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FASB Re-Leases Targeted Improvements to ASC 842

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Background

On July 30, 2018, the FASB issued [ASU 2018-11](#)¹ to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, [ASU 2016-02](#)² (codified as ASC 842).³ Specifically, under the amendments in ASU 2018-11:

- Entities may elect not to recast the comparative periods presented when transitioning to ASC 842 (Issue 1).
- Lessors may elect not to separate lease and nonlease components when certain conditions are met (Issue 2).

These amendments are consistent with the tentative decisions that the Board made at its November 29, 2017, meeting⁴ and further refined at its March 7, 2018,⁵ and March 28, 2018, meetings.⁶

In addition, on July 19, 2018, the FASB issued [ASU 2018-10](#),⁷ which made 16 separate amendments to ASC 842. For more information on these amendments, see the [appendix](#).

¹ FASB Accounting Standards Update No. 2018-11, *Targeted Improvements to Topic 842, Leases*.

² FASB Accounting Standards Update No. 2016-02, *Leases*.

³ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

⁴ See Deloitte's December 5, 2017, [Heads Up](#) for a detailed discussion of the tentative decisions made by the FASB at its November 29, 2017, meeting.

⁵ See Deloitte's March 8, 2018, [journal entry](#) for a summary of the FASB's March 7, 2018, meeting.

⁶ See Deloitte's March 30, 2018, [journal entry](#) for a summary of the FASB's March 28, 2018, meeting.

⁷ FASB Accounting Standards Update No. ASU 2018-10, *Codification Improvements to Topic 842, Leases*.

Key Provisions of ASU 2018-11

Scope

The scope of the amendments in the ASU is as follows:

- *Transition Relief (Issue 1)* — These amendments, which allow entities to report the comparative periods presented in the period of adoption under ASC 840, affect all entities with lease contracts that elect not to restate their comparative periods in transition.
- *Lessor Relief (Issue 2)* — These amendments, which give lessors the option of electing, as a practical expedient by class of underlying asset, not to separate the lease and nonlease components of a contract, only affect lessors whose lease contracts meet certain criteria (discussed below).

Note that while the Issue 1 amendments may benefit both lessees and lessors, the Issue 2 amendments will benefit only lessors.

Transition Relief (Issue 1)

ASC 842 originally required all entities to use a “modified retrospective” transition approach that is intended to maximize comparability and be less complex than a full retrospective approach. (See Deloitte’s [A Roadmap to Applying the New Leasing Standard](#) for further discussion of the effective date and transition guidance in ASC 842.)

Under the modified retrospective approach, ASC 842 is effectively implemented as of the beginning of the earliest comparative period presented in an entity’s financial statements. That is, a public business entity for which the standard becomes effective on January 1, 2019, would first apply ASC 842 and recognize an adjustment for the effects of the transition as of January 1, 2017 (i.e., the date of initial application).

ASU 2018-11 amends ASC 842 so that entities may elect not to recast their comparative periods in transition (the “Comparatives Under 840 Option”). The ASU allows entities to change their date of initial application to the beginning of the period of adoption. Therefore, a public business entity with a calendar year-end could elect to have a date of initial application of January 1, 2019. In doing so, the entity would:

- Apply ASC 840 in the comparative periods.
- Provide the disclosures required by ASC 840 for all periods that continue to be presented in accordance with ASC 840.
- Recognize the effects of applying ASC 842 as a cumulative-effect adjustment to retained earnings as of January 1, 2019.

The entity would not:

- Restate 2017 and 2018 for the effects of applying ASC 842.
- Provide the disclosures required by ASC 842 for 2017 and 2018.
- Change *how* it applies the transition requirements, only *when* it applies the transition requirements.



Connecting the Dots — ASC 840 Disclosures Required in the Comparative Periods

In response to the discussion at its March 7, 2018, meeting, the Board revised the language in ASU 2018-11 to clarify that an entity must provide the ASC 840 disclosures for all periods that are presented in accordance with ASC 840. As part of this requirement, the entity must apply the guidance in ASC 840-20-50-2(a) (commonly referred to as the “five-year table”) as of the latest balance sheet presented. Further, the ASU indicates that the latest balance sheet date presented should be the latest balance sheet date presented under ASC 840 (e.g., December 31, 2018, for a public business entity with a calendar year-end). Therefore, for a public business entity with a calendar year-end, the ASC 840-20-50-2(a) five-year table as of December 31, 2018, will be presented in the annual financial statements for the year ended December 31, 2019. Also, paragraph BC14 of ASU 2018-11 indicates that the ASU does not change, or create additional, “interim disclosure requirements that entities previously were not required to provide.”

