FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2018-11
July 2018

Leases (Topic 842)

Targeted Improvements

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

For additional copies of this Accounting Standards Update and information on applicable prices and discount rates contact:

Order Department
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Please ask for our Product Code No. ASU2018-11.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of May, November, and December by the Financial Accounting Foundation, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is $255 per year. POSTMASTER: Send address changes to Financial Accounting Series, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 470**

FASB

Accounting Standards Update

No. 2018-11
July 2018

Leases (Topic 842)

Targeted Improvements

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

Accounting Standards Update 2018-11

Leases (Topic 842)

Targeted Improvements

July 2018

CONTENTS

Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842),* to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. The FASB has been assisting stakeholders with implementation questions and issues as organizations prepare to adopt the new leases standard.

Many stakeholders inquired about the following two requirements in the new leases standard:

1. Comparative reporting requirements for initial adoption (transition—comparative reporting at adoption)
2. For lessors only, separating lease and nonlease components in a contract and allocating the consideration in the contract to the separate components (separating components of a contract).

Transition—Comparative Reporting at Adoption

Entities currently are required to adopt the new leases standard using a modified retrospective transition method. Under that transition method, an entity initially applies the new leases standard (subject to specific transition requirements and optional practical expedients) at the beginning of the earliest period presented in the financial statements (which is January 1, 2017, for calendar-year-end public business entities that adopt the new leases standard on January 1, 2019). This means that starting on January 1, 2017 (for those calendar-year-end public business entities just described), lessees must recognize lease assets and liabilities for all leases even though those leases may have expired before the effective date. Lessees also must provide the new and enhanced disclosures for each period presented, including the comparative periods. The Board decided on this approach in part based on preparers' feedback that this transition would allow them to adopt the new leases standard in a cost-effective manner with relatively limited changes to systems, while not significantly reducing the benefits that accrue to users.

As entities have started to implement the new leases standard, many preparers have cited their plan to implement new systems and are observing some unanticipated costs and complexities associated with the modified retrospective transition method, particularly the comparative period reporting requirements previously described. Accordingly, those preparers requested that the Board provide an additional (and optional) transition method with which to adopt the new leases standard. The Board decided to provide another transition method in addition to the existing transition method by allowing entities to initially apply the new leases standard at the adoption date (such as January 1, 2019, for calendar-year-end public business entities) and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption consistent with preparers' requests.

This additional transition method changes only *when* an entity is required to initially apply the transition requirements of the new leases standard; it does not change *how* those requirements apply.

Separating Components of a Contract

In accordance with the new leases standard, an entity must separate lease components from nonlease components (for example, maintenance services or other activities that transfer a good or service to the customer other than the right to use the underlying asset) in a contract. The lease components are accounted for in accordance with the new leases standard. An entity should account for the nonlease components in accordance with other Topics (for example, Topic 606, Revenue from Contracts with Customers, for lessors). The consideration in the contract is allocated to the lease and nonlease components on a relative standalone price basis (for lessees) or in accordance with the allocation guidance in the new revenue standard (for lessors). The new leases standard also provides lessees with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component. If a lessee makes that accounting policy election, it is required to account for the nonlease components together with the associated lease component as a single lease component and to provide certain disclosures. Lessors are not afforded a similar practical expedient.

The amendments in this Update address stakeholders' concerns about the requirement for lessors to separate components of a contract by providing lessors with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component, similar to the expedient provided for lessees. However, the lessor practical expedient is limited to circumstances in which the nonlease component or components otherwise would be accounted for under the new revenue guidance and both (1) the timing and pattern of transfer are the same for the nonlease component(s) and associated lease component and (2) the lease component, if accounted for separately, would be classified as an operating lease.

The amendments in this Update also clarify which Topic (Topic 842 or Topic 606) applies for the combined component. Specifically, if the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity should account for the combined component in accordance with Topic 606. Otherwise, the entity should account for the combined component as an operating lease in accordance with Topic 842. An entity that elects the lessor practical expedient also should provide certain disclosures.

Who Is Affected by the Amendments in This Update?

The amendments in this Update related to transition relief on comparative reporting at adoption affect all entities with lease contracts that choose the additional transition method, while the amendments in this Update related to separating components of a contract affect only lessors whose lease contracts qualify for the practical expedient.

What Are the Main Provisions?

Transition—Comparative Reporting at Adoption

The amendments in this Update provide entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption consistent with preparers' requests. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). An entity that elects this additional (and optional) transition method must provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840. The amendments do not change the existing disclosure requirements in Topic 840 (for example, they do not create interim disclosure requirements that entities previously were not required to provide).

Separating Components of a Contract

The amendments in this Update provide lessors with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component if the nonlease components otherwise would be accounted for under the new revenue guidance (Topic 606) and both of the following are met:

1. The timing and pattern of transfer of the nonlease component(s) and associated lease component are the same.
2. The lease component, if accounted for separately, 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 Topic 606. Otherwise, the entity must account for the combined component as an operating lease in accordance with Topic 842.

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

1. The fact that it elected the expedient
2. Which class(es) of underlying asset the lessor made the election to
3. 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
4. The Topic the entity applies to the combined component (Topic 606 or Topic 842).

What Are the Transition Requirements and When Will the Amendments Be Effective?

The amendments in this Update related to separating components of a contract affect the amendments in Update 2016-02, which are not yet effective but can be early adopted.

For entities that have not adopted Topic 842 before the issuance of this Update, the effective date and transition requirements for the amendments in this Update related to separating components of a contract are the same as the effective date and transition requirements in Update 2016-02.

For entities that have adopted Topic 842 before the issuance of this Update, the transition and effective date of the amendments related to separating components of a contract in this Update are as follows:

1. The practical expedient may be elected either in the first reporting period following the issuance of this Update or at the original effective date of Topic 842 for that entity.
2. 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 in this Update must apply the expedient, by class of underlying asset, to all existing lease transactions that qualify for the expedient at the date elected.

Amendments to the
FASB Accounting Standards Codification®

Summary of Amendments to the Accounting Standards Codification

1. The following table summarizes the amendments to the Accounting Standards Codification. The amendments are organized by area.

Area	**Paragraphs**
Issue 1: Transition—Comparative Reporting at Adoption	3–5
Issue 2: Separating Components of a Contract	6–10

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–12. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Issue 1: Transition—Comparative Reporting at Adoption

3. These amendments provide entities with an additional (and optional) transition method to adopt Topic 842. Under this transition method, an entity initially applies the transition requirements in Topic 842 at that Topic's effective date with the effects of initially applying Topic 842 recognized as a cumulative-effect adjustment to the opening balance of retained earnings (or other components of equity or net assets, as appropriate) in the period of adoption.

Amendments to Subtopic 842-10

4. Amend paragraphs 842-10-55-243 and 842-10-55-248, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Implementation Guidance and Illustrations

> Illustrations

> > Illustrations of Transition

> > > Illustration of Lessee Transition—Existing Capital Lease

842-10-55-243 Example 28 illustrates lessee accounting for the transition of existing capital leases when an entity elects the transition method in paragraph 842-10-65-1(c)(1).

> > > Illustration of Lessee Transition—Existing Operating Lease

842-10-55-248 Example 29 illustrates lessee accounting for the transition of existing operating leases when an entity elects the transition method in paragraph 842-10-65-1(c)(1).

