FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: January 5, 2018
Comments Due: February 5, 2018

Leases (Topic 842)

Targeted Improvements

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 842 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until February 5, 2018. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2018-200
- Sending a letter to "Technical Director, File Reference No. 2018-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

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. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Leases (Topic 842)

Targeted Improvements

January 5, 2018

Comment Deadline: February 5, 2018

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Summary and Questions for Respondents

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

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842),* to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. The FASB has been assisting stakeholders with implementation questions and issues as organizations prepare to adopt the new lease requirements.

About the FASB's transition support efforts, many stakeholders have inquired about the following two requirements in the new lease standard:

1. Comparative reporting for initial adoption (transition—comparative reporting at adoption)
2. Separating lease and nonlease components in a contract and allocating the consideration in the contract to the separate components (separating components of a contract).

Transition—Comparative Reporting at Adoption

Entities currently are required to adopt the new lease requirements using a modified retrospective transition method whereby an entity initially applies the new lease requirements (subject to specific transition requirements and optional practical expedients) at the beginning of the earliest period presented in the financial statements (January 1, 2017, for calendar-year-end public business entities that adopt the new lease requirements on January 1, 2019). This means that lessees must recognize lease assets and liabilities on the balance sheet for all leases, and must provide the new and enhanced disclosures, for each period presented (including comparative periods). The Board decided on this approach in part based on preparers' feedback that this transition would allow them to adopt the new lease requirements in a cost-effective manner with relatively limited changes to systems, while not significantly reducing the benefits that accrue to users.

As entities have started to implement the new lease requirements, many preparers have cited their plan to implement new systems and are observing some unanticipated costs and complexities associated with the modified retrospective transition method, particularly the comparative period reporting requirements. Accordingly, those preparers have requested that the Board provide an additional (and optional) transition method with which to adopt the new lease requirements. The Board decided to allow another transition method in addition to the existing requirements to transition to the new lease standard by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption consistent with the request by preparers.

This additional transition method would change *when* an entity would be required to initially apply the transition requirements of the new lease standard; it would not change *how* those requirements apply.

Separating Components of a Contract

The new lease guidance requires an entity to separate lease components from nonlease components (for example, maintenance services or other activities that transfer a good or service to the customer) in a contract. The lease components are accounted for in accordance with the new lease requirements. Entities should account for the nonlease components in accordance with other Topics (for example, Topic 606, Revenue from Contracts with Customers). 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 the new revenue standard (for lessors). The new lease guidance also provides lessees with a practical expedient, by class of underlying assets, to not separate nonlease components from the related lease components. If a lessee makes that accounting policy election, it is required to account for the nonlease components together with the related lease component as a single lease component and to provide certain disclosures. Lessors are not afforded a similar practical expedient.

The amendments in this proposed Update would address stakeholders' concerns about the requirement for lessors to separate components of a contract by providing lessors with a practical expedient, by class of underlying assets, to not separate nonlease components from the related lease components, similar to that provided for lessees. However, the lessor practical expedient would be limited to circumstances in which both (1) the timing and pattern of revenue recognition are the same for the nonlease component(s) and related lease component and (2) the combined single lease component would be classified as an operating lease.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update related to transition relief on comparative reporting at adoption would affect all entities with lease contracts that choose the transition option, while the amendments in this proposed Update related to separating components of a contract would affect only lessors whose lease contracts qualify for the practical expedient.

What Are the Main Provisions?

Transition—Comparative Reporting at Adoption

The amendments in this proposed Update would provide entities with an additional (and optional) transition method to adopt the new lease requirements by allowing entities to initially apply the requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption consistent with the request by preparers. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which the entity adopts the new lease requirements would continue to be in accordance with current GAAP (Topic 840), including disclosures.

Separating Components of a Contract

The amendments in this proposed Update would provide lessors with a practical expedient, by class of underlying assets, to not separate nonlease components from the related lease components and, instead, to account for those components as a single lease component, if both of the following are met:

1. The timing and pattern of revenue recognition for the nonlease component(s) and related lease component are the same.
2. The combined single lease component would be classified as an operating lease.