We believe that it is still unclear what the U.S. GAAP and SEC reporting requirements would be with respect to the five-year table in the first interim period in the year of adoption of ASC 842. While ASC 842 may not require entities to provide certain of the prescribed disclosures in interim financial statements, SEC rules and staff interpretations require SEC registrants to provide both annual and interim disclosures in the first interim period after the adoption of a new accounting standard and in each subsequent quarter in the year of adoption. Specifically, [Section 1500](#) of the SEC Financial Reporting Manual states:

[Regulation] S-X Article 10 requires disclosures about material matters that were not disclosed in the most recent annual financial statements. Accordingly, when a registrant adopts a new accounting standard in an interim period, the registrant is expected to provide both the annual and the interim period financial statement disclosures prescribed by the new accounting standard, to the extent not duplicative. These disclosures should be included in each quarterly report in the year of adoption.

We plan to seek further guidance from the FASB regarding what disclosures are required in interim periods during the year of adoption.

Effective Date and Transition

The transition relief amendments (Issue 1) in the ASU apply to entities that have not yet adopted ASC 842. Entities that have early adopted ASC 842 cannot elect the Comparatives Under ASC 840 Option.

Lessor Relief (Issue 2)

ASU 2016-02, as initially issued, required lessors to separate lease and nonlease components in all circumstances. Under this requirement, once separate components are identified, lessors are required to use the relative stand-alone selling price allocation method in ASC 606 to allocate the consideration in the contract to the separated components. ASC 842 (including the presentation and disclosure guidance) applies to the lease component, while other guidance, typically ASC 606 (including the presentation and disclosure guidance), applies to the nonlease component.

As a result of stakeholder feedback indicating that the costs of complying with the separation and allocation requirements for lessors outweigh the benefits, ASU 2018-11 amends ASC 842 to include a practical expedient under which lessors are not required to separate lease and nonlease components.



Connecting the Dots — Practical Expedient Creates Greater Alignment Between Lessee and Lessor Accounting

ASU 2018-11 aligns the lessor's accounting for the separation of lease and nonlease components with that for lessees. Unlike lessors, lessees have always been able, under ASC 842, to elect a practical expedient under which they can choose not to separate (and allocate consideration to) lease and nonlease components (see ASC 842-10-15-37). However, lessees do not have an option of accounting for the combined component under ASC 842 or other U.S. GAAP. A lessee's combined component must always be accounted for under ASC 842. Both lessors and lessees may now elect to account for the nonlease components in a contract as part of the single lease component to which they are related. Note that this election is an accounting policy election that must be made by class of underlying asset.

Criteria for Combining Lease and Nonlease Components

A lessor may elect to combine lease and nonlease components provided that the nonlease component(s) otherwise would be accounted for under the new revenue guidance in ASC 606 and both of the following conditions are met:

- *Criterion A* — The timing and pattern of transfer for the lease component are the same as those for the nonlease components associated with that lease component.
- *Criterion B* — The lease component, if accounted for separately, would be classified as an operating lease.

The ASU also clarifies that the presence of a nonlease component that is ineligible for the practical expedient does not preclude a lessor from electing the expedient for the lease component and nonlease component(s) that meet the criteria. Rather, the lessor would account for the nonlease components that do not qualify for the practical expedient separately from the combined lease and nonlease components that do qualify.



Connecting the Dots — Assessing Timing and Pattern of Transfer

In the final ASU, the Board amended Criterion A to focus on the timing and pattern of transfer (i.e., a "straight-line pattern of transfer . . . to the customer over the same time period") rather than on the timing and pattern of revenue recognition (as was originally proposed). The purpose of this amendment was to address concerns that the originally proposed practical expedient was unnecessarily restrictive and excluded contracts with variable consideration from its scope, since variable payments are accounted for differently under ASC 606 than they are under ASC 842.