5. Amend paragraph 842-10-65-1 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842),* No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842,* ~~and~~ No. 2018-10, *Codification Improvements to Topic 842, Leases*, and No. 2018-11, *Leases (Topic 842): Targeted Improvements*

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842),* No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842,* ~~and~~ No. 2018-10*, Codification Improvements to Topic 842, Leases*, and No. 2018-11, *Leases (Topic 842): Targeted Improvements*: [**Note**: See paragraph 842-10-S65-1 for an SEC Staff Announcement on transition related to Update 2016-02.]

a. A **public business entity**, a **not-for-profit entity** that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Earlier application is permitted.

b. All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Earlier application is permitted.

c. In the financial statements in which an entity first applies the pending content that links to this paragraph, the entity shall recognize and measure **leases** within the scope of the pending content that links to this paragraph that exist at the application date, as determined by the transition method that the entity elects ~~beginning of the earliest comparative period presented, using the approach described in (i) through (ee)~~. An entity shall apply the pending content that links to this paragraph using one of the following two methods:
   1. Retrospectively to each prior reporting period presented in the financial statements with the cumulative effect of initially applying the pending content that links to this paragraph recognized at the beginning of the earliest comparative period presented, subject to the guidance in (d) through (gg). Under this transition method, the application date shall be the later of the beginning of the earliest period presented in the financial statements and the **commencement date of the lease**.
   2. Retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment, subject to the guidance in (d) through (gg). Under this transition method, the application date shall be the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.

d. An entity shall adjust equity and, if the entity elects the transition method in (c)(1) ~~at the beginning of the earliest comparative period presented~~, ~~and~~ the other comparative amounts disclosed for each prior period presented in the financial statements, as if the pending content that links to this paragraph had always been applied, subject to the requirements in ~~(h)~~ (e) through (gg) ~~(ee)~~.

e. If a **lessee** elects not to apply the recognition and measurement requirements in the pending content that links to this paragraph to **short-term leases,** the lessee shall not apply the approach described in (k) through (t) to short-term leases.

See Examples 28 through 29 (paragraphs 842-10-55-243 through 55-254) for illustrations of the transition requirements for an entity that applies the pending content that links to this paragraph in accordance with (c)(1).

Practical expedients

f. An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a **lessor**), when applying the pending content that links to this paragraph to leases that commenced before the effective date:

1. An entity need not reassess whether any expired or existing **contracts** are or contain leases.
2. An entity need not reassess the lease classification for any expired or existing leases (for example, all existing leases that were classified as **operating leases** in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as **finance leases**).
3. An entity need not reassess **initial direct costs** for any existing leases.

g. An entity also may elect a practical expedient, which must be applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor) to use hindsight in determining the **lease term** (that is, when considering lessee options to extend or terminate the lease and to purchase the **underlying asset**) and in assessing impairment of the entity's **right-of-use assets**. This practical expedient may be elected separately or in conjunction with either one or both of the practical expedients in (f) and (gg).

gg. An entity also may elect a practical expedient to not assess whether existing or expired land easements that were not previously accounted for as leases under Topic 840 are or contain a lease under this Topic. For purposes of (gg), a land easement (also commonly referred to as a right of way) refers to a right to use, access, or cross another entity's land for a specified purpose. This practical expedient shall be applied consistently by an entity to all its existing and expired land easements that were not previously accounted for as leases under Topic 840. This practical expedient may be elected separately or in conjunction with either one or both of the practical expedients in (f) and (g). An entity that elects this practical expedient for existing or expired land easements shall apply the pending content that links to this paragraph to land easements entered into (or modified) on or after the date that the entity first applies the pending content that links to this paragraph as described in (a) and (b). An entity that previously accounted for existing or expired land easements under Topic 840 shall not be eligible for this practical expedient for those land easements.

Amounts previously recognized in respect of business combinations

h. If an entity has previously recognized an asset or a liability in accordance with Topic 805 on **business combinations** relating to favorable or unfavorable terms of an operating lease acquired as part of a business combination, the entity shall do all of the following:
   1. Derecognize that asset and liability (except for those arising from leases that are classified as operating leases in accordance with Topic 842 for which the entity is a lessor).
   2. Adjust the carrying amount of the right-of-use asset by a corresponding amount if the entity is a lessee.
   3. Make a corresponding adjustment to equity if assets or liabilities arise from leases that are classified as **sales-type leases** or **direct financing leases** in accordance with Topic 842 for which the entity is a lessor. Also see (w).

Disclosure

i. An entity shall provide the transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraph 250-10-50-1(b)(2). An entity that elects the transition method in (c)(2) shall provide the transition disclosures in paragraph 250-10-50-1(b)(3) as of the beginning of the period of adoption rather than at the beginning of the earliest period presented.

   Note: See paragraph 250-10-S99-6 on disclosure of the impact that recently issued accounting standards will have on the financial statements of a registrant.

j. If an entity uses one or more of the practical expedients in (f), (g), and (gg), it shall disclose that fact.

jj. An entity electing the transition method in (c)(2) shall provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840.

Lessees

Leases previously classified as operating leases under Topic 840

k. A lessee ~~should~~ shall initially recognize a right-of-use asset and a **lease liability** at the application date as determined in (c) ~~later of the beginning of the earliest period presented in the financial statements and the **commencement date of the lease**~~.

l. Unless, on or after the effective date, the lease is modified (and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8) or the lease liability is required to be remeasured in accordance with paragraph 842-20-35-4, a lessee shall measure the lease liability at the present value of the sum of the following, using a **discount rate for the lease** (which, for entities that are not public business entities, can be a risk-free rate determined in accordance with paragraph 842-20-30-3) established at the <u>application date as determined in (c)</u> ~~later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease~~:

1. The remaining minimum rental payments (as defined under Topic 840).
2. Any amounts **probable** of being owed by the lessee under a **residual value guarantee**.

m. For each lease classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3, a lessee shall initially measure the right-of-use asset at the initial measurement of the lease liability adjusted for both of the following:
   1. The items in paragraph 842-20-35-3(b), as applicable.
   2. The carrying amount of any liability recognized in accordance with Topic 420 on exit or disposal cost obligations for the lease.

n. For each lease classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3, a lessee shall subsequently measure the right-of-use asset throughout the remaining lease term in accordance with paragraph 842-20-35-3(b). If the initial measurement of the right-of-use asset in (m) is adjusted for the carrying amount of a liability recognized in accordance with Topic 420 on exit or disposal cost obligations for the lease, the lessee shall apply the recognition and subsequent measurement guidance in Sections 842-20-25 and 842-20-35, respectively, when the right-of-use asset has been impaired.

o. For each lease classified as a finance lease in accordance with paragraph 842-10-25-2, a lessee shall measure the right-of-use asset as the applicable proportion of the lease liability at the commencement date, which can be imputed from the lease liability determined in accordance with (l). The applicable proportion is the remaining lease term at the <u>application date as determined in (c)</u> ~~beginning of the earliest comparative period presented~~ relative to the total lease term. A lessee shall adjust the right-of-use asset recognized by the carrying amount of any prepaid or accrued **lease payments** and the carrying amount of any liability recognized in accordance with Topic 420 for the lease.

p. <u>If a lessee does not elect the practical expedients described in (f), any</u> ~~Any~~ unamortized initial direct costs that do not meet the definition of initial direct costs in this Topic shall be written off as an adjustment to equity <u>unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred</u> ~~(if incurred before the beginning of the earliest period presented in the financial statements) or to earnings of the comparative period presented (if incurred on or after the beginning of the earliest period presented), unless the lessee elects the practical expedients described in (f)~~.

q. If a modification to the contractual terms and conditions occurs on or after the effective date, and the modification does not result in a separate contract in accordance with paragraph 842-10-25-8, or the lessee is required to remeasure the lease liability for any reason (see paragraphs 842-20-35-4 through 35-5), the lessee shall follow the requirements in this Topic from the **effective date of the modification** or the remeasurement date.

