The Board decided that if an entity does not want to incur the transition cost of reassessing its unamortized initial direct costs but, instead, is willing to continue to recognize those costs in the statement of comprehensive income, it should be permitted not to reassess those costs.

BC394. In deciding to provide the practical expedient in paragraph BC392(b), the Board considered that a similar practical expedient related to the use of hindsight in determining the transaction price (that is, estimating variable consideration) was provided in the transition requirements in Topic 606. Similar to the rationale for that expedient, the Board decided that reflecting expectations that an entity knows at the time of reporting are important does not provide useful information to users. In the context of this practical expedient, the Board considered that it would generally not provide useful information to recognize a lease liability on the basis of a lease term that assumes the entity is reasonably certain to exercise an option to extend the lease when at the time of reporting the entity knows that it did not exercise that option. The Board decided not to include the use of the hindsight practical expedient into the package of the other practical expedients that must be elected together because the use of hindsight reduces the complexity of transition and provides more accurate, updated information to users such that the Board did not want an entity's ability to elect that expedient to be dictated by its decision on other expedients.

BC395. During the course of the leases project, some stakeholders suggested that the Board should adopt a prospective transition method (that is, applying Topic 842 only to leases that begin on or after the effective date). Although the approach would have been the least costly for preparers of financial statements to apply, the Board rejected this transition approach because information provided would not have been beneficial to users of financial statements, particularly for entities that enter into long-term operating leases (for example, a lessee with a 10-year lease, a 20-year lease, or even longer-term leases might not reflect a significant portion of its lease assets and lease liabilities in its statement of financial position until decades after the effective date of Topic 842). Instead, the Board focused on minimizing the cost of a modified retrospective approach, where appropriate.

Transition for Sale and Leaseback Transactions

BC396. Consistent with the transition proposals for lessees and lessors generally, the modified retrospective transition requirements applicable to sale and leaseback transactions were adopted by the Board with the objective to limit the cost and complexity of transition to preparers of financial statements while still providing useful information to users. With that objective, the key provisions of the sale and leaseback transition guidance and the Board's reasons for adopting those provisions are as follows:

- a. An entity should not reassess whether a transaction previously accounted for as a sale and leaseback in previous GAAP would have qualified as a sale (or purchase) in accordance with the guidance for determining whether the transfer of the asset is a sale in Subtopic 842-40. The Board concluded that the cost, time, and effort to reassess those transactions could be significant, particularly if the entities entered into the transaction many years in the past. The Board decided that the benefits of changing the accounting for the subset of transactions in which a sale was deemed to occur in previous GAAP, but would not have occurred in accordance with the guidance in Subtopic 842-40, or would have occurred at a different point in time in accordance with that guidance, would not justify the costs of the reassessment.
- b. An entity should reassess whether a transaction previously accounted for as a failed sale and leaseback in previous GAAP that remains a failed sale as of the effective date should be reassessed on whether a sale would have occurred in accordance with the guidance in Subtopic 842-40. In the Board's view, this is consistent with the transition guidance applicable to sales of assets in Topic 606. That is, under the modified retrospective transition guidance in Topic 606, an entity reassesses the accounting for any contract that is not completed before the effective date. In this case, a failed sale and leaseback is an uncompleted contract because the seller-lessee has not yet transferred control of the asset to the buyer-lessor.
- c. For any transaction previously accounted for as a sale and capital leaseback transaction in previous GAAP, the seller-lessee will continue to amortize any deferred gain or loss in the same manner as in previous GAAP. In this respect, the Board decided that the accounting effect of retrospectively applying Subtopic 842-40 to the transaction would not be significantly different from the accounting effect of continuing to account for the sale and leaseback in accordance with the previous guidance. In Subtopic 842-40, a finance leaseback precludes accounting for the transaction as a sale and a leaseback. The net accounting effect of recognizing the underlying asset and a financial liability as compared with continuing to recognize a right-of-use asset, a lease liability, and deferred gain, would not justify the costs of doing so.

- d. For any transaction previously accounted for as a sale and operating leaseback transaction in previous GAAP, the seller-lessee should recognize any deferred gain or loss not resulting from off-market terms as a cumulative-effect adjustment at the later of the date of initial application (to equity) and the date of sale (to earnings of the comparative period presented). That will adjust the seller-lessee's financial statements as if the historical gain or loss resulting from the sale of the asset had been recognized in accordance with Subtopic 842-40.
- e. For any deferred gain or loss on a sale and operating leaseback resulting from off-market terms, the seller-lessee will recognize a deferred loss as an adjustment to the leaseback right-of-use asset or account for any remaining deferred gain as a financial liability. Consistent with the basis for its decision in (d), the Board concluded that this will result in accounting that is consistent with the treatment of those items in Subtopic 842-40. The Board further concluded that in accounting for off-market deferred gains or losses differently from those in (d), off-market gains or losses reflect continued financing that should not be written off to equity in transitions.
- f. An entity should account for the leaseback in any transaction that qualified as a sale and leaseback in previous GAAP in accordance with the general transition requirements applicable to lessees and lessors in Topic 842. This decision is consistent with the Board's conclusion on sale and leaseback accounting overall that if an entity determines that a sale and leaseback of an asset has occurred, the accounting for the sale/purchase (that is, the transfer of control of the underlying asset) and the leaseback (that is, the transfer of a right to use the underlying asset, which is separate and distinct from the underlying asset itself) should not be affected by one another if the transaction is entered into at market terms.

Leveraged Leases

BC397. The Board decided that the existing accounting model for leveraged leases should not be retained. That is, all leases should be accounted for in a consistent manner and special rules should not exist for leases with certain characteristics. One reason is because leveraged lease accounting provides net presentation and some Board members do not agree with allowing a net presentation for only a subset of certain lease transactions. Another reason is to limit some of the complexity in the lease accounting guidance by eliminating the unique accounting for leveraged leases. As such, lessors should not distinguish leveraged leases from other leases in Topic 842. This is consistent with the proposed requirements in the 2010 and 2013 Exposure Drafts. However, the Board decided to grandfather existing leveraged leases during transition. Respondents to the 2013 Exposure Draft noted that the transition of existing leveraged leases to the current lessor model would require particular challenges when unwinding the income tax effects of the leveraged leases and income

statement results on transition that would not properly depict the economics of the transaction. The Board recognized that there would be significant complexities relating to unwinding existing leveraged leases and that the outcome of doing so would not be beneficial to users. Therefore, the Board decided to grandfather the accounting under previous guidance for existing leveraged lease transactions.