Determining Which Component Is Predominant

As with the lessee practical expedient, the FASB originally proposed that a lessor should always be required to account for the combined component as a lease under ASC 842. However, on the basis of feedback it received, the Board revised the final ASU to require an entity to perform another evaluation to determine whether the combined unit of account is accounted for as a lease under ASC 842 or as a revenue contract under ASC 606. Specifically, an entity should determine whether the nonlease component (or components) associated with the lease component is the predominant component of the combined component. If so, the 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.



Connecting the Dots — An Entity Will Need to Use Judgment to Determine the Predominant Component

As indicated in the ASU's Background Information and Basis for Conclusions, the FASB decided not to include a separate definition or threshold for determining whether "the nonlease component is the *predominant* component in the combined component." Rather, the Board indicates that an entity should consider whether it would "ascribe more value to the nonlease component(s) than to the lease component." Further, the Board acknowledged that the term "predominant" is used elsewhere in U.S. GAAP, including ASC 842⁸ and ASC 606.⁹

The FASB also indicates that it is comfortable with allowing entities to use judgment in making this determination. The Board explains that it does not expect that an entity will need to perform a detailed quantitative analysis or allocation to determine whether the nonlease component is predominant. Rather, it is sufficient if an entity can reasonably determine whether to apply ASC 842 or ASC 606.

At its March 28, 2018, meeting, the Board discussed a scenario in which the components were evenly split (e.g., a 50/50 split of value) and suggested that, in such circumstances, the combined component should be accounted for under ASC 842 because the nonlease component is not predominant. That is, the entity would need to demonstrate that the predominant element is the nonlease component; otherwise, the combined unit of account would be accounted for as a lease under ASC 842.

We believe that the final language in the ASU is intended to indicate that an entity would need to determine whether the lease or nonlease component (or components) is larger (i.e., has more value); only when the nonlease component is larger should the combined component be accounted for under ASC 606.



Connecting the Dots — Accounting for Variable Payments Follows the Scoping of the Combined Component

At its March 28, 2018, meeting, the Board decided that the Background Information and Basis for Conclusions of the new leasing standard should include language regarding the interaction between the practical expedient and the guidance in (1) ASC 842-10-15-39 on consideration in the contract and (2) ASC 842-10-15-40 on the recognition of variable payments. Specifically, the ASU clarified the Board's intent that the accounting for variable payments should be consistent with that for the combined component. That is, when the combined component is accounted for as a lease under ASC 842, there are no longer any nonlease variable payments; rather, there are only variable payments related to the combined lease component. Conversely, if the combined component is accounted for as a service under ASC 606, all variable payments related to the combined component should be accounted for in accordance with the variable consideration guidance in ASC 606.