Leases previously classified as capital leases under Topic 840

r. For each lease classified as a finance lease in accordance with this Topic, a lessee shall do all of the following:
   1. Recognize a right-of-use asset and a lease liability at the carrying amount of the lease asset and the capital lease obligation in accordance with Topic 840 at the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented or the commencement date of the lease~~.
   2. Include any unamortized initial direct costs that meet the definition of initial direct costs in this Topic in the measurement of the right-of-use asset established in (r)(1).
   3. If a lessee does not elect the practical expedients described in (f), write ~~Write~~ off any unamortized initial direct costs that do not meet the definition of initial direct costs in this Topic and that are not included in the measurement of the capital lease asset under Topic 840 as an adjustment to equity unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred ~~(if incurred before the beginning of the earliest period presented in the financial statements) or to earnings of the comparative period presented (if incurred on or after the beginning of the earliest period presented), unless the lessee elects the practical expedients described in (f)~~.
   4. If an entity elects the transition method in (c)(1), subsequently ~~Subsequently~~ measure the right-of-use asset and the lease liability in accordance with Section 840-30-35 before the effective date.
   5. Regardless of the transition method selected in (c), apply ~~Apply~~ the subsequent measurement guidance in paragraphs 842-20-35-4 through 35-5 and 842-20-35-8 after the effective date. However, when applying the pending content in paragraph 842-20-35-4, a lessee shall not remeasure the lease payments for amounts probable of being owed under residual value guarantees in accordance with paragraph 842-10-35-4(c)(3).
   6. Classify the assets and liabilities held under capital leases as right-of-use assets and lease liabilities arising from finance leases for the purposes of presentation and disclosure.

s. For each lease classified as an operating lease in accordance with this Topic, a lessee shall do the following:
   1. Derecognize the carrying amount of any capital lease asset and capital lease obligation in accordance with Topic 840 at the <u>application date as determined in (c)</u> ~~later of the beginning of the earliest comparative period presented or the commencement date of the lease~~. Any difference between the carrying amount of the capital lease asset and the capital lease obligation shall be accounted for in the same manner as prepaid or accrued rent.
   2. <u>If an entity elects the transition method in (c)(1) and the lease commenced before the beginning of the earliest period presented in the financial statements or if the entity elects the transition method in (c)(2), recognize</u> ~~Recognize~~ a right-of-use asset and a lease liability in accordance with paragraph 842-20-35-3 <u>at the application date as determined in (c)</u> ~~if the lease commenced before the beginning of the earliest period presented in the financial statements~~.
   3. <u>If an entity elects the transition method in (c)(1) and the lease commenced after the beginning of the earliest period presented in the financial statements, recognize</u> ~~Recognize~~ a right-of-use asset and a lease liability in accordance with paragraph 842-20-30-1 at the commencement date of the lease ~~if the lease commenced after the beginning of the earliest period presented in the financial statements~~.
   4. Account for the operating lease in accordance with the guidance in Subtopic 842-20 after initial recognition in accordance with (s)(2) or (s)(3).
   5. Write off any unamortized initial direct costs that do not meet the definition of initial direct costs in this Topic as an adjustment to equity <u>unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred</u> ~~(if incurred before the beginning of the earliest period presented in the financial statements) or to earnings of the comparative period presented (if incurred on or after the beginning of the earliest period presented)~~.

t. If a modification to the contractual terms and conditions occurs on or after the effective date, and the modification does not result in a separate contract in accordance with paragraph 842-10-25-8, or the lessee is required to remeasure the lease liability in accordance with paragraph 842-20-35-4, the lessee shall subsequently account for the lease in accordance with the requirements in this Topic beginning on the effective date of the modification or the remeasurement date.

Build-to-suit lease arrangements

u. A lessee shall apply a modified retrospective transition approach for leases accounted for as build-to-suit arrangements under Topic 840 that are existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements (if an entity elects the transition method in (c)(1)) or that are existing at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)) as follows:
   1. If an entity has recognized assets and liabilities solely as a result of a transaction's build-to-suit designation in accordance with Topic 840, the entity shall do the following:
      i. If an entity elects the transition method in (c)(1), the entity ~~should~~ shall derecognize those assets and liabilities at the later of the beginning of the earliest comparative period presented in the financial statements and the date that the lessee is determined to be the accounting owner of the asset in accordance with Topic 840.
      ii. If an entity elects the transition method in (c)(2), the entity shall derecognize those assets and liabilities at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.
      iii. Any difference ~~should~~ in (i) or (ii) shall be recorded as an adjustment to equity at ~~that~~ the date that those assets and liabilities were derecognized in accordance with (u)(1)(i) or (ii).
      iv. The lessee shall apply the lessee transition requirements in (k) through (t) to the lease.
   2. If the construction period of the build-to-suit lease concluded before the beginning of the earliest comparative period presented in the financial statements (if the entity elects the transition method in (c)(1)) or if it concluded before the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if the entity elects the transition method in (c)(2)), and the transaction qualified as a sale and leaseback transaction in accordance with Subtopic 840-40 before ~~the~~ that date ~~of initial application~~, the entity shall follow the general lessee transition requirements for the lease.

Lessors

Leases previously classified as operating leases under Topic 840

v. For each lease classified as an operating lease in accordance with this Topic, a lessor shall do all of the following:
   1. Continue to recognize the carrying amount of the underlying asset and any lease assets or liabilities at the application date as

determined in (c) ~~later of the date of initial application and the commencement date~~ as the same amounts recognized by the lessor immediately before that date in accordance with Topic 840.

2. Account for previously recognized securitized receivables as secured borrowings in accordance with other Topics.
3. If a lessor does not elect the practical expedients described in (f), write ~~Write~~ off any unamortized initial direct costs that do not meet the definition of initial direct costs in this Topic as an adjustment to equity unless the entity elects the transition method in (c)(1) and the costs were incurred after the beginning of the earliest period presented, in which case those costs shall be written off as an adjustment to earnings in the period the costs were incurred ~~(if incurred before the beginning of the earliest period presented in the financial statements) or to earnings of the comparative period presented (if incurred on or after the beginning of the earliest period presented), unless the lessor elects the practical expedients described in (f)~~.

w. For each lease classified as a direct financing or a sales-type lease in accordance with this Topic, the objective is to account for the lease, beginning on the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease~~, as if it had always been accounted for as a direct financing lease or a sales-type lease in accordance with this Topic. Consequently, a lessor shall do all of the following:
   1. Derecognize the carrying amount of the underlying asset at the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease~~.
   2. Recognize a **net investment in the lease** at the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease~~ as if the lease had been accounted for as a direct financing lease or a sales-type lease in accordance with Subtopic 842-30 since lease commencement.
   3. Record any difference between the amounts in (w)(1) and (w)(2) as ~~an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination; also see (h)(3)) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented)~~ follows:
      i. If an entity elects the transition method in (c)(1), as an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination; see

also (h)(3)) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented).

ii. If an entity elects the transition method in (c)(2), as an adjustment to equity.

4. Account for the lease in accordance with this Topic after the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease~~.

Leases previously classified as direct financing or sales-type leases under Topic 840

x. For each lease classified as a direct financing lease or a sales-type lease in accordance with this Topic, do all of the following:
   1. Continue to recognize a net investment in the lease at the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease,~~ at the carrying amount of the net investment at that date. This would include any unamortized initial direct costs capitalized as part of the lessor's net investment in the lease in accordance with Topic 840.
   2. If an entity elects the transition method in (c)(1), before ~~Before~~ the effective date, a lessor shall account for the lease in accordance with Topic 840.
   3. Regardless of the transition method selected in (c), beginning ~~Beginning~~ on the effective date, a lessor shall account for the lease in accordance with the recognition, subsequent measurement, presentation, and disclosure guidance in Subtopic 842-30.
   4. Beginning on the effective date, if a lessor modifies the lease (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8), it shall account for the modified lease in accordance with paragraph 842-10-25-16 if the lease is classified as a direct financing lease before the modification or paragraph 842-10-25-17 if the lease is classified as a sales-type lease before the modification. A lessor shall not remeasure the net investment in the lease on or after the effective date unless the lease is modified (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8).

y. For each lease classified as an operating lease in accordance with this Topic, the objective is to account for the lease, beginning on the application date as determined in (c) ~~later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease~~, as if it had always been accounted for as an operating lease in accordance with this Topic. Consequently, a lessor shall do all of the following:

1. Recognize the underlying asset at what the carrying amount would have been had the lease been classified as an operating lease under Topic 840.
2. Derecognize the carrying amount of the net investment in the lease.
3. Record any difference between the amounts in (y)(1) and (y)(2) as ~~an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented)~~ follows:
   i. If an entity elects the transition method in (c)(1), as an adjustment to equity (if the commencement date of the lease was before the beginning of the earliest period presented or if the lease was acquired as part of a business combination) or earnings (if the commencement date of the lease was on or after the beginning of the earliest period presented).
   ii. If an entity elects the transition method in (c)(2), as an adjustment to equity.
4. Subsequently account for the operating lease in accordance with this Topic and the underlying asset in accordance with other Topics.

