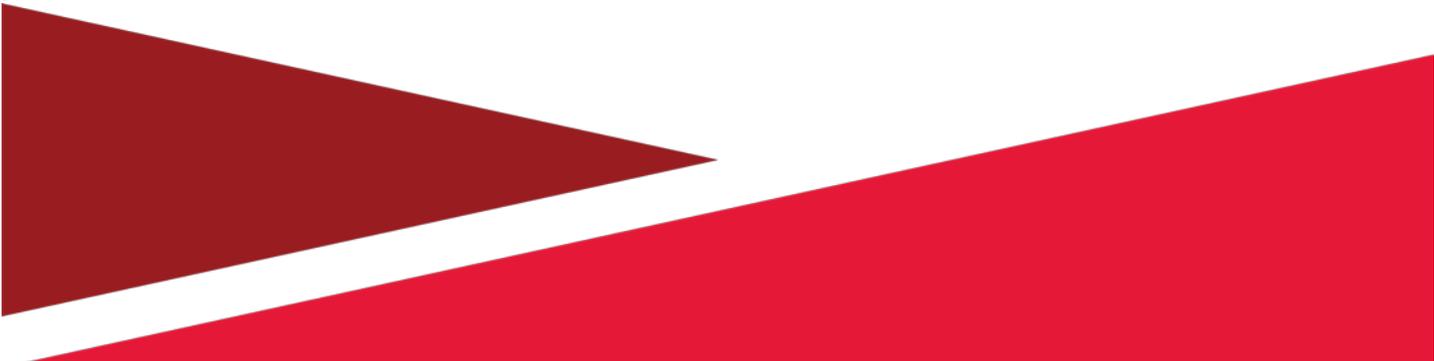


**FASB ACCOUNTING
STANDARDS UPDATE 2018-11,
LEASES – TARGETED IMPROVEMENTS**





This week the Financial Accounting Standards Board (FASB) issued targeted improvements to its ASU 2016-02 Leases (“the Standard” or “ASC 842”) to reduce costs and ease implementation. The amendments include optional transition relief for lessees and lessors as well as an option for lessors regarding separating contract components.

Although the eagerly anticipated changes will provide relief to reduce complexity and implementation time, the deadline is fast approaching with only five months before the effective date (for public year-end companies). For companies that have not started assessing the impacts of the new Lease Standard, time is of the essence.

TRANSITION RELIEF – REMOVAL OF REQUIREMENT TO RESTATE PRIOR PERIODS

In the amendment, the FASB granted an additional transition method option that removes the requirement to restate prior periods presented in the financial statements. Instead, an entity electing the option will initially apply ASC 842 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption (or other components of equity or net assets, as appropriate), and present the new disclosures only in the year of adoption. The original modified retrospective transition method to restate prior periods and related disclosures for the effects of ASC 842 remains an option for companies choosing to present comparable financial information.

EFFECTIVE DATE

ASC 842 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for:

- Public business entities
- Not-for-profits that issue securities that are traded, listed, or quoted on an exchange or an over-the-counter market
- Employee benefit plans that file or furnish financial statements to the SEC

All other entities have an additional year and would apply the new Standard for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years.

Transition Method	2017	2018	2019
ORIGINAL (Modified Retrospective)	ASC 842 (restated)		ASC 842
NEW Non-Comparative	ASC 840		

The application date is determined by the transition method selected.

For public year-end companies selecting the modified retrospective transition method, the cumulative-effect adjustment would be recorded on January 1, 2017 (the earliest period presented). Under the non-comparative transition method, the application date is the effective date or January 1, 2019.

CONSIDERATIONS

Companies should consider the importance of comparable information when making the decision on transition method and the relative effort involved in restating prior periods. If the non-comparative transition method is selected, disclosures under ASC 840 are included for the prior periods presented and the new disclosures under ASC 842 are included only for the current year. We recommend companies pay close attention to the completeness and accuracy of existing lease commitment disclosures in financials prior to the effective date.

Regardless of transition method selected, practical expedients are available to both lessees and lessors.

LESSORS – REMOVAL OF REQUIREMENT TO SEPARATE COMPONENTS OF A CONTRACT

In the original guidance in ASC 842, the FASB provided relief such that lessees had the option not to separate lease and nonlease components, but similar concessions were not provided for lessors. Thus they were required to separate lease and nonlease components and allocate the contract consideration using the methodology outlined in ASC 606, Revenue from Contracts with Customers. Stakeholders expressed concern that the cost of separation and allocation did not outweigh the benefits. In response, the FASB will now allow a practical expedient election for lessors, by class of underlying asset, to account for lease and nonlease components in a contract as a single component, if both of the following criteria are met:

- The timing and pattern of transfer for the lease component and the related nonlease component(s) are the same, and
- The lease component, if accounted for separately, would be classified as an operating lease under ASC 842.

The practical expedient must be applied to all existing transactions at the date elected, and can be applied either retrospectively or prospectively.

CONSIDERATIONS

The lessor should consider the magnitude of the nonlease component. If the nonlease component is predominant, the contract should be accounted for under ASC 606.

In the case where the components are equal, the contract would default to accounting for the entire contract as a lease or elect not to take the practical expedient. Additionally, if a nonlease component is ineligible for the practical expedient, a lessor could account for this unqualified nonlease component separately from the combined lease and nonlease components that do qualify for the practical expedient.

The FASB did not define predominant in the amendment, but used the term in ASC 842 under lease classification when assessing the remaining economic life compared to the lease term. “842-10-25-5 If a single lease component contains the right to use more than one underlying asset, an entity shall consider the remaining economic life of the predominant asset in the lease component...” An entity should be consistent in how they apply a predominance threshold.

Another consideration is the treatment of variable payments which is the key difference in accounting for the combined components between ASC 842 and ASC 606. Per ASC 842, variable payments that do not depend on an index or rate are excluded from the lease payments (lessor income), whereas variable payments are required to be estimated at contract inception and included in the contract consideration under ASC 606. If the contract is accounted for as a single component under ASC 842, the variable payments are also treated as part of the combined lease component.

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