

Leases — FASB Discusses ASC 842 Implementation Issues

At its November 30, 2016, meeting, the FASB discussed implementation issues related to the new leases guidance in ASC 842.¹ This was the first time the Board publicly addressed stakeholder feedback regarding the implementation of the new guidance since it was issued in February 2016 (ASU 2016-02²). The Board indicated that it will use future board meetings to address implementation issues raised by stakeholders rather than forming a transition resource group, as it did to address transition issues related to the new revenue recognition and credit losses guidance.

The Board discussed the following issues raised by stakeholders, none of which are expected to result in additional standard setting:

- *Impact of prior asset group impairments of operating lease right-of-use (ROU) asset measurement* — Some stakeholders have suggested that it is unclear whether an entity would be expected to allocate prior-period asset group impairments to the operating lease ROU asset when transitioning to ASC 842. The Board stated that a lessee should not revisit prior impairment allocation conclusions and should not include any previous impairments in the measurement of an ROU asset upon adopting the guidance.
- *Testing operating leases for impairment* — Stakeholders have questioned whether the interest portion of an operating lease payment should be included as a cash outflow when determining the undiscounted cash flows used in the asset group recoverability test. The Board generally agreed that lessees should exclude interest payments when calculating the undiscounted cash flows when assessing an asset group for impairment under ASC 360.³ However, some Board members also believe that an entity's decision to include interest in its impairment analysis could be viewed as an accounting policy election.
- *Determining the term of a head lease in a lease/sublease arrangement* — When a sublease has the same contractual terms as the head lease, some have suggested that it is unclear how an entity determines the lease term of the head lease. For example, some believe that if renewal options are included in the sublessee's lease term, then the head lessee's lease term is required to include those same renewal options. The Board, acknowledging that the current ASC 840 guidance is silent on this specific issue, does not believe the guidance in ASC 842-10-30-1(c) should be interpreted to mean that all renewal options outside the lessee's control are required to be included in the term of the head lease.
- *Accounting for sales-type leases with significant variable payments* — A lessor's initial measurement of a sales-type lease that includes a significant variable lease payment component may result in a loss at lease commencement (i.e., a day 1 loss) if the lease receivable plus the unguaranteed residual asset is less than the net carrying value of the underlying asset being leased. This could occur if payments on a lease of, for example, a solar farm are based entirely on the production of electricity (i.e., 100 percent variable). The Board discussed whether a day 1 loss would be appropriate in these situations or whether other possible approaches would be acceptable, including the use of a negative discount rate to avoid the loss at commencement. The Board believes that while stakeholders may disagree with the day 1 loss outcome, ASC 842 is clear on how the initial measurement guidance should be applied to sales-type leases. In addition, the Board stated that the use of a negative discount rate would not be appropriate and should not be applied under ASC 842.

¹ FASB Accounting Standards Codification (ASC) Topic 842, *Leases*. The guidance in ASC 842 supersedes the guidance in ASC 840, *Leases*.

² FASB Accounting Standards Update No. 2016-02, *Leases (Topic 842)*.

³ FASB Accounting Standards Codification Topic 360, *Property, Plant, and Equipment*.

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