Leases previously classified as leveraged leases under Topic 840

z. For leases that were classified as **leveraged leases** in accordance with Topic 840, and for which the commencement date is before the effective date, a lessor shall apply the requirements in Subtopic 842-50. If a leveraged lease is modified on or after the effective date, it shall be accounted for as a new lease as of the effective date of the modification in accordance with the guidance in Subtopics 842-10 and 842-30.
   1. A lessor shall apply the pending content that links to this paragraph to a leveraged lease that meets the criteria in (z) that is acquired in a business combination or an **acquisition by a not-for-profit entity** on or after the effective date.

Sale and leaseback transactions before the effective date

aa. If a previous sale and leaseback transaction was accounted for as a sale and a leaseback in accordance with Topic 840, an entity shall not reassess the transaction to determine whether the transfer of the asset would have been a sale in accordance with paragraphs 842-40-25-1 through 25-3.

bb. If a previous sale and leaseback transaction was accounted for as a failed sale and leaseback transaction in accordance with Topic 840 and remains a failed sale at the effective date: ~~date, the entity shall reassess whether a sale would have occurred at any point on or after the beginning of the earliest period presented in the financial statements in accordance~~

~~with paragraphs 842-40-25-1 through 25-3. The sale and leaseback transaction shall be accounted for on a modified retrospective basis from the date a sale is determined to have occurred.~~

1. If an entity elects the transition method in (c)(1), the entity shall reassess whether a sale would have occurred at any point on or after the beginning of the earliest period presented in the financial statements in accordance with paragraphs 842-40-25-1 through 25-3. The sale and leaseback transaction shall be accounted for on a modified retrospective basis from the date a sale is determined to have occurred.
2. If an entity elects the transition method in (c)(2), the entity shall reassess whether a sale would have occurred at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph in accordance with paragraphs 842-40-25-1 through 25-3 and recognize the sale as an adjustment to equity. The entity shall then account for the leaseback in accordance with the guidance in Subtopic 842-20 after the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph.

cc. An entity shall account for the leaseback in accordance with the lessee and lessor transition requirements in (k) through (y).

dd. If a previous sale and leaseback transaction was accounted for as a sale and capital leaseback in accordance with Topic 840, the transferor shall continue to recognize any deferred gain or loss that exists at the later of the beginning of the earliest comparative period presented in the financial statements ~~or~~ and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)) or that exists at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)), as follows:
1. If the underlying asset is land only, straight line over the remaining lease term.
2. If the underlying asset is not land only and the leaseback is a finance lease, in proportion to the amortization of the right-of-use asset.
3. If the underlying asset is not land only and the leaseback is an operating lease, in proportion to the recognition in profit or loss of the total lease cost.

ee. If a previous sale and leaseback transaction was accounted for as a sale and operating leaseback in accordance with Topic 840, the transferor shall do the following:
1. Recognize any deferred gain or loss not resulting from off-market terms (that is, where the consideration for the sale of the asset is not at **fair value** or the lease payments are not at market rates) as a cumulative-effect adjustment to equity unless the entity elects the transition method in (c)(1) and the date of sale is after the beginning of the earliest period presented, in which case any deferred gain or

loss not resulting from off-market terms shall be recognized in earnings in the period the sale occurred ~~at the later of the date of initial application (to equity) or the date of sale (to earnings of the comparative period presented)~~.

2. Recognize any deferred loss resulting from the consideration for the sale of the asset not being at fair value or the lease payments not being at market rates as an adjustment to the leaseback right-of-use asset at the later of the beginning of the earliest comparative period presented in the financial statements and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)) or at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)) ~~date of initial application~~.
3. Recognize any deferred gain resulting from the consideration for the sale of the asset not being at fair value or the lease payments not being at market rates as a financial liability at the later of the beginning of the earliest comparative period presented in the financial statements and the date of the sale of the underlying asset (if an entity elects the transition method in (c)(1)) or at the beginning of the reporting period in which the entity first applies the pending content that links to this paragraph (if an entity elects the transition method in (c)(2)) ~~date of initial application~~.

Issue 2: Separating Components of a Contract

6. The following amendments provide lessors with a practical expedient to not apply, in certain circumstances, the guidance for separating components of a contract in Topic 842.

Amendments to Subtopic 842-10

7. Amend paragraphs 842-10-15-30 through 15-31 and 842-10-15-38 and add paragraphs 842-10-15-42A through 15-42C, with a link to transition paragraph 842-10-65-2, as follows:

Leases—Overall

Scope and Scope Exceptions

> Separating Components of a Contract

842-10-15-30 The **consideration in the contract** shall be allocated to each separate lease component and nonlease component of the contract (see paragraphs 842-10-15-33 through 15-37 for lessee allocation guidance and paragraphs 842-10-15-38 through 15-42C ~~15-42~~ for lessor allocation guidance). Components of a contract include only those items or activities that transfer a good or service to the lessee. Consequently, the following are not components of a contract and do not receive an allocation of the consideration in the contract:

a. Administrative tasks to set up a contract or initiate the lease that do not transfer a good or service to the lessee
b. Reimbursement or payment of the lessor's costs. For example, a lessor may incur various costs in its role as a lessor or as owner of the underlying asset. A requirement for the lessee to pay those costs, whether directly to a third party or as a reimbursement to the lessor, does not transfer a good or service to the lessee separate from the right to use the underlying asset.

842-10-15-31 An entity shall account for each separate lease component separately from the nonlease components of the contract (that is, unless a lessee makes the accounting policy election described in paragraph 842-10-15-37 or unless a lessor makes the accounting policy election in accordance with paragraph 842-10-15-42A). Nonlease components are not within the scope of this Topic and shall be accounted for in accordance with other Topics.

> > Lessor

842-10-15-38 A **lessor** shall allocate (unless the lessor makes the accounting policy election in accordance with paragraph 842-10-15-42A) the **consideration in the contract** to the separate **lease** components and the nonlease components using the requirements in paragraphs 606-10-32-28 through 32-41. A lessor also shall allocate (unless the lessor makes the accounting policy election in accordance with paragraph 842-10-15-42A) any capitalized costs (for example, **initial direct costs** or **contract** costs capitalized in accordance with Subtopic 340-40 on other assets and deferred costs—contracts with customers) to the separate lease components or nonlease components to which those costs relate.

842-10-15-42A As a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset, choose to not separate nonlease components from lease components and, instead, to account for each separate lease component and the nonlease components associated with that lease component as a single component if the nonlease components otherwise would be accounted for under Topic 606 on revenue from contracts with customers and both of the following are met:

a. The timing and pattern of transfer for the lease component and nonlease components associated with that lease component are the same.

b. The lease component, if accounted for separately, would be classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3.

842-10-15-42B A lessor that elects the practical expedient in paragraph 842-10-15-42A shall account for the combined component:

a. As a single performance obligation entirely in accordance with Topic 606 if the nonlease component or components are the predominant component(s) of the combined component. In applying Topic 606, the entity shall do both of the following:
    1. Use the same measure of progress as used for applying paragraph 842-10-15-42A(a)
    2. Account for all variable payments related to any good or service, including the lease, that is part of the combined component in accordance with the guidance on variable consideration in Topic 606.

b. Otherwise, as an operating lease entirely in accordance with this Topic. In applying this Topic, the entity shall account for all variable payments related to any good or service that is part of the combined component as variable lease payments.

In determining whether a nonlease component or components are the predominant component(s) of a combined component, a lessor shall consider whether the lessee would be reasonably expected to ascribe more value to the nonlease component(s) than to the lease component.

842-10-15-42C A lessor that elects the practical expedient in paragraph 842-10-15-42A shall combine all nonlease components that qualify for the practical expedient with the associated lease component and shall account for the combined component in accordance with paragraph 842-10-15-42B. A lessor shall separately account for nonlease components that do not qualify for the practical expedient. Accordingly, a lessor shall apply paragraphs 842-10-15-38 through 15-42 to account for nonlease components that do not qualify for the practical expedient.