A lessor electing this proposed practical expedient would be required to disclose the class or classes of underlying assets for which it has elected the practical expedient and the nature of the nonlease components included within the single lease component.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The amendments in this proposed Update would affect the amendments in Update 2016-02, which are not yet effective but can be early adopted. The effective date and transition requirements for the amendments in this proposed Update would be the same as the effective date and transition requirements in Update 2016-02.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed amendments as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed amendments are asked to describe their suggested alternatives, supported by specific reasoning.

Transition—Comparative Reporting at Adoption

Question 1: Would the proposed optional transition method to apply the new lease requirements through a cumulative-effect adjustment in the period of adoption reduce the costs and complexity associated with implementing Topic 842? If not, please explain why.

Question 2: Is the proposed transition method, as written in this proposed Update, operable? If not, please explain why.

Separating Components of a Contract

Question 3: Would the practical expedient in this proposed Update for lessors to not separate nonlease components from the related lease components and, instead, to account for those components as a single lease component reduce the costs and complexity associated with applying Topic 842 by lessors? If not, please explain why.

Question 4: Is the proposed practical expedient, as written in this proposed Update, operable? If not, please explain why.

Question 5: Would the information in the financial statements, including disclosures, provided by lessors electing the practical expedient in this proposed Update be decision useful? If not, please explain why.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table summarizes the proposed amendments to the Accounting Standards Codification. The amendments are organized by area.

Area	**Paragraphs**
Issue 1: Transition—Comparative Reporting at Adoption	3 and 4
Issue 2: Separating Components of a Contract	5–9

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–9. 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 in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Issue 1: Transition—Comparative Reporting at Adoption

3. These proposed amendments would provide entities with an additional (and optional) transition method to adopt Topic 842. Under this proposed transition method, an entity would apply the transition requirements in Topic 842 at that Topic's effective date with the effects of initially applying Topic 842 recognized as a cumulative-effect adjustment to the opening balance of retained earnings (or other components of equity or net assets, as appropriate) in the period of adoption.

Note: Because amendments to paragraph 842-10-65-1 have been proposed in other recently issued proposed Accounting Standards Updates (that is, proposed Accounting Standards Update, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842,* and proposed Accounting Standards Update, *Technical Corrections and Improvements to Recently Issued Standards: II. Accounting Standards Update No. 2016-02*, Leases (Topic 842), the marked edits to paragraph 842-10-65-1 in this proposed Update include the amendments from those proposed Updates. Instruction notes have been added to identify when the marked changes relate only to those other proposed Updates and are not affected by the amendments in this proposed Update.

Amendments to Subtopic 842-10

4. Amend paragraph 842-10-65-1, as follows:

Leases—Overall

Transition and Open Effective Date Information

> 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):* [**Note**: See paragraph 842-10-S65-1 for an SEC Staff Announcement on transition related to Update 2016-02.]

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 application date, as determined by the transition method that the entity elects ~~beginning of the earliest comparative period presented, using the approach described in (i) through (ee)~~. An entity shall apply the pending content that links to this paragraph using one of the following two methods:
   1. Retrospectively to each prior reporting period presented in the financial statements with the cumulative effect of initially applying the pending content that links to this paragraph recognized at the beginning of the earliest comparative period presented, subject to

the guidance in (d) through (gg). Under this transition method, the application date shall be the later of the beginning of the earliest period presented in the financial statements and the **commencement date of the lease**.

2. Retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment, subject to the guidance in (d) through (gg). Under this transition method, the application date shall be the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.

d. An entity shall adjust equity and, if the entity elects the transition method in (c)(1) ~~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)~~ (e) through (gg) ~~(ee)~~.

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 (t) 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

[**Note:** Paragraph 842-10-65-1(g) through (gg) includes amendments from the proposed Update on the land easement practical expedient for transition and additional amendments to reflect the most recent Board decisions. No amendments were made to those paragraphs in this proposed Update.]

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~~either one or both of the practical expedients in (f) and (gg).

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

Amounts previously recognized in respect of business combinations

[**Note:** Paragraph 842-10-65-1(h)(3) includes amendments from the proposed Update on technical corrections and improvements to leases. No amendments were made to that paragraph in this proposed Update.]

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 that are classified as **sales-type leases** or **direct financing leases** in accordance with Topic 842 ~~840~~ for which the entity is a lessor. Also see (w).

Disclosure

[**Note:** Paragraph 842-10-65-1(j) includes amendments from the proposed Update on the land easement practical expedient for transition. No amendments were made to that paragraph in this proposed Update.]