Costs Incurred Relating to the Construction or Design of an Underlying Asset

BC398. Previous GAAP provided extensive requirements relating to a lessee's involvement in the construction of an asset that the lessee will lease when constructed (such contracts are typically build-to-suit leases, and are referred to as such in this section). This included detailed guidance with which to evaluate whether the lessee was the accounting owner of the asset during the construction period. If the lessee was the accounting owner of the asset during the construction period, it would recognize the asset in its statement of financial position as well as a financial liability for costs of the construction paid by the lessor. At the end of the construction period, the transaction was subject to the sale and leaseback guidance. The requirements in previous GAAP were initially written to address situations in which a lessee might attempt to keep assets "off balance sheet" by leasing an asset that it had constructed and avoiding applying the sale and leaseback requirements that would typically require the lessee to recognize the asset. In such transactions, the lessor sometimes would be a variable interest entity.

BC399. Topic 842 does not carry forward the requirements from previous GAAP for build-to-suit leases. In reaching this decision, the Board principally considered the following:

- a. The requirements in previous GAAP were written primarily to address off-balance-sheet concerns at a time when leases classified as operating leases were not recognized in a lessee's statement of financial position. The accounting model changes that require a lessee to recognize lease assets and lease liabilities and the sale and leaseback accounting changes, together with more recent changes to the consolidation requirements for variable interest entities, would reduce the need for specific requirements in this area. For example, regardless of whether the lessee is considered to control the asset during construction, the lessee will recognize a right-of-use asset at the commencement date of the lease.
- b. The requirements in previous GAAP made the assessment of whether the lessee is the accounting owner of the asset during the construction period on the basis of whether the lessee had substantially all of the construction period risks. The Board decided that this is not the appropriate basis on which to determine whether the lessee is, in effect, the owner of the asset before lease commencement. Rather, the lessee

should be considered the owner of the asset before lease commencement only if it controls that asset.

- c. The requirements in previous GAAP were complex to apply, and even though they have existed for many years, they continue to present practice issues.

BC400. Despite not carrying forward the previous guidance on how to account for costs incurred by a lessee relating to the construction or design of an asset, the Board decided, in response to feedback from stakeholders, to include some guidance in Topic 842 related to those costs. Consequently, Topic 842 provides for the following:

- a. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee should account for those costs in accordance with other Topics (for example, Topic 330 on inventory or Topic 360 on property, plant, and equipment). The Board included this guidance to ensure that entities recognize that even if they are no longer determined to be the accounting owner of an asset during construction, their costs incurred may qualify for recognition as an asset in accordance with other Topics. This may include assets like leasehold improvements that the lessee pays for during the construction period and that will benefit the lessee in future periods.
- b. If the lessee controls the underlying asset before lease commencement, the transaction is a sale and leaseback transaction that is accounted for in accordance with Subtopic 842-40. In adding this guidance, the Board concluded that if the lessee controls the asset as it is being constructed, it should recognize that asset just as it would any other asset it controls. The Board decided to provide the implementation guidance in paragraph 842-40-55-5 and Example 3 in Subtopic 842-40 to assist entities in determining when a lessee controls an underlying asset that is under construction before the commencement date, understanding that this concept is new in the context of evaluating leases. It is the Board's view that in each of the circumstances provided, the lessee controls the underlying asset as it is being constructed and, therefore, should evaluate the transaction in accordance with the sale and leaseback guidance. Paragraph 842-40-55-5 further articulates that the circumstances provided are not an all-inclusive list; additional circumstances (individually or in combination), if present, could demonstrate that a lessee controls an underlying asset that is under construction before the commencement date. Therefore, some judgment will be involved in undertaking the evaluation in some cases. The Board observed that, in concept, the evaluation under Subtopic 842-40 on whether an entity controls an asset that is under construction is similar to the evaluation undertaken in the revenue recognition guidance in accordance with paragraph 606-10-25-27 to determine whether a performance obligation is satisfied over time. The Board recognizes that this provision is different

from the previous GAAP build-to-suit requirements and, therefore, different accounting conclusions may result from application of the new guidance as compared to previous GAAP. However, it was not necessarily the Board's intention to achieve similar accounting results with the guidance in Subtopic 842-40 but, rather, to communicate that (1) a lessee can be the owner of an asset before lease commencement and (2) control is the appropriate basis on which to make that determination.

BC401. Some respondents to the 2010 and 2013 Exposure Drafts noted that those proposals did not provide any transition guidance for existing build-to-suit leases. Those respondents stated that transition guidance was needed if the Board was eliminating the previous accounting guidance. In response to that feedback, Topic 842 includes transition guidance on how to account for build-to-suit leases. That guidance includes how to account for recognized assets and liabilities (for example, a recognized asset and financial liability), as well as how to account for the lease. Consistent with the general transition requirements, the Board decided that lessees should apply a modified retrospective transition approach. That will allow relief for lessees while ensuring consistent recognition and measurement for these types of transactions on the effective date and for all comparative periods presented.

Application to Private Companies—Specific Topics

BC402. Paragraphs BC29–BC31 discuss, broadly, the factors the Board considered for private companies. This section summarizes the Board's considerations in deciding whether to modify some of the specific requirements in Topic 842 for private companies. During the leases project, the Board carefully considered the different needs of private companies in deciding to modify some of the requirements. In making those decisions, the Board considered input from preparers, auditors, and users of private company financial statements and considered the different needs of those users of private company financial statements compared with users of public business entity financial statements.

BC403. This section considers the Board's decisions on the following topics:

- a. Recognition
- b. Measurement
- c. Disclosures
- d. Presentation
- e. Transition.

Recognition

BC404. The Board considered feedback from preparers and users of private company financial statements to consider whether the requirement to recognize lease assets and lease liabilities on the balance sheet provides relevant information to users of a private company's financial statements at a reasonable

cost. In arriving at its decisions, the Board considered (as expressed in paragraph BC29) the Private Company Decision Making Framework; the Conceptual Framework; input from preparers, auditors, and users of private company financial statements; the different needs of users of private company financial statements compared with users of public business entity financial statements; and the recommendations of the PCC (as well as its predecessor, the PCFRC), including the recommendations of others, to have consistent accounting for public business entities and private companies. In this respect, and consistent with the feedback from private company financial statement users with whom outreach was performed, the Board concluded that the benefit to financial statement users of the requirement in Topic 842 to recognize lease assets and lease liabilities on the balance sheet for all entities justifies the costs to preparers to provide this information, particularly in light of the discussion in paragraphs BC9–BC11 and BC30.