8. Amend paragraphs 842-10-55-134 and 842-10-55-145, with a link to transition paragraph 842-10-65-2, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Illustrations of Allocating Consideration to Components of a Contract

> > > Example 11—Allocation of Consideration to Lease and Nonlease Components of a Contract

> > > > Case A—Allocation of Consideration in the Contract

842-10-55-134 In accordance with paragraph 842-10-15-31, Lessee and Lessor will account for the nonlease maintenance services components separate from the three separate lease components (unless Lessee elects the practical expedient in paragraph 842-10-15-37 or Lessor elects the practical expedient in paragraph 842-10-15-42A when the conditions in that paragraph are met—see Case B [paragraphs 842-10-55-138 through 55-140] for an example in which Lessee elects the practical expedient). In accordance with the identifying performance obligations guidance in paragraphs 606-10-25-19 through 25-22, Lessor further concludes that its maintenance services for each piece of leased equipment are distinct and therefore separate performance obligations, resulting in the conclusion that there are three separate lease components and three separate nonlease components (that is, three maintenance service performance obligations).

> > > Example 12—Activities or Costs That Are Not Components of a Contract

> > > > Case C—Common Area Maintenance

842-10-55-144 Assume the same facts and circumstances as in Case B (paragraph 842-10-55-143), except that the lease is of space within the building, rather than for the entire building, and the fixed annual lease payment of $13,000 also covers Lessor's performance of common area maintenance activities (for example, cleaning of common areas, parking lot maintenance, and providing utilities to the building). Consistent with Case B, the taxes and insurance are not components of the contract. However, the common area maintenance is a component because Lessor's activities transfer services to Lessee. That is, Lessee receives a service from Lessor in the form of the common area maintenance activities it would otherwise have to undertake itself or pay another party to provide (for example, cleaning the lobby for its customers, removing snow from the parking lot for its employees and customers, and providing utilities). The common area maintenance is a single component in this contract rather than multiple components, because Lessor performs the activities as needed (for example, plows snow or undertakes minor repairs when and as necessary) over the same period of time.

842-10-55-145 Therefore, the contract in Case C includes two components—a lease component (that is, the right to use the building) and a nonlease component. The consideration in the contract of $65,000 is allocated between those 2 components (unless Lessee elects the practical expedient in paragraph 842-10-15-37 or Lessor elects the practical expedient in paragraph 842-10-15-42A when the conditions in that paragraph are met). The~~; the~~ amount allocated to the lease component is the lease payments in accounting for the lease.

Amendments to Subtopic 842-30

9. Amend paragraph 842-30-50-3 and add paragraph 842-30-50-3A, with a link to transition paragraph 842-10-65-2, as follows:

Leases—Lessor

Disclosure

842-30-50-3 A lessor shall disclose both of the following:

a. Information about the nature of its leases, including:
   1. A general description of those leases
   2. The basis and terms and conditions on which **variable lease payments** are determined
   3. The existence and terms and conditions of options to extend or terminate the lease
   4. The existence and terms and conditions of options for a **lessee** to purchase the **underlying asset.**
b. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
   1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-27)
   2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraphs 842-10-15-28 through 15-32), unless a lessor elects the practical expedient in paragraph 842-10-15-42A and all nonlease components in the contract qualify for that practical expedient
   3. The determination of the amount the lessor expects to derive from the underlying asset following the end of the **lease term**.

842-30-50-3A An entity that elects the practical expedient in paragraph 842-10-15-42A on not separating nonlease components from associated lease components (including an entity that accounts for the combined component entirely in Topic 606 on revenue from contracts with customers) shall disclose the following, by class of underlying asset:

a. Its accounting policy election and the class or classes of underlying assets for which it has elected to apply the practical expedient
b. The nature of:

1. The lease components and nonlease components combined as a result of applying the practical expedient
2. The nonlease components, if any, that are accounted for separately from the combined component because they do not qualify for the practical expedient

c. The Topic the entity applies to the combined component (this Topic or Topic 606).

10. Add paragraph 842-10-65-2 and its related heading as follows:

Leases—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2018-11, *Leases (Topic 842): Targeted Improvements*:

842-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-11, *Leases (Topic 842): Targeted Improvements*:

a. An entity that has not yet adopted the pending content that links to paragraph 842-10-65-1 shall apply the pending content that links to paragraph 842-10-65-2, by class of underlying asset, to all new and existing **leases** when the entity first applies the pending content that links to paragraph 842-10-65-1 and shall apply the same transition method elected for the pending content that links to paragraph 842-10-65-1.
b. An entity that has adopted the pending content that links to paragraph 842-10-65-1 shall apply the pending content that links to this paragraph, by class of underlying asset, to all new and existing leases either:
    1. In the first reporting period following the issuance of the pending content that links to paragraph 842-10-65-2
    2. At the original effective date of this Topic for that entity as determined in paragraph 842-10-65-1(a) and (b).
c. An entity that has adopted the pending content that links to paragraph 842-10-65-1 shall apply the pending content that links to this paragraph, by class of underlying asset, to all new and existing leases either:
    1. Retrospectively to all prior periods beginning with the fiscal years in which the pending content that links to paragraph 842-10-65-1 was initially applied
    2. Prospectively.

Amendments to Status Sections

11. Amend paragraph 842-10-00-1, by adding the following items to the table, as follows:

842-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-10-15-30	Amended	2018-11	07/30/2018
842-10-15-31	Amended	2018-11	07/30/2018
842-10-15-38	Amended	2018-11	07/30/2018
842-10-15-42A through 15-42C	Added	2018-11	07/30/2018
842-10-55-134	Amended	2018-11	07/30/2018
842-10-55-145	Amended	2018-11	07/30/2018
842-10-55-243	Amended	2018-11	07/30/2018
842-10-55-248	Amended	2018-11	07/30/2018
842-10-65-1	Amended	2018-11	07/30/2018
842-10-65-2	Added	2018-11	07/30/2018

12. Amend paragraph 842-30-00-1, by adding the following items to the table, as follows:

842-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-30-50-3	Amended	2018-11	07/30/2018
842-30-50-3A	Added	2018-11	07/30/2018

The amendments in this Update were adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Mr. Schroeder dissented.

Mr. Schroeder dissents from the issuance of the guidance in this Update. His primary concern relates to providing lessees with an additional transition alternative. An entity (lessee) that elects to apply the new lease guidance using this additional method would not recognize lease assets and liabilities on the balance sheet of any comparative period presented. Mr. Schroeder asserts that the amendments in this Update result in an entity initially providing an incomplete representation of its rights and obligations (for any comparative period presented) and users losing decision-useful information. In turn, this lack of consistency between an entity's comparative years also results in less comparability between entities in the year of adoption.

Consistency and Comparability

Investors need to understand year-over-year changes in lease-related assets and liabilities for many reasons, including to assess whether those changes are the result of shifts in an entity's leasing strategy (such as changes in duration, quality, or quantity of leased space or equipment). As stated in the basis for conclusions of Concepts Statement 8, "Relevant and faithfully represented information is most useful if it can be readily compared with similar information reported by other entities and by the same entity in other periods" (paragraph BC 3.33). However, the amendments in this Update provide an option that allows an entity to not provide comparative information.

Optionality in accounting generally should be avoided, particularly for such a significant accounting change. Mr. Schroeder observes that comparative information is becoming even more critical as investors and other users increasingly transition to consuming greater portions of financial data in digital form. This secular trend is at least partially driven by cost pressures that Mr. Schroeder believes should be factored into the Board's cost-benefit assessment.

Separating Components

The Update also provides lessors with an accounting policy election by class of underlying assets to not separate nonlease components from the related lease components. This policy election, applied by class of underlying assets, allows a lessor to account for those components as a single lease component if both (1) the *timing and pattern of transfer* for the lease component and nonlease component or components are the same and (2) the lease component, if accounted for separately, would be classified as an operating lease.

Mr. Schroeder believes that providing such a policy election fails to adequately meet the objective of improving financial reporting because it reduces the availability of certain decision-useful information. He reasons that while the "timing and pattern of transfer" may be the same, the economic value of those inflows may be significantly different.

If a practical expedient is provided, Mr. Schroeder would have preferred that the specific criterion focus on value creation and decision usefulness of the information based on investors' needs. Some commercial property lessors informed the Board that investors assess the varying streams differently. Permitting such a policy election—focusing on patterns of transfer that do not necessarily track the underlying economics—places a greater cost on investors that must either cope with less decision-useful information or persuade lessors to provide it. Both outcomes add costs to investors in different ways.