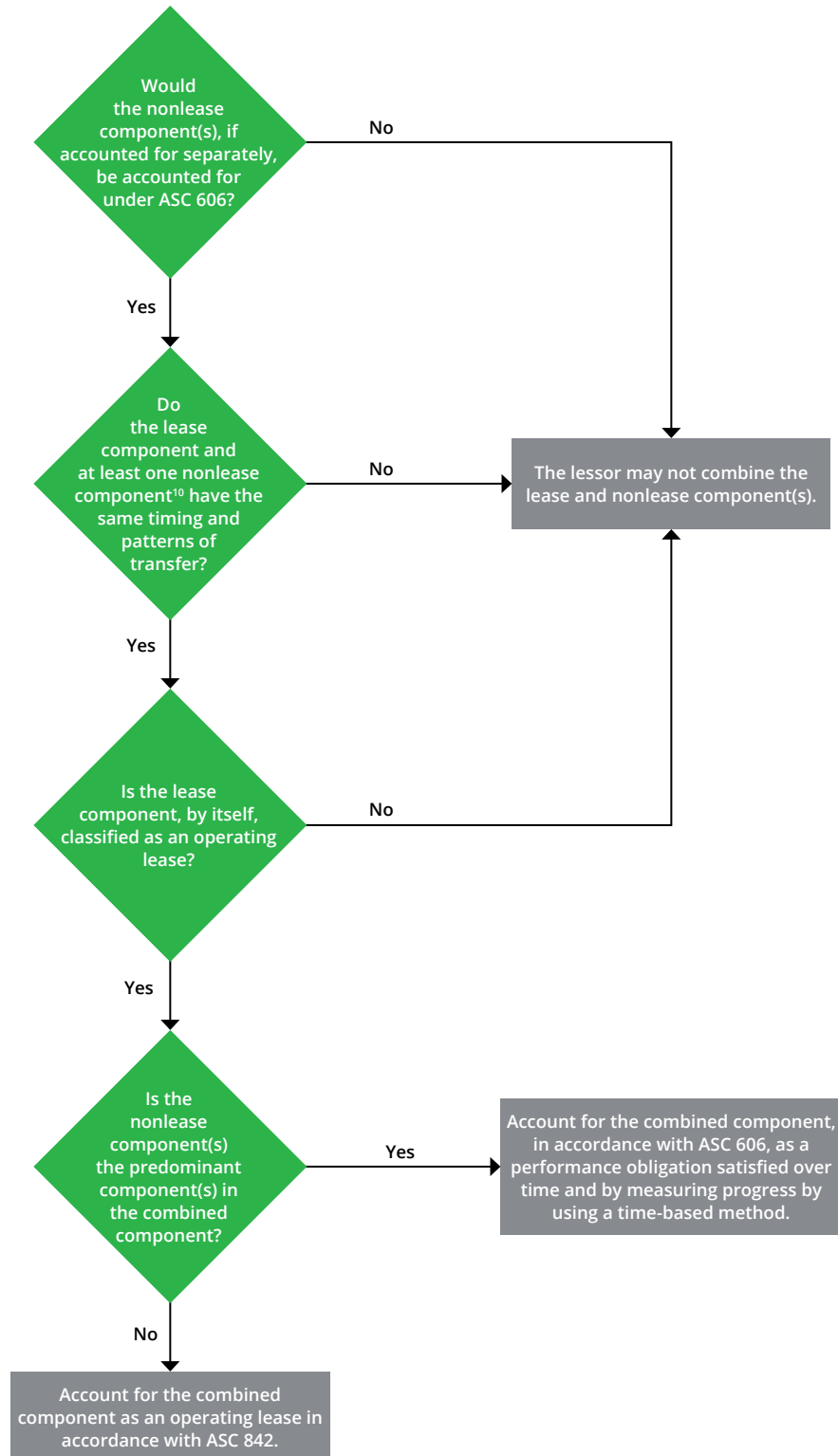
Disclosure Requirements

A lessor must disclose the following by class of underlying asset: (1) that it has elected the practical expedient, (2) the class(es) of underlying asset for which the election was made, (3) the nature of the items that are being combined and any nonlease components that were not eligible for the practical expedient, and (4) which standard applies to the combined component (i.e., ASC 842 or ASC 606).

⁸ ASC 842-10-25-5 states that "an entity shall consider the remaining economic life of the predominant asset in the lease component" to determine the classification when multiple underlying assets comprise a single lease component.

⁹ ASC 606-10-55-65A allows entities to use the sales-based and usage-based royalty exception to estimating variable consideration when "a license of intellectual property is the predominant item to which the royalty relates (for example, the license of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates)."

The flowchart below summarizes when a lessor may apply the practical expedient related to not separating lease and nonlease components in a contract.



¹⁰ An entity must apply the practical expedient, when elected, to all eligible nonlease components by class of underlying asset; however, the presence of a nonlease component (or components) that is ineligible for the practical expedient does not preclude a lessor from applying the practical expedient.

Effective Date and Transition

For entities that have not yet adopted ASU 2016-02, the effective date of the lessor relief practical expedient (Issue 2) is aligned with the new leasing standard's effective date and transition requirements. That is, the expedient's effective date is as follows:

- *Public business entities* — Fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.
- *All other entities* — Fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Entities that early adopted ASU 2016-02 before the issuance of ASU 2018-11 may apply the lessor practical expedient to all new and existing leases either retrospectively or prospectively and may elect to apply it as of either (1) the lessor's first reporting period after the issuance of the ASU or (2) the mandatory effective date of ASC 842 (i.e., January 1, 2019, for calendar-year-end public entities). For example, an entity that has early adopted ASU 2016-02 and elects the practical expedient may decide not to recast past periods already presented under ASC 842, thereby choosing prospective application.