BC405. In response to the 2010 Exposure Draft, the PCFRC noted that private companies should recognize lease assets and lease liabilities, consistent with public companies, subject to some limited practical expedients that the Board adopted in Topic 842 (for example, on determining a lessee's incremental borrowing rate, accounting for related party leases, and exempting private companies from disclosing a reconciliation of lease assets or lease liabilities). In response to the 2013 Exposure Draft, and again during redeliberations before issuing the amendments in this Update, the PCC suggested a classification approach for lessees that would be similar to that proposed in the 2013 Exposure Draft, based on the expected consumption of the underlying asset by the lessee during the lease term (see paragraphs BC52–BC55). However, under the PCC proposal, private company lessees would not be required to recognize lease assets and lease liabilities arising from those leases for which significant consumption of the underlying asset did not occur (effectively, what were classified as "Type B leases" in the 2013 proposals). The Board rejected this alternative because the Board concluded that all leases create assets and liabilities for lessees that should be recognized (that is, consumption of the economic benefits of the underlying asset is not a determinative factor in assessing whether the right of use conveyed by the lease is an asset to the lessee or whether the lessee has an obligation to pay for that right of use) and, consistent with paragraph BC29, there is no compelling rationale for a difference in this respect between public business entities and all other entities. The Board also observed that the PCC alternative would conflict with the feedback the Board received from private company lenders and a significant majority of other private company stakeholders with whom it had engaged that said that all leases—finance and operating—create liabilities for lessees. The PCC approach also would appear to result in income statement and statement of cash flows results more consistent with that in the 2013 Exposure Draft, which a majority of the respondents to that Exposure Draft rejected. Furthermore, most preparers, including those from private companies, in response to the 2013 Exposure Draft, said that the consumption-based

classification approach would be more costly and complex to apply than a classification approach substantially aligned with that in previous GAAP.

Measurement

BC406. Topic 842 includes a practical expedient for lessees that are private companies that allows an accounting policy election for the initial and subsequent measurement of all liabilities to make lease payments. Under that election, those liabilities could be discounted under the requirements of Topic 842 using a risk-free rate determined at lease commencement using a period comparable with the term of the lease. A private company that chooses to apply this practical expedient is required to apply it to all leases and to disclose that it has elected to use the practical expedient. As stated in paragraph BC121, a private company that elects the practical expedient might conclude that it can determine a single, risk-free rate to be applied to all leases within a particular portfolio because using that single rate will not result in a materially different answer than using a risk-free rate determined for each individual lease. This might, for example, permit a private company to use a single, risk-free rate, determined at lease commencement, to discount leases with similar but not identical lease terms.

BC407. Most private company stakeholders supported the practical expedient when it was first proposed in the 2013 Exposure Draft. The Board decided to provide this practical expedient in response to concerns of private companies and not-for-profit entities and their stakeholders. The Board concluded that it would be too costly for some entities to identify an incremental borrowing rate that takes into account the credit of the lessee and the effect of the leased asset as collateral. For certain private companies, particularly those with little or no comparable borrowings, the costs to determine and audit their incremental borrowing rate would not be justified by the incremental benefits of using that rate.

BC408. The Board considered whether to permit private company lessees to use a zero discount rate. However, several Board members were concerned that the approach would completely ignore the time value of money. Some Board members said that it was not necessary to provide practical expedients because the discount rate may not be as critical to determining the lease classification as it was in previous GAAP. However, the Board decided that the use of a risk-free rate will address the input from private company stakeholders to reach a reasonable balance between the costs and benefits and recognize the time value of money.

Disclosures

BC409. The 2013 Exposure Draft proposed an exception for private companies to the requirement that a lessee should provide a reconciliation of the opening and closing balances of the liabilities to make lease payments. The Board ultimately decided to eliminate that proposed disclosure requirement to Topic 842 for all entities (public or private). Paragraphs BC283–BC286 explain the Board's decision to eliminate the reconciliation disclosure.

Presentation

BC410. The Private Company Decision-Making Framework states that, generally, both private and public companies should apply the same financial statement presentation guidance established by the Board because of the presumption that information that is important enough to be presented on the face of financial statements is relevant to most financial statement users. The only substantive difference in presentation between previous GAAP and Topic 842 is the addition of lease assets and lease liabilities to an entity's balance sheet.

BC411. At various points during the project, some have suggested that the Board could permit private companies to apply alternative presentation requirements (for example, presenting lease assets net of the related lease liabilities in an adjacent presentation). However, nonfinancial lease assets and financial lease liabilities do not meet the requirements for offsetting in GAAP. There are also different classification (current and noncurrent) requirements for financial and nonfinancial assets that would prevent an adjacent, net presentation. Therefore, the Board did not pursue this alternative.

BC412. When considering the Private Company Decision-Making Framework, the Board decided that the presentation in the financial statements should be the same for both public business entities and private companies, and that there is no need for any presentation alternatives for private companies.

Transition

BC413. The Board decided to require lessees and lessors to apply a modified retrospective transition approach for capital and operating leases (as defined in previous GAAP on leases) existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. The modified retrospective transition approach in conjunction with the practical expedients provided will substantially reduce the cost and complexity of transitioning to Topic 842 for preparers (as compared with the proposals in the 2013 Exposure Draft), while not significantly reducing the quality of the information provided to financial statement users.

BC414. The modified retrospective transition approach will provide a relatively noncomplex method of transition at a reasonable cost, especially when compared with a full retrospective approach because, in general:

- a. Lessees will not need to restate their prior statements of comprehensive income or cash flows or have them audited (if they elect the practical expedients). Lessees will solely need to recognize right-of-use assets and lease liabilities at each prior reporting date presented in the financial statements (which, for private companies will generally only be one prior balance sheet). Lessees already should have most of the data necessary to do this based on their prior-period prepaid/accrued rent balances and

information maintained for their lease maturity table disclosure. This information was required to apply the leases guidance in previous GAAP.

- b. Lessees will not need significant new systems capabilities to apply Topic 842, which means that lessees will not have to invest in or implement those systems.
- c. Lessees will not need to, for example, load thousands of leases into a fixed asset or other system to apply operating lease accounting for most leases.

Because of the nature of the modified retrospective transition approach, the Board decided not to provide any transition alternatives for private companies. The Board concluded that, absent providing a purely prospective transition method, it cannot provide any further transition relief than that resulting from the modified retrospective method and the practical expedients that apply or are available to all entities. The Board's decision is consistent with the guidance in paragraphs 5.1–5.7 in Chapter 5, "Determining the Transition Method for Applying Guidance," of the Private Company Decision-Making Framework.

Consequential Amendments

Business Combinations

BC415. The Board decided that when the acquirer in a business combination is a lessee, the acquirer should measure the acquiree's lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition. Measuring the acquired lease as if it were a new lease at the date of acquisition includes undertaking a reassessment of all of the following:

- a. The lease term
- b. Any lessee options to purchase the underlying asset
- c. Lease payments (for example, amounts probable of being owed by the lessee under a residual value guarantee)
- d. The discount rate for the lease.

The acquiree's right-of-use asset should be measured at the amount of the lease liability, adjusted for any off-market terms (that is, favorable or unfavorable terms) present in the lease. Prepaid or accrued rent should not be recognized because such amounts do not meet the definition of an asset or a liability in Concepts Statement 6 under the acquisition method of Topic 805, Business Combinations. Instead, the remaining lease payments required under the terms of the lease are considered in evaluating whether the terms of the lease are favorable or unfavorable at the acquisition date.

