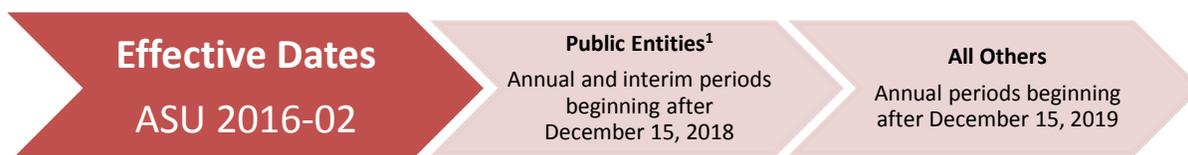


Additional Relief Finalized for Leases

The Financial Accounting Standards Board (FASB) recently finalized additional relief for the new lease guidance, Accounting Standards Update (ASU) 2016-02, *Leases* (Topic 842), which requires lessees to recognize all leases with terms greater than 12 months on their balance sheet. The relief in ASU 2018-11, *Leases* (Topic 842) *Targeted Improvements*, addresses two areas of operational challenge highlighted by companies as implementation efforts ramp up in anticipation of the 2019 effective date for public entities¹.



Transition – Comparative Reporting at Adoption

Early adopters identified operational challenges in comparable period reporting requirements under a modified retrospective approach. The amendments in ASU 2018-11 create an additional (and optional) transition method whereby an entity initially applies Accounting Standards Codification (ASC) 842 at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjusting the comparative periods presented. Prior periods presented would continue under guidance in ASC 840. If elected, a lessee would not have to measure and recognize leases that expired prior to the effective date, or consider the effects of each modification for leases that were modified more than once during the comparative period presented. This new method would change **when** an entity would be required to initially apply the new lease standard's transition requirements; it would not change **how** those requirements apply. The amendments do not change ASC 840's existing disclosure requirements. If elected, an entity would continue to provide the required ASC 840 disclosures for all prior periods.

Separating Components of a Contract

Under ASC 842, lessees have a practical expedient—by class of underlying assets—to not separate lease and nonlease components. If elected, a lessee is required to account for the lease and nonlease components as a single lease component with special disclosures. The amendments in ASU 2018-11 extend this expedient to lessors. However, the lessor practical expedient would be limited to circumstances in which both:

- The timing and pattern of revenue recognition are the same for the nonlease and related lease component
- The combined single lease component would be classified as an operating lease

If the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity is required to account for the combined component in accordance with ASC 606. Otherwise, the entity must account for the combined component as an operating lease in accordance with ASC 842.

¹ A public entity is defined as any one of these:

- A public business entity
- A not-for-profit entity that has issued—or is a conduit bond obligor for—securities traded, listed or quoted on an exchange or over-the-counter market
- An employee benefit plan that files or furnishes financial statements to the U.S. Securities and Exchange Commission

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An entity electing this practical expedient—including an entity that accounts for the combined component entirely in ASC 606—is required to disclose the following by class of underlying asset:

- The fact that it elected the expedient
- Which class(es) of underlying asset the lessor made the election to
- The nature of (a) the lease component and nonlease component(s) that were combined as a result of applying the practical expedient and (b) any nonlease components that were not eligible for the practical expedient and, thus, not combined
- The topic the entity applies to the combined component (Topic 606 or 842)

Transition

These amendments have the same effective date and transition requirements as the leases standard. Early adopters of ASC 842 have special transition guidance. The practical expedient may be elected either in the first reporting period following the issuance of ASU 2018-11 or at the original effective date of Topic 842 for that entity. The practical expedient may be applied either retrospectively or prospectively.

All entities, including early adopters, that elect the practical expedient related to separating components of a contract must apply the expedient—by class of underlying asset—to all existing lease transactions that qualify for the expedient at the date elected.

Other Projects

Earlier this month, FASB released a set of technical corrections in ASU 2018-10, *Codification Improvements to Topic 842, Leases*, which provides clarity on several items to prevent possible diversity in practice.

In March 2018, FASB added a project to address narrow-scope lessor issues, including taxes collected from lessees and certain lessor costs paid directly by lessees. FASB agreed lessors could analogize to revenue guidance in ASC 606 that allows an accounting policy election to exclude from the transaction price certain sales taxes that the entity collects from a customer. Lessors also could analogize to ASC 606 to exclude certain lessor costs from variable consideration in the lease contract when those lessor costs are paid by the lessee and the uncertainty in the amount paid is not expected to ultimately be resolved. An exposure draft with a short comment period is planned for the third quarter of 2018. A final standard should be issued before year-end.



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The adoption of ASC 842 will be complex and likely will require significant hours to correctly implement. BKD can help educate your team, provide implementation tools and assist with analysis and documentation. If you would like assistance in complying with the new leases standard, contact your trusted BKD advisor. BKD has prepared a library of **BKD Thoughtware**® on this issue. Visit our [Hot Topics](#) page to learn more.

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