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).

   Note: See paragraph 250-10-S99-6 on disclosure of the impact that recently issued accounting standards will have on the financial statements of a registrant.

j. If an entity uses one or ~~both~~ more of the practical expedients in ~~(f) and~~ (f), (g), and (gg), it shall disclose that fact.

Lessees

Leases previously classified as operating leases under Topic 840

[**Note:** Paragraph 842-10-65-1(p) includes amendments from the proposed Update on technical corrections and improvements to leases in addition to amendments from this proposed Update.]

k. A lessee ~~should~~ shall initially recognize a right-of-use asset and a **lease liability** at the application date as determined in (c) ~~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 application date as determined in (c) ~~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 <u>application date as determined in (c)</u> ~~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. <u>If a lessee does not elect the practical expedients described in (f), any</u> ~~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~~ <u>unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred</u>.

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

[**Note:** Paragraph 842-10-65-1(r)(3) and (s)(5) includes amendments from the proposed Update on technical corrections and improvements to leases in addition to amendments from this proposed Update.]

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 application date as determined in (c) ~~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. If a lessee does not elect the practical expedients described in (f), write ~~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 does not elect the practical expedients described in (f))~~ as an adjustment to equity unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred.
    4. If an entity elects the transition method in (c)(1), subsequently ~~Subsequently~~ measure the right-of-use asset and the lease liability in accordance with Section 840-30-35 ~~840-20-35~~ before the effective date.
    5. Regardless of the transition method selected in (c), apply ~~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 application date as determined in (c) ~~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. If an entity elects the transition method in (c)(1) and the lease commenced before the beginning of the earliest period presented in the financial statements or if the entity elects the transition method in (c)(2), recognize ~~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. If an entity elects the transition method in (c)(1) and the lease commenced after the beginning of the earliest period presented in the financial statements, recognize~~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 (s)(2) or (s)(3).
5. If a lessee does not elect the practical expedients described in (f), write ~~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 as an adjustment to equity unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred.

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 (if an entity elects the transition method in (c)(1)) or that are existing at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)) 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 shall do the following:
    - i. If an entity elects the transition method in (c)(1), the entity ~~should~~ shall 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.
    - ii. If an entity elects the transition method in (c)(2), the entity shall derecognize those assets and liabilities at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.
    - iii. Any difference ~~should~~ in (i) or (ii) shall be recorded as an adjustment to equity at ~~that~~ the date that those assets and liabilities were derecognized in accordance with (u)(1)(i) or (ii).
    - iv. The lessee shall apply the lessee transition requirements in (k) through (t) 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 (if the entity elects the transition method in (c)(1)) or if it concluded before the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if the entity elects the transition method in (c)(2)), and the transaction qualified as a sale and leaseback transaction in accordance with Subtopic 840-40 before that ~~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

[**Note:** Paragraph 842-10-65-1(v)(3) and (w)(3) includes amendments from the proposed Update on technical corrections and improvements to leases in addition to amendments from this proposed Update.]

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 application date as determined in (c) ~~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. If a lessor does not elect the practical expedients described in (f), write ~~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))~~as an adjustment to equity unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred.

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 application date as determined in (c) ~~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 application date as determined in (c)~~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 application date as determined in (c) ~~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~~ follows:
   i. If an entity elects the transition method in (c)(1), as an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination; see also (h)(3)) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented).
   ii. If an entity elects the transition method in (c)(2), as an adjustment to equity.
4. Account for the lease in accordance with this Topic after the application date as determined in (c) ~~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

[**Note:** Paragraph 842-10-65-1(x)(4) includes amendments from the proposed Update on technical corrections and improvements to leases. No amendments were made to this paragraph in this proposed Update. Paragraph 842-10-65-1(y)(3) includes amendments from the proposed Update on technical corrections and improvements to leases in addition to amendments from this proposed Update.]

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 application date as determined in (c) ~~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. If an entity elects the transition method in (c)(1), before ~~Before~~ the effective date, a lessor shall account for the lease in accordance with Topic 840.
   3. Regardless of the transition method selected in (c), beginning ~~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~~ before the modification or paragraph 842-10-25-17 if the ~~modified~~ lease is classified as a sales-type lease ~~after~~ before 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 application date as determined in (c) ~~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~~ follows:
    i. If an entity elects the transition method in (c)(1), as an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented).
    ii. If an entity elects the transition method in (c)(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 effective date ~~beginning of the earliest comparative period presented~~

[**Note:** The heading preceding paragraph 842-10-65-1(aa) and paragraph 842-10-65-1(bb) include amendments from the proposed Update on technical corrections and improvements to leases in addition to amendments from this proposed Update.]