BC416. The Board considered whether an acquirer should be required to follow the general principle in Topic 805 and measure the acquiree's right-of-use assets and lease liabilities at fair value on the date of acquisition. However, the Board

decided that the benefits associated with measuring lease assets and lease liabilities at fair value will not justify the costs because obtaining fair value information—particularly for the right-of-use asset—might be difficult and, thus, costly. The Board also noted that when the acquirer is a lessee, the guidance on the measurement of lease assets and lease liabilities will result in recognizing a net carrying amount for the lease at the date of acquisition that approximates the fair value of the lease at that date.

BC417. The Board decided that when the acquirer in a business combination is a lessor of sales-type or direct financing leases, an acquirer should recognize the acquirer's net investment in the lease on the basis of the present value of the remaining lease payments and the residual value of the underlying asset. The residual value is determined as the difference between the fair value of the underlying asset at the date of acquisition and the present value of the remaining lease payments. The portion of the residual value of the underlying asset that is guaranteed and the present value of the remaining lease payments are included in the lease receivable. The remaining portion of the residual value of the underlying asset is the unguaranteed residual asset. The Board considered requiring the measurement of the net investment in the lease and its components—both the lease receivable and the unguaranteed residual asset—at fair value at the date of acquisition. However, the Board noted that there will be costs associated with measuring each of those assets at fair value and that it had decided not to require such a measurement basis for the lease receivable and the unguaranteed residual asset more generally because of those costs. Although the proposed initial measurement of the lease receivable and the unguaranteed residual asset may not represent the fair value of those assets, the sum of the initial measurement of those assets (that is, the net investment in the lease) will equal the fair value of the underlying asset, which is consistent with the principles in Topic 805. Consequently, the Board concluded that the benefits of requiring an acquirer to measure the lease receivable and the unguaranteed residual asset at fair value will not justify the costs.

Comparison with IFRS 16, *Leases*

BC418. While Topic 842 and IFRS 16 are consistent in many areas, including, of most importance, the conclusion that all leases create assets and liabilities that should be recognized by lessees in the statement of financial position, there are a number of differences between them. The most important difference between Topic 842 and IFRS 16 is the lessee accounting model. Many but not all of the other differences between Topic 842 and IFRS 16 stem from the Boards' different decisions about the lessee accounting model. Some of the other key differences include gain or loss recognition in sale and leaseback transactions and when a lessor will recognize selling profit on some finance leases. There are some minor differences between Topic 842 and IFRS 16 in the accounting for foreign exchange, embedded derivatives, disclosures, business combinations, and transfer/transition of secured lease receivables. In addition, there are existing

differences in other areas of GAAP and IFRS that affect the accounting for leases including the existing requirements for impairment, the accounting for investment properties, and the revaluation of assets. The following paragraphs set out the main differences between Topic 842 and IFRS 16.

Lessee Accounting Model

BC419. Topic 842 and IFRS 16 include different lessee accounting models. Throughout the course of the leases project, the primary improvement envisioned for new leases guidance was the recognition of lease (right-of-use) assets and lease liabilities for those leases classified as operating leases in previous GAAP and IFRS. However, stakeholders of both the FASB and the IASB expressed concern that the Boards' earlier proposals (that is, in the 2010 and 2013 Exposure Drafts) would be costly to implement and complex to apply. Both Boards made significant changes to their earlier proposals in response to stakeholders' concerns about the cost of transitioning to and applying the new leases guidance, but those changes differed because the Boards' stakeholders provided significantly different feedback about the drivers of cost and complexity in the earlier proposals and what changes the Boards should make to address cost and complexity.

BC420. Topic 842 classifies leases as either finance or operating on the basis of a lease classification approach that is substantially similar to that in previous GAAP and previous IFRSs. This, combined with the recognition and subsequent measurement guidance applicable to lessees in Topic 842 for each type of lease, means that the effect of leases in the statement of comprehensive income and the statement of cash flows will be substantially the same as in previous GAAP and that most lessees will not have to implement significant new systems or processes to adopt the new guidance. The FASB's decisions on lease classification, as well as recognition and measurement for each type of lease, was significantly influenced by the following feedback from the FASB's stakeholders:

- a. Determining lease classification, in a manner substantially similar to previous GAAP, would not be difficult and was not a significant area of cost or complexity in previous GAAP.
- b. Retaining lease classification criteria substantially similar to that in previous GAAP, as well as recognition provisions of the nature included in Topic 842, would significantly reduce costs for U.S. preparers as compared with the previous proposals because it would preserve the alignment that existed in previous GAAP between GAAP and tax/regulatory reporting. Many U.S. stakeholders communicated that the Boards' earlier proposals would have broken that alignment and, therefore, required them to maintain multiple sets of books and records when they previously only maintained a single set.
- c. The most significant cost of adopting new leases guidance on the basis of the Boards' previous proposals would be implementing new accounting systems (for example, to track and account for a significant number of new financial liabilities) and processes. Many U.S. stakeholders

communicated that a lessee accounting model of the nature included in Topic 842 would significantly reduce or eliminate those costs because lessees would be able to substantially retain their existing systems for tracking finance and operating leases (even if unsophisticated) and processes (that is, because the lease classification guidance is substantially the same and the effect of leases in the statement of comprehensive income and the statement of cash flows would be minimal).

BC421. IFRS 16 accounts for all leases in the same manner as finance leases, and, in addition to a lessee recognition and measurement exemption for short-term leases, it includes a similar lessee exemption for leases of “small assets” (that is, leases of underlying assets that are individually small, including being of low value, which the basis for conclusions in IFRS 16 indicates are assets of approximately \$5,000 or less for all entities). Topic 842 does not include any recognition and measurement exemption for leases of small assets. In contrast to feedback received from U.S. stakeholders applying GAAP, the following feedback significantly influenced the IASB’s decisions enacted in IFRS 16:

- a. IFRS stakeholders generally communicated that eliminating lease classification would simplify the accounting for leases because it would remove a key area of judgment and eliminate the need to have a process for determining lease classification.
- b. Many IFRS stakeholders stated that, rather than retain a lease classification assessment, the concerns about implementing new systems and processes would be best addressed by exempting high-volume, low-dollar leases from the new recognition and measurement requirements. In this way, all significant leases would be accounted for in the same manner, but a lessee’s systems and processes would, in effect, not need to be able to capture all of the lessee’s leases. A lessee would continue to account for high-volume, low-dollar leases in the same manner as operating leases were accounted for in previous IFRS.
- c. IFRS stakeholders generally did not comment on the effect of the leases proposals on tax or regulatory reporting. That is largely because IFRS stakeholders understand that IFRS is applied in numerous jurisdictions with different tax and regulatory reporting requirements such that it would be impossible to align IFRS with those disparate requirements.

BC422. There are other differences between Topic 842 and IFRS 16 that directly relate to the different decisions reached on the lessee accounting model.