Upon transition to ASU 2018-11, a lessor electing the practical expedient would be required to apply it to all new *and existing* transactions within a class of underlying assets that qualify for the expedient as of the date elected. That is, a lessor would not be permitted to apply the practical expedient only to new or modified transactions within a class of underlying assets.



Connecting the Dots

At its July 25, 2018, meeting,¹¹ the FASB also deliberated potential Codification improvements to the amendments in ASU 2016-13,¹² including clarifying the accounting for the impairment of operating lease receivables. The Board tentatively decided to clarify that operating lease receivables are not within the scope of ASC 326 and will expose this decision for public comment. For more information on the Board's proposed amendments to the current expected credit losses standard, see Deloitte's July 27, 2018, [journal entry](#).

¹¹ See Deloitte's July 27, 2018, [journal entry](#) for a summary of the FASB's July 25, 2018, meeting.

¹² FASB Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

Appendix — Minor Amendments Made by ASU 2018-10 to New Leasing Standard

ASU 2018-10¹³ (issued on July 19, 2018) makes narrow-scope amendments (i.e., minor changes and clarifications) to certain aspects of the new leasing standard (i.e., ASC 842). The following table, reproduced from the final ASU, summarizes the 16 amendments that were made:

Area for Improvement	Summary of Amendments
Issue 1: Residual Value Guarantees	
Stakeholders noted that paragraph 460-10-60-32 incorrectly refers readers to the guidance in Topic 842 about sale-leaseback-sublease transactions, when, in fact, it should refer readers to the guidance about guarantees by a seller-lessee of the underlying asset's residual value in a sale and leaseback transaction.	The amendment corrects the cross-reference in paragraph 460-10-60-32.
Issue 2: Rate Implicit in the Lease	
Stakeholders raised questions about the treatment of certain sales-type leases with significant variable payments under Topic 842 and whether the application of Topic 842 could result in a negative rate implicit in the lease, rather than a loss at the commencement date of the lease.	The amendment clarifies that a rate implicit in the lease of zero should be used when applying the definition of the term <i>rate implicit in the lease</i> results in a rate that is less than zero.
Issue 3: Lessee Reassessment of Lease Classification	
Topic 842 is clear that when a lease is modified and that modification is not accounted for as a separate contract, an entity (that is, a lessee or a lessor) should reassess, at the effective date of the modification, lease classification on the basis of the modified terms and conditions and the facts and circumstances existing as of that date. Although Topic 842 also requires a lessee to reassess lease classification if there is a change in the lease term or the assessment of a lessee option to purchase the underlying asset, stakeholders expressed that it is not clear whether the lessee should reassess lease classification on the basis of the facts and circumstances existing as of the date the reassessment is required.	The amendment consolidates the requirements about lease classification reassessments into one paragraph and better articulates how an entity should perform the lease classification reassessment, that is, on the basis of the facts and circumstances, and the modified terms and conditions, if applicable, as of the date the reassessment is required.
Issue 4: Lessor Reassessment of Lease Term and Purchase Option	
Topic 842 requires a lessor to not reassess the lease term or a lessee purchase option unless the lease is modified and that modification is not accounted for as a separate contract. Topic 842 also requires a lessor to account for the exercise of a lessee option to extend or terminate the lease or to purchase the underlying asset in the same manner as a lease modification. Stakeholders questioned why a lessor should account for a lessee exercise of such options in a manner similar to a lease modification when the exercise of those options is consistent with the assumptions that the lessor made in accounting for the lease at the commencement date of the lease (or the most recent effective date of a modification that is not accounted for as a separate contract).	The amendment clarifies that a lessor should account for the exercise by a lessee of an option to extend or terminate the lease or to purchase the underlying asset as a lease modification unless the exercise of that option by the lessee is consistent with the assumptions that the lessor made in accounting for the lease at the commencement date of the lease (or the most recent effective date of a modification that is not accounted for as a separate contract).

¹³ The effective date of the amendments in ASU 2018-10 is aligned with that of ASU 2016-02. For entities that have early adopted ASC 842, the ASU is effective upon issuance and has the same transition requirements as those in ASC 842.