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,~~ date:

1. If an entity elects the transition method in (c)(1), 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)~~.
2. If an entity elects the transition method in (c)(2), the entity shall reassess whether a sale would have occurred at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph in accordance with paragraphs 842-40-25-1 through 25-3 and recognize the sale as an adjustment to equity. The entity shall then account for the leaseback in accordance with the guidance in Subtopic 842-20 after the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.

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~~ and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)) or that exists at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)), 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)~~ unless the entity elects the transition method in (c)(1) and the date of sale is after the beginning of the earliest period presented, in which case any deferred gain or loss not

resulting from off-market terms shall be recognized in earnings in the period the sale occurred.

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~~ later of the beginning of the earliest comparative period presented in the financial statements and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)), or at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)).

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~~ later of the beginning of the earliest comparative period presented in the financial statements and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)), or at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)).

Issue 2: Separating Components of a Contract

5. The following amendments would provide lessors with a practical expedient to not apply, in certain circumstances, the guidance for separating components of a contract in Topic 842.

Amendments to Subtopic 842-10

6. Amend paragraph 842-10-15-31, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Scope and Scope Exceptions

> Separating Components of a Contract

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 or unless a lessor makes the accounting policy election described in paragraph 842-

10-15-42A). Nonlease components are not within the scope of this Topic and shall be accounted for in accordance with other Topics.

7. Amend paragraph 842-10-15-38 and add paragraph 842-10-15-42A, with a link to transition paragraph 842-10-65-1, as follows:

> > Lessor

842-10-15-38 A **lessor** shall allocate (unless the lessor makes the accounting policy election described in paragraph 842-10-15-42A) 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 (unless the lessor makes the accounting policy election described in paragraph 842-10-15-42A) 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.

842-10-15-42A As a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset, choose to not 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 if both of the following are met:

a. The timing and pattern of revenue recognition for the lease component and nonlease components associated with that lease component are the same.
b. The combined single lease component is classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3.

8. Amend paragraph 842-10-55-134, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Illustrations of Allocating Consideration to 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

842-10-55-134 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 <u>or Lessor</u> elects the practical expedient—see Case B [paragraphs 842-10-55-138 through 55-140] <u>for an example in which Lessee elects the practical expedient</u>). 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).

Amendments to Subtopic 842-30

9. Amend paragraph 842-30-50-3 and add paragraph 842-30-50-3A, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Lessor

Disclosure

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)<u>, unless a lessor elects the practical expedient in paragraph 842-10-15-42A</u>
   3. The determination of the amount the lessor expects to derive from the underlying asset following the end of the **lease term**.

842-30-50-3A A lessor that elects the practical expedient on not separating nonlease components from lease components in paragraph 842-10-15-42A shall disclose its accounting policy election and the class or classes of underlying assets for which it has elected to apply the practical expedient. A lessor electing this practical expedient also shall disclose the nature of the nonlease components included within the single lease component.

The amendments in this proposed Update were approved for publication by six members of the Financial Accounting Standards Board. Mr. Schroeder voted against publication of the amendments. His alternative view is set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel

Background Information, Basis for Conclusions, and Alternative View

Introduction and Background

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The amendments in Update 2016-02 were issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. Since the issuance of the leasing amendments in February 2016, the FASB has been educating and assisting stakeholders with implementation questions and issues as organizations prepare to adopt the new lease standard.

BC3. In recent months, some stakeholders have inquired about the following two requirements in the new lease standard:

a. Comparative reporting for initial adoption (transition—comparative reporting at adoption)
b. Separating lease and nonlease components in a contract and allocating the consideration in the contract to the separate components (separating components of a contract).

BC4. A discussion of these issues and the basis for conclusions reached by the Board for addressing those issues are provided below.

Benefits and Costs

BC5. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements. Overall, the Board concluded that the amendments in this proposed Update would simplify the implementation, or continued application, of Topic 842. Therefore, the expected costs reduction to many stakeholders would justify the reduction in the expected benefits that would accrue to present and potential investors, creditors, donors, and other users.