Subleases

BC423. Topic 842 requires that when classifying a sublease, an intermediate lessor should determine the classification of the sublease with reference to the underlying asset and not with reference to the right-of-use asset arising from the head lease (for example, in classifying the sublease, the intermediate lessor would

evaluate whether the sublease is for a major part of the remaining economic life of the underlying asset, not the remaining term of the head lease). IFRS 16 requires an intermediate lessor to determine the classification of the sublease with reference to the right-of-use asset arising from the head lease. The Boards' different decisions in this regard stem largely from the differences in the lessee accounting model (that is, each Board considered the accounting effect that should result from a sublease in the context of accounting for the head lease). However, the Boards also differed on whether the same lease should be classified differently by a lessor solely because it is or is not a sublease. Under the approach in IFRS 16, a lessor might account for a lease as an operating lease, but an intermediate lessor entering into the same lease might account for the lease as a finance lease.

Presentation, Disclosure, and Transition

BC424. There are a number of differences in the presentation, disclosure, and transition requirements of Topic 842 and IFRS 16 that are primarily a consequence of the differences between the lessee accounting models.

Reassessment of Variable Lease Payments

BC425. IFRS 16 requires a lessee to reassess variable lease payments that depend on an index or a rate and, therefore, to remeasure the lease liability whenever there is a change in the contractual cash flows resulting from a change in the reference index or rate (for example, when a change in the Consumer Price Index takes effect under the contract). Topic 842 does not include this requirement; a lessee will only reassess variable lease payments that depend on an index or rate when the lease liability is remeasured for another reason independent of a change in a reference index or rate (for example, because of a change in the lease term). While the IASB decided that the requirements in IFRS 16 will more accurately reflect the lessee's lease liability throughout the lease term, the FASB decided that the benefits of reassessing variable lease payments that depend on an index or a rate and remeasuring the lease liability correspondingly would not justify the costs.

Lessor Accounting

BC426. The lessor accounting models in Topic 842 and IFRS 16 are substantially converged. However, some differences exist. Because both Boards decided to substantially retain the lessor accounting models in previous GAAP and IFRS, respectively, many of the relatively minor differences that existed between previous GAAP and IFRS exist between Topic 842 and IFRS 16. In addition to those differences, some additional differences resulted from the FASB's decision to align certain aspects of the lessor accounting guidance and the revenue recognition guidance in Topic 606, while the IASB decided that it wanted to change the lessor accounting guidance in previous IFRS as little as possible, even if that meant there were potential differences between the lessor accounting guidance in IFRS 16 and the revenue recognition guidance in IFRS 15.

Recognition of Selling Profit for Direct Financing Leases

BC427. Topic 842 precludes the recognition of any selling profit on direct financing leases. Selling profit, if any, is deferred at lease commencement and recognized as additional interest income over the lease term. IFRS 16 does not differentiate between sales-type and direct financing leases; all such leases are classified as finance leases. Consequently, any selling profit on leases accounted for under IFRS 16 that would be classified as direct financing leases in accordance with Topic 842 is recognized at lease commencement. The FASB concluded that recognizing selling profit at lease commencement for direct financing leases would be inconsistent with the sale guidance in Topic 606. Because selling profit is infrequent in direct financing leases, this difference between Topic 842 and IFRS 16 is not expected to significantly affect comparability between lessors applying GAAP and those applying IFRS.

Collectibility

BC428. Topic 842 includes explicit guidance about the effect on a lessor's accounting for a lease if collectibility of the lease payments is not probable. This guidance affects both recognition and lease classification. IFRS 16 does not include any explicit collectibility guidance. The FASB decided that explicit guidance on collectibility should be included in Topic 842 both (a) to align the collectibility guidance for sales-type leases with that for outright sales in Topic 606 and (b) because previous GAAP on lessor accounting included similar collectibility guidance to that in Topic 842. Previous IFRSs, in contrast, did not include collectibility guidance for lessors. As a result, the IASB decided that it was not necessary to include collectibility guidance specific to lessors in IFRS 16.

Modifications of Sales-Type and Direct Financing Leases

BC429. Previous GAAP and IFRS have significantly different models for accounting for lease modifications. Previous IFRS relied on the financial instruments guidance to account for modifications to finance leases (that is, those leases that would, in general, be classified as sales-type or direct financing leases in Topic 842) because the lessor's lease receivable in those leases is a financial asset. In keeping with the IASB's decision not to change the previous lessor accounting guidance, the IASB decided to retain the requirement that a lessor account for modifications to finance leases. The FASB, in contrast, decided that the guidance applicable to lessors for modifications, regardless of the classification of the original lease, should be similar to that in the revenue recognition guidance in Topic 606. The FASB decided it is preferable to have (a) similar modifications guidance for lessors and sellers of goods and services because many leasing contracts also include nonlease components and (b) similar guidance for lease modifications regardless of the classification of the original lease. In addition, the FASB concluded that the financial instruments guidance in GAAP would be more complex to apply than the modifications guidance in Topic 842 and, in any event, would not result in converged outcomes with IFRS because the financial

instruments guidance in GAAP is different from the financial instruments guidance in IFRS.

Sale and Leaseback Transactions

BC430. In a sale and leaseback transaction, Topic 842 requires a seller-lessee to account for any gain or loss on the sale of the asset consistently with the guidance that would apply to any other sale of the underlying asset. That is consistent with the Board's view that the right-of-use asset conveyed to a lessee in a lease is separate and distinct from the underlying asset itself (that is, the seller-lessee sells the entire underlying asset and then obtains a separate and distinct right-of-use asset as a result of the lease). In contrast, IFRS 16 requires a seller-lessee to recognize only the amount of any gain on sale that relates to the rights retained in the underlying asset at the end of the leaseback. The IASB concluded that from an economic standpoint, the seller-lessee has sold only a portion of the underlying asset (that is, its interest in the residual value of the underlying asset at the end of the leaseback); it has retained that portion of the underlying asset embodied in the right to use the asset for the duration of the leaseback.

Accounting for All Entities Other Than Public Business Entities

BC431. Topic 842 permits an accounting policy election for private companies to use a risk-free rate to discount the lease liability. IFRS 16 does not provide any accounting alternatives for private companies. IFRS maintains separate accounting standards for small and medium-sized entities and, therefore, does not include different accounting requirements for small and medium-sized entities within its standards applicable to entities that are not small or medium-sized entities.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

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Auditing Standards

The Sarbanes-Oxley Act of 2002, as amended, directs the Board to establish, by rule, auditing and related professional practice standards for registered public accounting firms to follow in the preparation of audit reports for public companies and other issuers, and broker-dealers.