(Table continued)

Area for Improvement	Summary of Amendments
Issue 5: Variable Lease Payments That Depend on an Index or a Rate	
Stakeholders noted that the guidance in paragraph 842-10-35-4(b) about remeasurement of the lease payments when a contingency upon which some or all of the variable lease payments are based is resolved might be perceived as applying to any variable lease payments, including those that depend on an index or rate, which would be inconsistent with the Board's decisions on this issue.	The amendment clarifies that a change in a reference index or rate upon which some or all of the variable lease payments in the contract are based does not constitute the resolution of a contingency subject to the guidance in paragraph 842-10-35-4(b). Variable lease payments that depend on an index or a rate should be remeasured, using the index or rate at the remeasurement date, only when the lease payments are remeasured for another reason (that is, when one or more of the events described in paragraph 842-10-35-4(a) or (c) occur or when a contingency unrelated to a change in a reference index or rate under paragraph 842-10-35-4(b) is resolved).
Issue 6: Investment Tax Credits	
Stakeholders indicated that there is an inconsistency in terminology used about the effect that investment tax credits have on the fair value of the underlying asset between the definition of the term <i>rate implicit in the lease</i> and the lease classification guidance in paragraph 842-10-55-8.	The amendment removes that inconsistency in terminology.
Issue 7: Lease Term and Purchase Option	
Stakeholders indicated that the description in paragraph 842-10-55-24 about lessor-only termination options is inconsistent with the description in paragraph 842-10-55-23 about the noncancellable period of a lease.	The amendment removes that inconsistency by clarifying that the period covered by a lessor-only option to terminate the lease is included in the lease term.
Issue 8: Transition Guidance for Amounts Previously Recognized in Business Combinations	
Stakeholders indicated that the transition guidance for lessors in paragraph 842-10-65-1(h)(3) is unclear because it relates to leases classified as direct financing leases or sales-type leases under Topic 840, while the lead-in sentence to paragraph 842-10-65-1(h) provides transition guidance for leases classified as operating leases under Topic 840.	The amendment clarifies that paragraph 842-10-65-1(h)(3) applies to lessors for leases classified as direct financing leases or sales-type leases under Topic 842, not Topic 840. In other words, paragraph 842-10-65-1(h)(3) applies when an entity does not elect the package of practical expedients in paragraph 842-10-65-1(f), and, for a lessor, an operating lease acquired as part of a previous business combination is classified as a direct financing lease or a sales-type lease when applying the lease classification guidance in Topic 842. The amendment also cross-references to other transition guidance applicable to those changes in lease classification for lessors.
Issue 9: Certain Transition Adjustments	
When an entity initially applies Topic 842 retrospectively to each prior reporting period and does not elect the package of practical expedients in Topic 842, paragraph 842-10-65-1(p) requires a lessee to write off, as an adjustment to equity, any unamortized initial direct costs that do not meet the definition of <i>initial direct costs</i> under Topic 842 for leases previously classified as operating leases under Topic 840. Stakeholders questioned why those nonqualifying costs should be charged to equity when those costs are incurred after the beginning of the earliest period presented in the financial statements in which an entity adopts Topic 842. Similar issues also were noted elsewhere in the transition guidance when an entity initially applies Topic 842 retrospectively to each prior reporting period.	The amendments clarify whether to recognize a transition adjustment to earnings rather than through equity when an entity initially applies Topic 842 retrospectively to each prior reporting period.

(Table continued)