Mr. Schroeder believes that not all costs have been considered, specifically those of investors and other users. Additionally, he disagrees with preparers' assertions that the expected costs reduction from these amendments outweighs the reduction in benefits that would accrue to present and potential investors. Therefore, Mr. Schroeder would maintain both the comparative reporting and separation requirements.

Mr. Schroeder supported the issuance of Update 2016-02 because it provided a much needed increase in transparency through several key requirements, including comparative reporting and separating components. In voting with the majority, he accepted carrying over a more complex and costly two-model approach, as well as losing an opportunity to have a standard that converged with International Financial Reporting Standards (IFRS). Therefore, if the amendments in this Update are needed, Mr. Schroeder would have preferred to provide additional time so that entities could adopt a single-model approach. That accounting model would better align with the economics of leasing, would be easier for investors to understand, and would be less complex and less costly for entities to implement and maintain. This last point is particularly true for those entities that also must comply with the single-model approach required by IFRS Standards. Mr. Schroeder believes that once an entity has transitioned to IFRS 16, *Leases,* its longer-term application will be less costly (relative to Update 2016-02) because there is no need to classify leases as either operating leases or finance leases, which reduces operational complexity.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
R. Harold Schroeder
Marc A. Siegel

Background Information and Basis for Conclusions

Introduction and Background

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The amendments in Update 2016-02 were issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. Since the issuance of the amendments in February 2016, the FASB has been educating and assisting stakeholders with implementation questions and issues as organizations prepare to adopt the new leases standard.

BC3. In recent months, some stakeholders inquired about the following two requirements in the new leases standard:

a. Comparative reporting for initial adoption (transition—comparative reporting at adoption)
b. For lessors only, separating lease and nonlease components in a contract and allocating the consideration in the contract to the separate components (separating components of a contract).

BC4. A discussion of these issues and the basis for conclusions reached by the Board for addressing those issues are provided below.

Benefits and Costs

BC5. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements. Overall, the Board concluded that the amendments in this Update simplify the implementation, or continued application, of Topic 842. Therefore, the expected reduction in costs to many stakeholders justify the reduction in the expected benefits that will accrue to present and potential investors, creditors, donors, and other users.

Basis for Conclusions

Transition—Comparative Reporting at Adoption

BC6. In accordance with the transition requirements in the new leases standard, an entity must recognize and measure leases within its scope that exist at the date of initial application, which is the later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease. An entity also must adjust equity at the beginning of the earliest period presented, and other comparative amounts disclosed for each prior period presented in the financial statements, as if the new leases standard had always been applied, subject to specific other transition requirements (such as the use of *minimum rental payments* as applied in current GAAP in measuring operating leases, rather than the use of *lease payments* as defined in the new leases standard) and optional practical expedients. This transition method reflects the primary improvement of the new leases standard as compared with prior GAAP—the recognition by lessees of lease assets and lease liabilities on the balance sheet for all leases, and the provision of enhanced disclosures about an entity's leasing activities, for each period presented in the financial statements in which an entity adopts the new standard (which includes the comparative periods). The Board decided on this method on the basis of preparers' feedback that this transition would not require significant new systems and, thus, would not be overly costly or complex to implement.

BC7. However, as preparers have started to implement the new leases standard, many have encountered unanticipated costs and complexities associated with this modified retrospective transition method, particularly with respect to its transition requirements for the comparative periods, including disclosures. Many preparers cited their plan to implement new systems to effectively adopt Topic 842, whereas previously this was not anticipated. As a result, preparers requested that the Board provide an additional (and optional) transition method. This transition method would allow an entity to initially apply the new leases standard to all leases that exist at the adoption date, with the cumulative effect of initially applying the new leases standard recognized as an adjustment to retained earnings as of the adoption date. For example, for calendar-year-end public business entities that adopt the new leases standard on January 1, 2019, the date of initial application would be January 1, 2019, rather than the later of January 1, 2017 (the beginning of the earliest period presented) and the lease commencement date. Under this transition method, an entity's reporting for the comparative periods presented would continue to be in accordance with current GAAP (Topic 840), including disclosures. Preparers said that this would significantly reduce the costs and complexities associated with initially applying the new leases standard.

BC8. At its November 29, 2017 meeting, the Board deliberated this request. The Board discussed concerns raised about users losing trend information because the requirement to apply the new leases standard to the comparative periods would not apply. Specifically, in the financial statements in which an entity adopts the new leases standard, an entity (lessee) that elects to apply the new guidance using the additional (and optional) transition method will not recognize lease assets and liabilities on the balance sheet of the comparative period presented, which may result in the loss of important information to users (such as leverage trends). That entity also will not provide the required and enhanced disclosures for the comparative periods, which also may result in users losing information (such as changes in strategies with respect to leasing transactions).

BC9. However, the Board observed that information about the comparative periods will be available considering the disclosures required under current GAAP, including the operating lease obligations disclosure, such that information about the comparative period will not be completely removed. The Board further noted that while the disclosure about operating leases under current GAAP provides the information on an undiscounted basis, users still have some insight into an entity's cash flows and obligations related to its leases in the comparative periods. One Board member emphasized that users have difficulty performing a constructive capitalization of an entity's leases based on that disclosure without disclosures about the weighted-average discount rate and weighted-average life of the entity's operating leases, which are not required under current GAAP.

BC10. The Board also discussed concerns raised about the decrease in consistency in how entities initially apply the new leases standard because of the additional optionality that this transition method introduces. Limiting optionality in transition was one of the Board's overarching goals in setting the transition requirements in Update 2016-02. However, the Board noted that while the transition method creates optionality about *when* entities initially apply the new leases standard, it does not change *how* entities must apply the transition requirements. That is, all entities apply the same guidance on how to initially recognize and measure existing leases in transition regardless of the transition method elected.

BC11. On balance, the Board decided to provide an additional (and optional) transition method consistent with that requested and proposed by preparers. In making this decision, the Board considered that the information provided on the balance sheet for leases will be delayed by only one year (and the prior-period disclosures will still be available, as previously explained) and that this transition method still achieves the primary objective of having leases recognized on the balance sheet at the effective date.

BC12. The Board decided to provide transition relief to allow entities to focus on applying the new leases standard on and after the effective date and reduce costs associated with applying the new leases standard to leases existing before the effective date (some of which may have expired by that date). In addition, the

Board concluded that the reduction of costs afforded by this transition relief justifies the potential loss of benefits to users, while still achieving the overall objective of the new standard of having leases recognized on the balance sheet. The Board noted that because this additional transition method is optional, entities that have early adopted the new leases standard will not be penalized.

BC13. On January 5, 2018, the Board issued proposed Accounting Standards Update, *Leases (Topic 842): Targeted Improvements*, for public comment, with a comment period that ended on February 5, 2018. Along with the amendments on transition method, the proposed Update included amendments on separating components of a contract specific to lessors, which is discussed in a separate section below. Forty-seven respondents to the proposed Update commented on the additional (and optional) transition method. All of those respondents unconditionally supported the additional (and optional) transition as proposed.

BC14. At its March 7, 2018 meeting, the Board considered the feedback received on the additional (and optional) transition method in the proposed Update and decided to proceed with this transition method in this Update. The Board also decided to clarify in paragraph 842-10-65-1(jj) that if an entity elects this new transition method, it must provide the required Topic 840 disclosures for all periods that continue to be reported in accordance with Topic 840 (in doing so, the balance sheet that continues to be reported under Topic 840 should be considered the latest balance sheet presented for purposes of applying the Topic 840 disclosure requirements). The amendments in this Update do not change the existing disclosure requirements in Topic 840 (for example, they do not create interim disclosure requirements that entities previously were not required to provide).

Separating Components of a Contract

BC15. The new leases standard requires that entities (lessors and lessees) separate lease components from nonlease components in a contract. Components of a contract include only those items or activities that transfer a good or a service to a lessee. Examples of nonlease components include equipment maintenance services, common area maintenance services in real estate, and other activities that transfer a good or service to the lessee other than the right to use the underlying asset. Lease components must be accounted for in accordance with the new leases standard, while nonlease components must be accounted for in accordance with other Topics (such as the new revenue guidance for lessors). The consideration in the contract is allocated to the lease and nonlease components on a relative standalone price basis (for lessees) or in accordance with the allocation guidance in the new revenue guidance (for lessors).