Basis for Conclusions

Transition—Comparative Reporting at Adoption

BC6. The transition requirements in the new lease standard require that an entity recognize and measure leases within its scope that exist at the date of initial application, which is the later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease. The transition requirements also require that an entity adjust equity at the beginning of the earliest period presented, and other comparative amounts disclosed for each prior period presented in the financial statements, as if the new lease requirements had always been applied, subject to specific other transition requirements (such as the use of *minimum rental payments* as applied in current GAAP in measuring operating leases, rather than the use of *lease payments* as defined in the new lease standard) and optional practical expedients. This transition method reflects the primary improvement of the new lease standard as compared with prior GAAP—the recognition by lessees of lease assets and lease liabilities on the balance sheet for all leases, and the provision of enhanced disclosures about an entity's leasing activities, for each period presented in the financial statements in which an entity adopts the new standard (which includes the comparative periods). The Board decided on this method based on preparers' feedback that this transition would not require significant new systems and, thus, would not be overly costly or complex to implement.

BC7. However, as preparers have started to implement the new lease standard, many have encountered unanticipated costs and complexities associated with the modified retrospective transition method, particularly with respect to its transition requirements for the comparative periods, including disclosures. Many preparers have cited their plan to implement new systems to more robustly adopt Topic 842, whereas previously this was not anticipated. As a result, preparers have requested that the Board provide an additional (and optional) transition method. This transition method would allow an entity to initially apply the new lease requirements to all leases that exist at the adoption date, with the cumulative effect of initially applying the new lease guidance recognized as an adjustment to retained earnings as of the adoption date. For example, for calendar-year-end public business entities that adopt the new lease standard on January 1, 2019, the date of initial application would be January 1, 2019, rather than the later of January 1, 2017 (the beginning of the earliest period presented) and the lease commencement date. Under this transition method, an entity's reporting for the comparative periods presented would continue to be in accordance with current GAAP (Topic 840), including disclosures. Preparers have said that this would significantly reduce the costs and complexities associated with initially applying the new lease requirements.

BC8. At its November 29, 2017 meeting, the Board deliberated this request. The Board discussed concerns raised about information loss to users due to removing the requirement to apply the new lease requirements to the comparative periods in transition. Specifically, in the financial statements in which an entity adopts the new lease standard, an entity (lessee) that elects to apply the new guidance using the proposed transition method would not recognize lease assets and liabilities on the balance sheet of the comparative period presented, which may result in the loss of important information to users (such as leverage trends). That entity also would not provide the required and enhanced disclosures for the comparative periods, which also could result in the loss of information to users (such as changes in strategies with respect to leasing transactions).

BC9. However, the Board observed that the comparative periods would include the disclosures required under current GAAP, including the operating lease obligations disclosure, such that information about the comparative period would not be completely removed. The Board further noted that while the disclosure about operating leases under current GAAP provides the information on an undiscounted basis, users would still have some insight into the cash flows and obligations of an entity related to its leases in the comparative periods. One Board member emphasized that users have difficulty performing a constructive capitalization of an entity’s leases based on that disclosure without disclosures about the weighted-average discount rate and weighted-average life of the entity’s operating leases, which are not required under current GAAP.

BC10. The Board also discussed concerns raised about the decrease in consistency in how entities initially apply the new lease requirements because of the additional optionality that this proposed transition method would introduce. Limiting optionality in transition was one of the Board’s overarching goals in setting the transition requirements in Update 2016-02. However, it was noted that while the proposed transition method would create optionality about *when* entities initially apply the new lease requirements, it would not change *how* entities must apply the transition requirements. That is, all entities would apply the same guidance on how to initially recognize and measure existing leases in transition regardless of the transition method elected.

BC11. On balance, the Board decided to provide an additional (and optional) transition method consistent with that requested by preparers. In making this decision, the Board considered that the information provided on the balance sheet would be delayed by only one year (and the prior-period information would not be completely removed, as previously explained), and that this proposed transition method still would achieve the primary objective of having leases recognized on the balance sheet at the effective date. In addition, the proposed transition method would allow preparers to focus implementation of the new lease standard to the period of adoption and subsequent periods.