The following is a list of PCAOB auditing standards for audits of financial statements for fiscal years beginning on or after December 15, 2024. Downloadable PDF booklets of the auditing standards that are effective for audits of that and other periods are also available:

- [PCAOB auditing standards for audits of financial statements for fiscal years beginning on or after Dec. 15, 2024](#) 
- [PCAOB auditing standards for audits of financial statements for fiscal years ending on or after June 15, 2025 through Dec. 14, 2025 \(that is, beginning on or after June 16, 2024 through Dec. 14, 2024\)](#) 
- [PCAOB auditing standards for audits of financial statements for fiscal years ending on Dec. 15, 2024 through Jun. 14, 2025](#) 
- [PCAOB auditing standards for audits of financial statements for fiscal years ending on Dec. 15, 2020 through Dec. 14, 2024](#) 
- [PCAOB auditing standards for audits of financial statements for fiscal years ending Dec. 15, 2017 through Dec. 14, 2020](#) 
- [PCAOB auditing standards, as reorganized beginning Dec. 31, 2016, for audits of financial statements for fiscal years ending before Dec. 15, 2017](#) 

For periods not listed above, applicable auditing standards are available in the

archive.

Find analogous auditing standards of the ASB and the IAASB using the **Find an Analogous Standard** reference tool.

General Auditing Standards

1000 General Principles and Responsibilities

- AS 1000: General Responsibilities of the Auditor in Conducting an Audit

1100 General Concepts

- AS 1101: Audit Risk
- AS 1105: Audit Evidence
- AS 1110: Relationship of Auditing Standards to Quality Control Standards

1200 General Activities

- AS 1201: Supervision of the Audit Engagement
- AS 1206: Dividing Responsibility for the Audit with Another Accounting Firm
- AS 1210: Using the Work of an Auditor-Engaged Specialist
- AS 1215: Audit Documentation
- AS 1220: Engagement Quality Review

1300 Auditor Communications

- AS 1301: Communications with Audit Committees
- AS 1305: Communications About Control Deficiencies in an Audit of Financial Statements

cited in HUNT V. PRICEWATERHOUSECOOPERS, LLC
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Audit Procedures

2100 Audit Planning and Risk Assessment

- AS 2101: Audit Planning
- AS 2105: Consideration of Materiality in Planning and Performing an Audit
- AS 2110: Identifying and Assessing Risks of Material Misstatement

2200 Auditing Internal Control Over Financial Reporting

- AS 2201: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

2300 Audit Procedures in Response to Risks—Nature, Timing, and Extent

- AS 2301: The Auditor's Responses to the Risks of Material Misstatement
- AS 2305: Substantive Analytical Procedures
- AS 2310: The Auditor's Use of Confirmation
- AS 2315: Audit Sampling

2400 Audit Procedures for Specific Aspects of the Audit

- AS 2401: Consideration of Fraud in a Financial Statement Audit
- AS 2405: Illegal Acts by Clients
- AS 2410: Related Parties
- AS 2415: Consideration of an Entity's Ability to Continue as a Going Concern

2500 Audit Procedures for Certain Accounts or Disclosures

- AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements
- AS 2505: Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments
- AS 2510: Auditing Inventories

2600 Special Topics

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General Auditing Standards



Audit Procedures



Auditor Reporting



Matters Relating to Filings Under Federal Securities Laws



Other Matters Associated with Audits



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AS 3101: The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion

Guidance on AS 3101:

- [Staff Questions and Answers on Adjustments to Prior-Period Financial Statements Audited by a Predecessor Auditor\(PDF\)](#)
- [Staff Guidance for Auditors of SEC-Registered Brokers and Dealers\(PDF\)](#)
- [Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion \(Jul. 1, 2024\)\(PDF\)](#)
- [Staff Guidance – Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017\(PDF\)](#)
- [Implementation of Critical Audit Matters: The Basics \(March 18, 2019\)\(PDF\)](#)
- [Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies \(March 18, 2019\)\(PDF\)](#)
- [Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs \(March 18, 2019\)\(PDF\)](#)
- [Annotated Example Auditor's Report for the Audit of a Broker or Dealer \(Dec. 18, 2018\) \(PDF\).](#)

Summary Table of Contents

Introduction

.01 This standard establishes requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements¹ (the "auditor's unqualified report").

.02 The auditor is in a position to express an unqualified opinion on the financial statements when the auditor conducted an audit in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") and concludes that the financial statements, taken as a whole,² are presented fairly, in all material respects,⁴ in conformity with the applicable financial reporting framework.⁵

.03 When the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB, some circumstances require that the auditor express a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements and state the reasons for the departure from the unqualified opinion. AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, describes reporting requirements related to departures from unqualified opinions and other reporting circumstances.

Objectives

.04 The objectives of the auditor when the auditor concludes that an unqualified opinion is appropriate are to:

1. Issue a written report that expresses an unqualified opinion on the financial statements and describes the basis for that opinion; and
2. Communicate in the auditor's unqualified report **critical audit matters**,⁶ when required, relating to the audit of the financial statements or state that the auditor determined that there are no critical audit matters.

The Auditor's Unqualified Report

.05 The auditor's unqualified report includes:⁷

1. The basic elements,⁸ as described in paragraphs .06–.10;
2. Communication regarding critical audit matters relating to the audit of the current period's financial statements, as described in paragraphs .11–.17, unless such requirements do not apply;

Note: Communication of critical audit matters is not required for audits of (1) brokers⁹ and dealers¹⁰ reporting under Exchange Act Rule 17a-5; (2) investment companies registered under the Investment Company Act of 1940 ("Investment Company Act"),¹¹ other than companies that have elected to be regulated as business development companies;¹² (3) employee stock purchase, savings, and similar plans;¹³ and (4) emerging growth companies.¹⁴ Auditors of these entities may consider voluntarily including communication of critical audit matters as described in this standard.

3. Other explanatory language (or an explanatory paragraph), as appropriate in the circumstances, as described in paragraphs .18–.19; and
4. Information about certain audit participants, if the auditor decides to provide this information in the auditor's report, as described in paragraph .20.

Basic Elements

Title

.06 The auditor's report must include the title, "Report of Independent Registered Public Accounting Firm."

Addressee

.07 The auditor's report must be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. The auditor's report may include additional addressees.

Opinion on the Financial Statements

.08 The first section of the auditor's report must include the section title "Opinion on the Financial Statements" and the following elements:

1. The name of the company whose financial statements were audited;
2. A statement identifying each financial statement and any related schedule(s) that has been

audited;¹⁵

3. The date of, or period covered by, each financial statement and related schedule, if applicable, identified in the report;
4. A statement indicating that the financial statements, including the related notes and any related schedule(s), identified and collectively referred to in the report as the financial statements, were audited; and
5. An opinion that the financial statements present fairly, in all material respects, the financial position of the company as of the balance sheet date and the results of its operations and its cash flows for the period then ended in conformity with the applicable financial reporting framework.¹⁶ The opinion should also include an identification of the applicable financial reporting framework.