BC16. Lessees may elect, as an accounting policy election by class of underlying asset, to not separate nonlease components from the lease components to which they are associated. Lessors were not afforded a similar practical expedient.

BC17. During the development of the new leases standard, the Board decided that in any contract that contains lease and nonlease components, the lessor effectively is both leasing an asset (the lease component) and selling a service (the nonlease component). Accordingly, accounting for the lease components in accordance with the new leases standard and the nonlease components in accordance with, typically, the new revenue guidance was consistent with the corresponding guidance on scope included in that revenue guidance. The Board rationalized that a nonlease component should not be subject to different accounting requirements solely because it is included in a contract that contains a lease. The Board also decided to require lessors to allocate the consideration in the contract to lease and nonlease components in accordance with the new revenue guidance because that resulted in consistent accounting for entities that are both a lessor and a seller of goods or services in the same contract. The Board's view was that leasing transactions are fundamentally a revenue-generating activity in which the item the lessor transfers to the customer is the right to use the underlying asset. Therefore, the Board considered it appropriate for a lessor to allocate consideration to the lease and the nonlease components in the same manner that a seller allocates the transaction price (and changes thereof) to performance obligations in a revenue contract.

BC18. Since the issuance of the new leases standard, some stakeholders requested that the Board permit lessors to not separate nonlease components from the associated lease component, consistent with the practical expedient afforded to lessees. Those stakeholders emphasized that separating nonlease components (such as common area maintenance) from the associated lease component would have little, if any, meaningful accounting effect, except for presentation and disclosure, if the timing and pattern of revenue recognition for the lease and nonlease components are the same. Those stakeholders also asserted that any allocation method they would use to separate the components would be judgmental in nature (for example, because of the lack of observable standalone selling prices for each of the components in the contract) and that separating lease and nonlease components does not align with, or accurately reflect, the economics of how their transactions are negotiated or evaluated by users of their financial statements.

BC19. Those stakeholders also requested that if the Board decided not to provide a practical expedient similar to that afforded to lessees, the Board should reconsider the allocation requirements related to their contracts. They cited difficulties in establishing a standalone selling price to allocate the consideration in the contract to the lease and nonlease components on a relative basis. Specifically, because they do not typically lease assets or provide services separately, they asserted that they are unable to identify an observable price for either of the components. Consequently, these stakeholders would be required to estimate the standalone selling price for each component using a suitable estimation approach in accordance with the new revenue guidance. However, those stakeholders expressed that they are unable to find a suitable method to estimate the standalone selling price of the components, particularly the lease component, without amendments to the allocation guidance in the new revenue guidance.

BC20. At its November 29, 2017 meeting, the Board decided to provide lessors with a practical expedient to not separate nonlease components from the associated lease component if certain criteria are met. The practical expedient proposed was as follows:

> **842-10-15-42A** As a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset, choose to not separate nonlease components from lease components and, instead, to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:
>
> a. The timing and pattern of revenue recognition for the lease component and nonlease components associated with that lease component are the same. [Criterion A]
> b. The combined single lease component is classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3. [Criterion B]

BC21. In providing this practical expedient, the Board considered that under the new revenue guidance, an entity is not precluded from accounting for distinct goods or services as if they were a single performance obligation if the accounting outcome is the same as accounting for the goods and services as individual performance obligations. Similarly, under the new leases standard, an entity is not precluded from accounting for multiple lease components as a single lease component if the outcome from doing so would be the same as accounting for the lease components separately. Therefore, the Board concluded that a lessor should not be precluded from combining a lease component and a nonlease component solely because one component is within the scope of the new leases standard and the other component is within the scope of the new revenue guidance. The Board decided that lessors should not be precluded from combining lease and nonlease components when the timing and pattern of revenue recognition are the same. In other words, if the only difference between accounting for a lease and the associated nonlease components separately is presentation and disclosure, then the timing and pattern of revenue recognition are considered the same. To remain true to its objective to further align lessor guidance with the new revenue guidance, the Board intended to limit the practical expedient to arrangements for which the nonlease components otherwise would be accounted for under only Topic 606 (and not other Topics).

BC22. At its November 29, 2017 meeting, the Board also acknowledged the application issues that some lessor stakeholders expressed about the allocation of the consideration in the contract between lease and nonlease components for their specific fact patterns, particularly when there is no observable standalone selling price for at least one of the components. However, the Board noted that the consistency of having lessors comply with the allocation objective and allocation requirements in the new revenue guidance was heavily deliberated when developing the new leases standard. Furthermore, they noted that leasing is a revenue-generating activity and that the allocation requirements should not differ just because the contract is a contract that contains a lease (as opposed to another service contract). Moreover, the Board highlighted that stakeholders from all industries have been applying the allocation guidance in the new revenue guidance, including the estimation techniques, as preparers have been preparing to adopt that revenue guidance. Consequently, the Board concluded that lessors that do not elect or qualify for the practical expedient should apply the allocation guidance in the new revenue guidance and comply with the allocation objective in that standard without additional clarifications of, or amendments to, the new revenue guidance or new leases standard.

BC23. The proposed practical expedient was issued as part of the January 5, 2018 proposed Update. Forty-five respondents commented on the practical expedient. Overall, respondents supported providing lessors with a practical expedient to not separate nonlease components from the associated lease component if certain criteria are met. However, some respondents raised various concerns, including the following:

a. The criteria (Criterion A and Criterion B) for qualifying for the expedient were unnecessarily restrictive and would have resulted in certain arrangements not qualifying for the expedient that many respondents thought the Board intended to include.
b. The requirement to account for the combined lease component in accordance with the new leases standard, regardless of the magnitude of the nonlease component or components that are combined with the associated lease component, would not always result in decision-useful information.
c. Additional guidance would be needed to apply the expedient consistently, such as in situations in which there are multiple nonlease components and some of these components do not qualify for combination with the associated lease component.

BC24. At its March 28, 2018 meeting, the Board considered the feedback received from respondents and decided to make the changes to the practical expedient as follows (the concerns expressed by respondents also are explained in more detail below).

Criterion A

BC25. To qualify for the practical expedient, Criterion A would have required that the timing and pattern of *revenue recognition* for the lease component and nonlease component(s) associated with that lease component be the same. The Board required this based on certain stakeholders' feedback that a practical expedient was warranted when the only differences in accounting for the lease component (under the new leases standard) and the nonlease component(s) (under revenue guidance) separately were presentation and disclosure. In other words, the accounting outcome would not have changed, regardless of whether the components were separated or not. However, many respondents highlighted that by requiring the timing and pattern of *revenue recognition* of the components to be the same, certain contracts with variable consideration may be ineligible for the practical expedient considering the differences in requirements on variable payments that exist between the new leases standard and the revenue guidance. Respondents had different interpretations of the term *pattern of revenue recognition* with some focusing on the accounting method (straight-line versus variable) while others focused on the overall effect on the income statement. But in either interpretation, some arrangements that the practical expedient was intended to address may not have qualified for the expedient. For example, "net lease" structures with variable consideration that relates specifically to the nonlease component (as is the case for common area maintenance services for which the lessee reimburses the lessor for actual costs incurred) could have a timing and pattern of *revenue recognition* that differs under the revenue guidance from that which would result from applying the new leases standard. Many of the respondents who commented on Criterion A suggested that the Board amend that criterion to require that the timing and pattern of *transfer* (rather than *revenue recognition*) be the same, primarily to address those concerns about arrangements with variable consideration.

BC26. The Board agreed with the concerns that Criterion A, as proposed, would have limited the application of the practical expedient to situations in which the results of applying the variable payment guidance in both the new leases standard and the new revenue guidance are the same (gross leases and some, but not all, net leases). The Board also acknowledged that it did not intend to exclude arrangements from qualifying for the practical expedient solely because of differences in accounting for variable consideration between the Topics on leases and revenue. Finally, the Board expects that changing Criterion A from "timing and pattern of *revenue recognition*" to "timing and pattern of *transfer*" would likely still result in an accounting outcome that is predominantly a presentation and disclosure issue for most arrangements.