BC12. The Board decided to provide transition relief to allow entities to focus on applying the new lease standard on and after the effective date rather than increasing costs for implementation of the new lease requirements to leases before the effective date. In addition, the Board believes that the reduction of costs afforded by this transition relief justifies the potential loss of benefits to users, while still achieving the overall objective of the new standard of having leases recognized on the balance sheet. The Board noted that because this additional transition method is optional, entities that have early adopted the lease standard would not be penalized.

Separating Components of a Contract

BC13. The new lease standard requires that entities (lessors and lessees) separate lease from nonlease components in a contract. Components of a contract include only those items or activities that transfer a good or a service to a lessee. Examples of nonlease components include equipment maintenance services, common area maintenance services in real estate, or other activities that transfer a good or service to the lessee separate from the right to use the underlying asset. Lease components must be accounted for in accordance with the new lease requirements, while nonlease components are accounted for in accordance with other Topics (such as the new revenue recognition standard for lessors). 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 the new revenue recognition standard (for lessors).

BC14. Lessees may elect, as an accounting policy election by class of underlying asset, to not separate nonlease components from the lease components to which they relate. Lessors are not afforded a similar practical expedient.

BC15. During the development of the new lease standard, the Board decided that in any contract that contains lease and nonlease components, the lessor effectively is both leasing an asset (the lease component) and selling a service (the nonlease component). Accordingly, accounting for the lease components in accordance with the new lease standard and the nonlease components in accordance with, typically, the new revenue recognition standard was consistent with the corresponding guidance on scope included in that revenue standard. The Board rationalized that a nonlease component should not be subject to different accounting requirements solely because it is included in a contract that contains a lease. The Board also decided to require lessors to allocate the consideration in the contract to lease and nonlease components in accordance with the new revenue guidance because that resulted in consistent accounting for entities that are both a lessor and a seller of goods or services in the same contract. The Board's view was that leasing transactions are fundamentally a revenue-generating activity in which the item the lessor transfers to the customer is the right to use the underlying asset. Therefore, the Board considered it appropriate for a lessor to allocate consideration to the lease and the nonlease components in the same manner that a seller allocates the transaction price (and changes thereof) to performance obligations in a revenue contract.

BC16. Since the issuance of the new lease standard, some stakeholders have requested that the Board permit lessors to not separate nonlease components from the related lease components, consistent with the practical expedient afforded to lessees. Those stakeholders have emphasized that, except for presentation and disclosure, the timing and pattern of revenue recognition for the lease and nonlease components would be the same regardless of whether the nonlease components (such as common area maintenance) are separated from the lease component. Those stakeholders also have asserted that any allocation method they would use to separate the components would be judgmental in nature (for example, because of the lack of observable standalone selling prices for each of the components in the contract) and that separating lease and nonlease components does not align with, or accurately reflect, the economics of how their transactions are negotiated or evaluated by users of their financial statements.

BC17. Those stakeholders also have requested that if the Board chooses not to provide a practical expedient similar to that afforded to lessees, the Board should reconsider the allocation requirements related to their contracts. They have cited difficulties in establishing a standalone selling price to allocate the consideration in the contract to the lease and nonlease components on a relative basis. Specifically, because they do not typically lease assets or provide services separately, they asserted that they are unable to utilize an observable price for each of the components. Consequently, these stakeholders would be required to estimate the standalone selling price for each component using a suitable estimation approach in accordance with the new revenue recognition requirements. However, those stakeholders have expressed that they are unable to find a suitable method to estimate the standalone selling price of the components, particularly the lease component, without amendments to the allocation guidance in the new revenue guidance.

BC18. At its November 29, 2017 meeting, the Board considered those stakeholders' requests about the separation and allocation requirements specific to lessors in the new lease standard. The Board ultimately concluded that a practical expedient similar to that provided to lessees should be provided for lessors in situations in which the timing and pattern of revenue recognition are the same for the lease and nonlease components associated with the lease component. Consistent with the practical expedient provided to lessees, the practical expedient in this proposed Update only applies to nonlease components that are associated with the lease component.