Area for Improvement	Summary of Amendments
Issue 10: Transition Guidance for Leases Previously Classified as Capital Leases Under Topic 840	
<p>Paragraph 842-10-65-1(r) provides guidance to lessees for leases previously classified as capital leases under Topic 840 and classified as finance leases under Topic 842. Paragraph 842-10-65-1(r)(4) provides subsequent measurement guidance before the effective date when an entity initially applies Topic 842 retrospectively to each prior reporting period, but it refers readers to the subsequent measurement guidance in Topic 840 about operating leases. It should refer them to the subsequent measurement guidance applicable to capital leases.</p>	<p>The amendment corrects that reference.</p>
Issue 11: Transition Guidance for Modifications to Leases Previously Classified as Direct Financing or Sales-Type Leases Under Topic 840	
<p>Paragraph 842-10-65-1(x) provides transition guidance applicable to lessors for leases previously classified as direct financing leases or sales-type leases under Topic 840 and classified as direct financing leases or sales-type leases under Topic 842. For modifications to those leases beginning after the effective date, paragraph 842-10-65-1(x)(4) refers readers to other applicable guidance in Topic 842 to account for the modification, specifically paragraphs 842-10-25-16 through 25-17, depending on how the lease is classified after the modification. Stakeholders noted that it should refer to how the lease is classified <i>before</i> the modification to be consistent with the guidance provided in paragraphs 842-10-25-16 through 25-17.</p>	<p>The amendment corrects that inconsistency.</p>
Issue 12: Transition Guidance for Sale and Leaseback Transactions	
<p>Stakeholders noted that the heading above the transition guidance on sale and leaseback transactions appears to suggest that there is no transition guidance for sale and leaseback transactions that occur after the earliest comparative period presented in the financial statements in which an entity adopts Topic 842 but before the effective date. Some stakeholders also questioned some of the references included in paragraph 842-10-65-1(bb).</p>	<p>The amendments clarify that the transition guidance on sale and leaseback transactions in paragraph 842-10-65-1(aa) through (ee) applies to all sale and leaseback transactions that occur before the effective date and corrects the referencing issues noted.</p>
Issue 13: Impairment of Net Investment in the Lease	
<p>Paragraph 842-30-35-3 provides guidance to lessors for determining the loss allowance of the net investment in the lease and describes the cash flows that should be considered when the lessor determines that loss allowance. Stakeholders questioned whether the guidance, as written, would accelerate and improperly measure the loss allowance because the cash flows associated with the unguaranteed residual asset appear to be excluded from the evaluation.</p>	<p>The amendment clarifies the application of the guidance for determining the loss allowance of the net investment in the lease, including the cash flows to consider in that assessment.</p>

(Table continued)

Area for Improvement	Summary of Amendments
Issue 14: Unguaranteed Residual Asset	
<p>Paragraph 842-30-35-4 provides guidance explaining that if a lessor sells the lease receivable associated with a direct financing lease or a sales-type lease and retains an interest in the residual value of the asset, the lessor should not continue to accrete the unguaranteed residual asset to its estimated value over the remaining lease term. Stakeholders questioned whether the Board intended to change the application as compared with current generally accepted accounting principles (GAAP) because the guidance in paragraph 840-30-35-53 (which will be superseded by the amendments in Update 2016-02) requires a lessor to continue to recognize interest resulting from accretion of the unguaranteed residual asset to its estimated value unless the lessor sells <i>substantially all</i> of the minimum rental payments.</p>	<p>The amendment clarifies that a lessor should not continue to accrete the unguaranteed residual asset to its estimated value over the remaining lease term to the extent that the lessor sells substantially all of the lease receivable associated with a direct financing lease or a sales-type lease, consistent with Topic 840.</p>
Issue 15: Effect of Initial Direct Costs on Rate Implicit in the Lease	
<p>Stakeholders noted that the ordering of the illustration in Case C of Example 1 in paragraphs 842-30-55-31 through 55-39 has raised questions about how initial direct costs factor into determining the rate implicit in the lease for lease classification purposes for lessors only.</p>	<p>The amendment more clearly aligns the illustration to the guidance in paragraph 842-10-25-4.</p>
Issue 16: Failed Sale and Leaseback Transaction	
<p>In accordance with Subtopic 842-40, Leases—Sale and Leaseback Transactions, when a sale and leaseback transaction does not qualify as a sale, an entity should account for the transaction as a financing arrangement. Paragraph 842-40-30-6(a) further requires a seller-lessee to adjust the interest rate as necessary to prevent negative amortization of the financial liability recognized. Some stakeholders questioned whether the language used in paragraph 842-40-30-6(a) actually meets the objective of preventing negative amortization of the financial liability recognized by a seller-lessee in a failed sale and leaseback transaction.</p>	<p>The amendment clarifies that a seller-lessee in a failed sale and leaseback transaction should adjust the interest rate on its financial liability as necessary to ensure that the interest on the financial liability does not exceed the total payments (rather than the principal payments) on the financial liability. This clarification is also reflected in the relevant illustration on failed sale and leaseback transactions that is contained in Subtopic 842-40.</p>

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