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Targeted improvements to the new leasing guidance ASC 842

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The Board discussed feedback received on the proposed practical expedient related to the separation and allocation requirements of lease and nonlease components for lessors included in the proposed ASU, Leases (Topic 842): Targeted Improvements, along with other implementation issues arising from ASU 2016-02, Leases.

Under the proposed practical expedient, a lessor would be permitted to choose, by class of underlying asset, not to separate nonlease components from lease components, and instead to account for each separate lease component and related nonlease component as a single lease component, if both of the following conditions are met:

- the timing and pattern of revenue recognition for the lease component and the nonlease component associated with that lease component are the same (referred to as Criterion A).
- the combined single lease component is classified as an operating lease under ASC 842 (referred to as Criterion B).

The Board made the following tentative decisions related to the proposed practical expedient:

- to amend Criterion A to replace the term “revenue recognition” with the term *transfer*
- to amend Criterion B to require the lease component (instead of the combined single lease component), if accounted for separately, to be classified as an operating lease under ASC 842

- To allow a lessor to account for the combined component of an arrangement qualifying for the practical expedient as a single performance obligation under ASC 606, *Revenue from Contracts with Customers*, when the nonlease component(s) associated with the lease component is the predominant component of the combined component. Otherwise, the lessor would account for the combined component as an operating lease under ASC 842.

The Board directed the staff to clarify in a final ASU that a lessor would be permitted to apply the practical expedient to combine the lease component and nonlease component(s) qualifying for the practical expedient even when there are nonlease components that are not eligible for the practical expedient within a contract.

The Board also made the following tentative decisions related to transition guidance and the effective date for the proposed leasing improvements:

- a lessor would be required to apply the practical expedient to all existing lease transactions that qualify for the expedient at the date elected.
- the effective date and transition requirements for a final ASU would be the same as those under ASC 842 unless the lessor has already adopted ASC 842, in which case, it would elect the practical expedient either (1) in the first reporting period following the issuance of a final ASU containing the practical expedient, or (2) at the original effective date of ASC 842. Lessors that early adopt the leasing guidance would apply the practical expedient either retrospectively or prospectively.

The Board directed the staff to draft a final ASU related to the proposed practical expedient and the proposed additional (and optional) transition method for adoption of ASC 842 for vote by written ballot.

The Board also discussed additional implementation issues raised by stakeholders related to how a lessor should account for certain lessor costs, such as sales taxes and property taxes and insurance, and agreed with the staff's recommendation to allow lessors to analogize to certain guidance in ASC 606 when accounting for these costs. The Board tentatively decided to add a separate project to its technical agenda to address these issues.

Source:

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