Basis for Opinion

.09 The second section of the auditor's report must include the section title "Basis for Opinion" and the following elements:

1. A statement that the financial statements are the responsibility of the company's management;
2. A statement that the auditor's responsibility is to express an opinion on the financial statements based on the audit;
3. A statement that the audit was conducted in accordance with the standards of the PCAOB;
4. A statement that PCAOB standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud;
5. A statement that the audit included:
 1. Performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks;
 2. Examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements;
 3. Evaluating the accounting principles used and significant estimates made by management; and
 4. Evaluating the overall presentation of the financial statements;
6. A statement that the auditor believes that the audit provides a reasonable basis for the auditor's opinion; and
7. A statement that the auditor is a public accounting firm registered with the PCAOB (United States) and is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB.

Signature, Tenure, Location, and Date

.10 The auditor's report must include the following elements:

1. The signature of the auditor's firm;¹⁷
2. A statement containing the year the auditor began serving consecutively as the company's auditor;¹⁸

Note: For purposes of this subparagraph, references to the auditor include other firms that the auditor's firm has acquired or that have merged with the auditor's firm. If there is uncertainty as to the year the auditor began serving consecutively as the company's auditor,

such as due to firm or company mergers, acquisitions, or changes in ownership structure, the auditor should state that the auditor is uncertain as to the year the auditor became the company's auditor and provide the earliest year of which the auditor has knowledge.

3. The city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's report has been issued;¹⁹ and
4. The date of the auditor's report.²⁰

Critical Audit Matters

Determination of Critical Audit Matters

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.^{20B} Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

.12 In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit:

1. The auditor's assessment of the risks of material misstatement, including significant risks;
2. The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;
3. The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;
4. The degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;
5. The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team^{20A} regarding the matter; and
6. The nature of audit evidence obtained regarding the matter.

Note: It is expected that, in most audits, the auditor would determine that at least one matter involved especially challenging, subjective, or complex auditor judgment.

Communication of Critical Audit Matters

.13 The auditor must communicate in the auditor's report critical audit matters²¹ relating to the audit of the current period's financial statements or state that the auditor determined that there are no critical audit matters.

Note: When the current period's financial statements are presented on a comparative basis with those of one or more prior periods, the auditor may communicate critical audit matters relating to a prior period. This may be appropriate, for example, when (1) the prior period's financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor's report on the prior period's financial statements because the previously issued auditor's report could no longer be relied upon.

.14 For each critical audit matter communicated in the auditor's report the auditor must:

1. Identify the critical audit matter;
2. Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter;
3. Describe how the critical audit matter was addressed in the audit; and

Note: In describing how the critical audit matter was addressed in the audit, the auditor may describe: (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the audit procedures performed; (3) an indication of the outcome of the audit procedures; and (4) key observations with respect to the matter, or some combination of these elements.

4. Refer to the relevant financial statement accounts or disclosures that relate to the critical audit matter.

Note 1: Language that could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for the critical audit matters or the auditor's opinion on the financial statements is not appropriate and may not be used. The language used to communicate a critical audit matter should not imply that the auditor is providing a separate opinion on the critical audit matter or on the accounts or disclosures to which they relate.

Note 2: When describing critical audit matters in the auditor's report, the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit.

Language Preceding Critical Audit Matters in the Auditor's Report

.15 The following language, including the section title "Critical Audit Matters," should precede critical audit matters communicated in the auditor's report:

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Note: If the auditor communicates critical audit matters for prior periods, the language preceding the critical audit matters should be modified to indicate the periods to which the critical audit matters relate.

.16 In situations in which the auditor determines that there are no critical audit matters, the auditor should include the following language, including the section title "Critical Audit Matters," in the auditor's report:

Critical Audit Matters

Critical audit matters are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

Documentation of Critical Audit Matters

.17 For each matter arising from the audit of the financial statements that:

1. Was communicated or required to be communicated to the audit committee; and
2. Relates to accounts or disclosures that are material to the financial statements;

the auditor must document whether or not the matter was determined to be a critical audit matter (i.e., involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination.^{[22](#)}

Explanatory Language Added to the Auditor's Report

.18 Other standards of the PCAOB require that, in certain circumstances, the auditor include explanatory language (or an explanatory paragraph) in the auditor's report, while not affecting the auditor's opinion on the financial statements. These circumstances include when:

1. There is substantial doubt about the company's ability to continue as a going concern;^{[23](#)}
2. The auditor divides responsibility with, and makes reference in the auditor's report to the audit and report of, another public accounting firm;^{[24](#)}
3. There has been a change between periods in accounting principles or in the method of their application that has a material effect on the financial statements;^{[25](#)}
4. There has been a change in a reporting entity, unless the change in the reporting entity results from a transaction or event, such as the creation, cessation, or complete or partial purchase or disposition of a subsidiary or other business unit;^{[26](#)}
5. A material misstatement in previously issued financial statements has been corrected;^{[27](#)}
6. The auditor performs an integrated audit and issues separate reports on the company's financial statements and internal control over financial reporting;^{[28](#)}
7. Management is required to report on the company's internal controls over financial reporting but such report is not required to be audited,^{[29](#)} and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of the company's internal control over financial reporting;^{[30](#)}
8. Certain circumstances relating to reports on comparative financial statements exist;^{[31](#)}
9. Selected quarterly financial data required by Item 302(a) of Regulation S-K is not appropriately presented, has been omitted, or has not been reviewed;^{[32](#)}
10. Supplementary information required by the applicable financial reporting framework has been omitted, the presentation of such information departs materially from the requirements of the applicable financial reporting framework, the auditor is unable to complete prescribed procedures with respect to such information, or the auditor is unable to remove substantial doubts about whether the supplementary information conforms to the requirements of the applicable financial reporting framework;^{[33](#)}
11. There has been a change in an investee year end that has a material effect on the company's financial statements;^{[34](#)} and
12. Other information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements.^{[35](#)}

Emphasis of a Matter

.19 The auditor may emphasize a matter regarding the financial statements in the auditor's report ("emphasis paragraph").³⁶ The following are examples of matters, among others, that might be emphasized in the auditor's report:³⁷

1. Significant transactions, including significant transactions with related parties;
2. Unusually important subsequent events, such as a catastrophe that has had, or continues to have, a significant effect on the company's financial position;
3. Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period;
4. An uncertainty relating to the future outcome of significant litigation or regulatory actions; and
5. That the entity is a component of a larger business enterprise.

If the auditor adds an emphasis paragraph in the auditor's report, the auditor should use an appropriate section title.