BC19. The Board discussed that under the new revenue guidance, an entity is not precluded from accounting for distinct goods or services as if they were a single performance obligation if the accounting outcome is the same as accounting for the goods and services as individual performance obligations. Similarly, under the new lease standard, an entity is not precluded from accounting for multiple lease components as a single lease component if the outcome from doing so would be the same as accounting for the lease components separately. Therefore, the Board questioned why a lessor would be precluded from combining a lease component and a nonlease component solely because one component is within the scope of the new lease guidance and the other component is within the scope of the new revenue guidance. The discussion highlighted that leasing is a revenue-generating activity and, therefore, lessors should not be precluded from combining lease and nonlease components when the timing and pattern of revenue recognition are the same. If the only difference between accounting for a lease and the associated nonlease component separately is presentation and disclosure, then the timing and pattern of revenue recognition are considered the same.

BC20. The expected reduction in costs to lessors (by not having to separate and allocate) likely justify the reduction of benefits that accrue to users by providing the proposed practical expedient. Additionally, the Board noted that because this practical expedient is an option that can be elected under specific circumstances, entities that have early adopted the lease standard would not be penalized.

BC21. An entity is not precluded from accounting for multiple lease and associated nonlease components as a single lease component if the requirements of the practical expedient in this proposed Update are met. If an entity elects the practical expedient in this proposed Update, it must apply the expedient consistently to all nonlease components eligible to be combined with lease components.

BC22. The separation and allocation requirements in the new lease standard affect how a lessor determines lease classification (operating, sales-type, or direct financing) because only consideration allocated to the lease component (lease payments) is considered in determining whether the present value of the lease payments and residual value guaranteed by the lessee or a third-party equal or exceed substantially all of the fair value of the underlying asset being leased. This determination ultimately affects the pattern of income recognized by a lessor, along with any selling profit or loss recognized immediately or deferred.

BC23. In deciding to provide a practical expedient to lessors, the Board was concerned that providing this expedient could result in a change in lease classification (for example, from operating to sales-type) solely due to increased amounts attributed to the lease payments without a corresponding change to the fair value of the underlying asset and, therefore, in a change in revenue recognition pattern solely as a result of combining the nonlease components to the related lease components. Because of those concerns, the Board limited the practical expedient to situations in which both:

a. The timing and pattern of revenue recognition for the lease component and nonlease components associated with that lease component are the same.
b. The combined lease component is classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3.

BC24. In deciding on the requirements of the proposed practical expedient for lessors, the Board also considered that a lessor would not need to apply the separation and allocation guidance to determine whether it would qualify for the proposed practical expedient because that would have defeated the purpose of that practical expedient. For example, the lessor may be able to determine that a maintenance service is a performance obligation satisfied over time and that the measure of progress is time based (and therefore straight-line) without having to know the amount allocated to the maintenance performance obligation. In addition, because the proposed practical expedient would include a requirement that the combined single (lease) component must be classified as an operating lease, this must mean that the lease component, if separated from the nonlease components, also would be classified as an operating lease. Therefore, the pattern of revenue recognition for the lease component also could be determined without having to know the amount allocated to that lease component.

BC25. The Board also acknowledged the possibility under the proposed practical expedient that a sizeable portion of the consideration in the contract may relate to a nonlease component but that, nonetheless, that nonlease component would be combined with the lease component for accounting purposes if the lessor elects the proposed practical expedient for that class of underlying assets. The Board considered whether to limit the ability for an entity to elect the practical expedient to situations in which the nonlease component would not be a significant (or other terms such as predominant, substantial, and so forth) portion of the overall consideration in the contract. However, the Board concluded that introducing another layer of requirements based on the magnitude of the nonlease components for either (a) qualifying for the proposed practical expedient or (b) accounting for the combined component either entirely under the new lease guidance or entirely under another Topic (such as the new revenue guidance) was not warranted. In reaching this conclusion, the Board stressed that requiring entities to consider the magnitude of the nonlease component would add another level of complexity that the proposed practical expedient was designed to reduce.

BC26. The Board also highlighted that this proposed practical expedient would be an option and not a requirement and that if a lessor wants to account for the nonlease component within the new revenue guidance, it could choose to do so. The Board also felt that the disclosure requirements in the new lease standard would result in sufficient information for users to analyze the combined components. Moreover, the Board decided that introducing a threshold based on magnitude could result in inconsistent application of the practical expedient and additional questions about what any term used for magnitude should be interpreted as (for example, significant, predominant, substantial, and so forth).