Information about Certain Audit Participants

.20 The auditor may include in the auditor's report information regarding the engagement partner and/or other accounting firms participating in the audit that is required to be reported on PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*.³⁸ If the auditor decides to provide information about the engagement partner, other accounting firms participating in the audit, or both, the auditor must disclose the following:

1. *Engagement partner*—the engagement partner's full name as required on Form AP; or
2. *Other accounting firms participating in the audit*:
 1. A statement that the auditor is responsible for the audits or audit procedures performed by the other public accounting firms and has supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards;
 2. *Other accounting firms individually contributing 5% or more of total audit hours*—for each firm, (1) the firm's legal name, (2) the city and state (or, if outside the United States, city and country) of headquarters' office, and (3) percentage of total audit hours as a single number or within an appropriate range, as is required to be reported on Form AP; and
 3. *Other accounting firms individually contributing less than 5% of total audit hours*—(1) the number of other accounting firms individually representing less than 5% of total audit hours and (2) the aggregate percentage of total audit hours of such firms as a single number or within an appropriate range, as is required to be reported on Form AP.

APPENDIX A – Definition

A1. For purposes of this standard, the term listed below is defined as follows:

A2. Critical audit matter – Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.

Note: Required audit committee communications are set forth in PCAOB standards, including AS

1301, *Communications with Audit Committees*, and Appendix B of that standard which refers to other PCAOB rules and standards.

APPENDIX B – An Illustrative Auditor's Unqualified Report Including Critical Audit Matters

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of *[titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows]*, for each of the three years in the period ended December 31, 20X2, and the related notes *[and schedules]* (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company *as of* *[at]* December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with *[the applicable financial reporting framework]*.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters [if applicable]

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[Include critical audit matters]

[Signature]

We have served as the Company's auditor since *[year]*.

[City and State or Country]

[Date]

cited in HUNT v. PRICEWATERHOUSECOOPERS, LLP
No. 24-3568 archived November 4, 2025

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Information Regarding Judgment and Post-Judgment Proceedings

Judgment

- This Court has filed and entered the attached judgment in your case. Fed. R. App. P. 36. Please note the filed date on the attached decision because all of the dates described below run from that date, not from the date you receive this notice.

Mandate (Fed. R. App. P. 41; 9th Cir. R. 41-1 & -2)

- The mandate will issue 7 days after the expiration of the time for filing a petition for rehearing or 7 days from the denial of a petition for rehearing, unless the Court directs otherwise. To file a motion to stay the mandate, file it electronically via the appellate electronic filing system or, if you are a pro se litigant or an attorney with an exemption from the electronic filing requirement, file one original motion on paper.

Petition for Panel Rehearing and Petition for Rehearing En Banc (Fed. R. App. P. 40; 9th Cir. R. 40-1 to 40-4)

(1) Purpose

A. Panel Rehearing:

- A party should seek panel rehearing only if one or more of the following grounds exist:
 - A material point of fact or law was overlooked in the decision;
 - A change in the law occurred after the case was submitted which appears to have been overlooked by the panel; or
 - An apparent conflict with another decision of the Court was not addressed in the opinion.
- Do not file a petition for panel rehearing merely to reargue the case.

B. Rehearing En Banc

- A party should seek en banc rehearing only if one or more of the following grounds exist:
 - Consideration by the full Court is necessary to secure or maintain uniformity of the Court's decisions; or
 - The proceeding involves a question of exceptional importance; or

- The opinion directly conflicts with an existing opinion by another court of appeals or the Supreme Court and substantially affects a rule of national application in which there is an overriding need for national uniformity.

(2) Deadlines for Filing:

- A petition for rehearing or rehearing en banc must be filed within 14 days after entry of judgment. Fed. R. App. P. 40(d).
- If the United States or an agency or officer thereof is a party in a civil case, the time for filing a petition for rehearing is 45 days after entry of judgment. Fed. R. App. P. 40(d). The deadlines for seeking reconsideration of a non-dispositive order are set forth in 9th Cir. R. 27-10(a)(2).
- If the mandate has issued, the petition for rehearing should be accompanied by a motion to recall the mandate.
- See Advisory Note to 9th Cir. R. 40-1 (petitions must be received on the due date).
- An order to publish a previously unpublished memorandum disposition extends the time to file a petition for rehearing to 14 days after the date of the order of publication or, in all civil cases in which the United States or an agency or officer thereof is a party, 45 days after the date of the order of publication. 9th Cir. R. 40-4.

(3) Statement of Counsel

- A petition should contain an introduction stating that, in counsel's judgment, one or more of the situations described in the "purpose" section above exist. The points to be raised must be stated clearly.

(4) Form & Number of Copies (9th Cir. R. 40-1; Fed. R. App. P. 32(c)(2))

- The petition shall not exceed 15 pages unless it complies with the alternative length limitations of 4,200 words or 390 lines of text.
- The petition must be accompanied by a copy of the panel's decision being challenged.
- An answer, when ordered by the Court, shall comply with the same length limitations as the petition.
- If a pro se litigant elects to file a form brief pursuant to Circuit Rule 28-1, a petition for panel rehearing or for rehearing en banc need not comply with Fed. R. App. P. 32.

- The petition or answer must be accompanied by a Certificate of Compliance found at Form 11, available on our website at www.ca9.uscourts.gov under *Forms*.
- Attorneys must file the petition electronically via the appellate electronic filing system. No paper copies are required unless the Court orders otherwise. If you are a pro se litigant or an attorney exempted from using the appellate ECF system, file one original petition on paper. No additional paper copies are required unless the Court orders otherwise.

Bill of Costs (Fed. R. App. P. 39, 9th Cir. R. 39-1)

- The Bill of Costs must be filed within 14 days after entry of judgment.
- See Form 10 for additional information, available on our website at www.ca9.uscourts.gov under *Forms*.

Attorneys Fees

- Ninth Circuit Rule 39-1 describes the content and due dates for attorneys fees applications.
- All relevant forms are available on our website at www.ca9.uscourts.gov under *Forms* or by telephoning (415) 355-8000.

Petition for a Writ of Certiorari

- The petition must be filed with the Supreme Court, not this Court. Please refer to the Rules of the United States Supreme Court at www.supremecourt.gov.

Counsel Listing in Published Opinions

- Please check counsel listing on the attached decision.
- If there are any errors in a published opinion, please send a letter **in writing within 10 days** to:
 - Thomson Reuters; 610 Opperman Drive; PO Box 64526; Eagan, MN 55123 (Attn: Maria Evangelista, maria.b.evangelista@tr.com);
 - **and** electronically file a copy of the letter via the appellate electronic filing system by using the Correspondence filing category, or if you are an attorney exempted from electronic filing, mail the Court one copy of the letter.

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

Form 10. Bill of Costs

Instructions for this form: <http://www.ca9.uscourts.gov/forms/form10instructions.pdf>

9th Cir. Case Number(s)

Case Name

The Clerk is requested to award costs to *(party name(s))*:

I swear under penalty of perjury that the copies for which costs are requested were actually and necessarily produced, and that the requested costs were actually expended.

Signature

Date

(use "s/[typed name]" to sign electronically-filed documents)

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