BC27. The Board acknowledged the application issues that some lessor stakeholders have expressed about the allocation of the consideration in the contract between lease and nonlease components for their specific fact patterns, particularly when there is no observable standalone selling price for at least one of the components (or performance obligations). However, the Board noted that the consistency of having lessors comply with the allocation objective and allocation requirements in the new revenue standard was heavily deliberated when developing the new lease standard. Furthermore, they noted that leasing is a revenue-generating activity and that the allocation requirements should not differ just because the contract is a contract that contains a lease (as opposed to another service contract). Moreover, the Board highlighted that stakeholders from all industries have been applying the allocation guidance in the new revenue standard, including the estimation techniques, for nonlease contracts, as preparers have been preparing to adopt that revenue standard. Consequently, the Board concluded that lessors that do not elect or qualify for the proposed practical expedient should apply the allocation guidance in the new revenue standard and comply with the allocation objective in that standard without additional clarifications of, or amendments to, the new revenue standard or lease standard.

Effective Date and Transition

BC28. Because the amendments in this proposed Update affect the new lease standard, which is not yet effective (but for which early adoption is permitted), the Board decided that the effective date and transition requirements for the amendments in this proposed Update should be the same as those for Update 2016-02 (and any other Topic amended by Update 2016-02). The effective date and transition requirements for Update 2016-02 are detailed in paragraph 842-10-65-1 of that Update. The Board also concluded that it was unnecessary to provide different transition requirements for early adopters because the Board is unaware of any entity that has early adopted that would be significantly affected by the amendments in this proposed Update.

Alternative View

BC29. Mr. Schroeder disagrees with the issuance of the guidance in this proposed Update. His primary concern relates to providing lessees with an additional transition alternative. An entity (lessee) that elects to apply the new lease guidance using this additional method would not recognize lease assets and liabilities on the balance sheet of any comparative period presented. Mr. Schroeder asserts that applying the amendments in this proposed Update would result in an entity initially providing an incomplete representation of its rights and obligations (for any comparative period presented) and users losing decision-useful information. In turn, this lack of consistency between an entity’s comparative years also would, in the year of adoption, result in less comparability between entities.

BC30. Investors need to understand year-over-year changes in lease-related assets and liabilities for many reasons, including to assess whether those changes are the result of shifts in an entity's leasing strategy (such as changes in duration, quality of leased space, and square footage). As stated in the basis for conclusions of Concepts Statement 8, "Relevant and faithfully represented information is most useful if it can be readily compared with similar information reported by other entities and by the same entity in other periods" (paragraph BC3.33). However, this proposed Update would provide an option that would allow an entity to not provide comparative information. Optionality in accounting generally should be avoided, particularly for such a significant accounting change. And, Mr. Schroeder observes that comparative information is becoming even more critical as investors and other users increasingly transition to consuming greater portions of financial data in digital form. This secular trend is at least partially driven by cost pressures that Mr. Schroeder believes should be factored into the Board's cost-benefit assessment.

BC31. The proposed Update also would provide lessors with an accounting policy election by class of underlying assets to not separate nonlease components from the related lease components. Mr. Schroeder believes that providing such a policy election fails to adequately meet the objective of improving financial reporting because it reduces the availability of certain decision-useful information.

BC32. Mr. Schroeder believes that not all costs have been considered, specifically those of investors and other users. Additionally, he disagrees with preparers' assertions that the expected costs reduction from these amendments would outweigh the reduction in benefits that would accrue to present and potential investors. Therefore, Mr. Schroeder would maintain both the comparative reporting and separation requirements.

BC33. Mr. Schroeder supported the issuance of Update 2016-02 because it provided a much-needed increase in transparency through several key requirements, including comparative reporting and separating components. In voting with the majority, he accepted carrying over a more complex and costly two-model approach, as well as losing an opportunity to have a standard that is converged with IFRS. Therefore, if the amendments in this proposed Update are needed, Mr. Schroeder would prefer to provide additional time so that entities could adopt a single-model approach. Such an accounting model would better align with the economics of leasing, would be easier for investors to understand, and would be less complex and less costly for entities to implement and maintain. This latter point is particularly true for those entities that also must comply with the single-model approach required by IFRS. Mr. Schroeder believes that once an entity has transitioned to IFRS 16, *Leases,* its longer-term application will be less costly (relative to Update 2016-02) because there is no need to classify leases as either operating leases or finance leases, which reduces operational complexity.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.