BC27. Accordingly, the Board decided to change Criterion A from "timing and pattern of *revenue recognition*" to "timing and pattern of *transfer.*" The Board noted that this change provides the following benefits:

a. It addresses the initial population of transactions that the Board intended to address with the expedient.
b. It simplifies the application of Criterion A because the evaluation focuses on the components themselves, that is, whether the timing and pattern of transfer is time based and over time (a straight-line pattern of transfer of the lease and nonlease components to the customer over the same time period). Consideration of the payment structure would not be as important because the amounts recognized would not have to be exactly the same to qualify.
c. It results in a more consistent application of Criterion A because the guidance that an entity will apply is consistent with the new revenue guidance on series (see paragraph 606-10-25-15).

Criterion B

BC28. Criterion B in the proposed Update would have required that the *combined* single lease component be classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3. When performing the present value lease classification tests (specifically paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1)) to the *combined* component under Criterion B in the proposed Update, lease payments in the numerator would have included those payments in the consideration in the contract related to the nonlease components that are combined with the lease component (because those would now be considered lease payments). However, the fair value of the associated nonlease components would not have been included in the denominator of the present value test because the new leases standard is explicit that the denominator is the fair value of the *underlying asset*, which is a defined term in the new leases standard (it does not consider any associated services provided in the lease contract). Accordingly, the more significant the nonlease component(s), the more likely that the *combined* component would have been classified as a sales-type lease or a direct financing lease by a lessor, therefore preventing the lessor from qualifying for the practical expedient.

BC29. Consistent with this, many respondents expressed concerns that Criterion B in the proposed Update would have resulted in lessors with “small lease–big nonlease” arrangements not being able to elect the practical expedient. These respondents were concerned that relief would have not been provided for lessors with minor lease components even though, if the lease and nonlease components were accounted for separately, they would have had the same timing and pattern of transfer to the lessee. Some other respondents questioned why the practical expedient was limited to operating leases. These respondents suggested either amending Criterion B to require that lease classification simply not change upon combination of the components or removing Criterion B in its entirety.

BC30. The Board agreed that Criterion B in the proposed Update was unnecessarily restrictive and would have resulted in many “small lease–big nonlease” arrangements not being afforded the practical expedient solely because of the size of the nonlease component(s), even when the timing and pattern of transfer of the individual components would have been the same. Accordingly, the Board decided to amend Criterion B to require that the lease component (not the *combined* component), if accounted for separately, be classified as an operating lease. The Board concluded that this change continues to capture arrangements that the Board contemplated for this practical expedient, that is, those that include only components for which the timing and pattern of transfer is over time and time based (not a point in time). The Board also reasoned that the timing and pattern of transfer for the lease component if this component is an operating lease will often be consistent with the services (the nonlease components) associated with the lease component that it was trying to address in the proposed Update. The Board emphasized that determining whether the lease component (if accounted for separately) would be classified as an operating lease generally should not require a detailed quantitative analysis but, rather, can often be determined using a reasonable qualitative assessment.

BC31. The Board noted that its objective in providing the practical expedient was to align the accounting by lessors under the new leases standard more closely with the revenue guidance. To remain true to this objective, the Board decided not to extend the practical expedient to other arrangements in which the lease component, if accounted for separately, would be classified as a sales-type lease (underlying asset transferred at a point in time) or to other arrangements for which the combined component would have included nonlease component(s) within the scope of a Topic other than Topic 606 (such as Topic 310, Receivables).

Determining What Accounting Guidance to Apply for the Combined Component

BC32. The practical expedient in the proposed Update would have required that all arrangements qualifying for the expedient be combined and accounted for as a single *lease* component under the new leases standard, regardless of the magnitude of the nonlease component(s). Many respondents disagreed with this requirement. Broadly, these respondents expressed that "forcing" entities to account for the combined component as a lease component if the nonlease component or components are of a certain magnitude could result in less relevant and less decision-useful information for investors. Most of these respondents requested that the Board allow entities to account for combined components under the new revenue guidance (rather than the new leases standard) when the nonlease component is the *predominant* component of the combined component. They noted that the term *predominance* is not a new concept because the revenue guidance in paragraph 606-10-55-65A related to the sales-based and usage-based royalties exception for licenses of intellectual property already utilizes this concept of *predominance*. That guidance notes that ". . . 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"* (emphasis added). These respondents noted that *predominance* also is used in the new leases standard, specifically paragraph 842-10-25-5 pertaining to lease classification of a single lease component that contains the right to use more than one underlying asset. That paragraph states that ". . . an entity shall consider the remaining economic life of the *predominant* asset in the lease component for purposes of applying the criterion in paragraph 842-10-25-2(c)" (emphasis added). The application of paragraph 842-10-25-5 also is illustrated in Example 13 of Subtopic 842-10 and specifically paragraph 842-10-55-149.

BC33. The Board agreed with respondents' concerns and decided that if the nonlease component or components associated with the lease component are the *predominant* component(s) of the combined component, a lessor should account for the combined component as a single performance obligation in accordance with the new revenue guidance. Otherwise, the lessor should account for the combined component as an operating lease in accordance with the new leases standard.

BC34. The Board decided that if an entity applies the new leases standard to the combined component in accordance with paragraph 842-10-15-42B, the combined component should be accounted for as an operating lease to preserve the timing and pattern of transfer of the components on an individual basis if accounted for separately (which is over time and time based). For the same reason, if an entity applies Topic 606 entirely to the combined component in accordance with paragraph 842-10-15-42B, the measure of progress toward complete satisfaction of the combined component used to recognize revenue should be consistent with that method identified for the lease and nonlease components when assessing the criterion in paragraph 842-10-15-42A(a). The Board also reasoned that because the practical expedient is limited to operating leases, the lessor would have recognized the underlying asset on its books if the lease had been accounted for separately. Similarly, if the lessor had accounted for the nonlease component(s) separately, it would have recognized the assets used to fulfill the services on its books. Therefore, combining the nonlease component(s) with the associated lease component will not change the recognition of assets by a lessor. Accordingly, the Board concluded that allowing lessors to account for combined components either under Topic 842 or Topic 606 was more appropriate than solely under Topic 842 in all situations considering that the balance sheet and revenue profiles of the individual components are preserved when combined. Moreover, the Board acknowledged that both the new leases standard and the new revenue guidance were subject to extensive and recent due process and are robust accounting models.

BC35. The Board also acknowledged that although the guidance for lessors in the new leases standard was largely derived from the new revenue guidance (such as the guidance on separation and allocation, collectibility, modifications, and so forth), it is not completely aligned. Notwithstanding, the Board was comfortable with allowing stakeholders discretion for determining whether the nonlease component is the *predominant* component of the combined component. The Board concluded that an entity should be able to reasonably determine which Topic to apply (based on predominance) without having to perform a detailed quantitative analysis or theoretical allocation to each component.

BC36. On the basis of outreach performed, the Board concluded that a significant number of arrangements that will qualify for the practical expedient are already being combined under existing leases guidance and, therefore, are accounted for in their entirety under either the legacy leases guidance or the legacy (or new) revenue guidance. Consequently, the Board expects that electing this expedient and the guidance on which Topic to apply to the combined component should result in investors being provided with information that is consistent with what they currently receive in most cases. However, because some entities may under current GAAP account for revenue from leases separately from other revenue, the Board decided to require lessors electing the practical expedient to apply the expedient, by class of underlying asset, to all existing leases to maintain the consistency of information provided to users. The Board also decided to require entities electing the practical expedient to provide specific disclosures (see paragraph 842-30-50-3A).

Applying the Practical Expedient for Arrangements with Multiple Nonlease Components

BC37. In providing the practical expedient in the proposed Update, the Board intended for a lessor electing the practical expedient to combine nonlease components with the associated lease component to do so for all nonlease components in the arrangement that qualify for the expedient (those that are associated with the lease component and that meet the criteria to be combined). The Board did not intend to exclude from the practical expedient arrangements that include multiple nonlease components, some of which meet the criteria to be combined and some others that do not. In those instances, the Board expected that a lessor would combine all nonlease components that qualify for the expedient with the associated lease component and account for them as a single component, while separately accounting for the nonlease component or components that do not qualify. In doing so, the lessor would be required to apply the separation and allocation guidance in the new leases standard to the separate components (that is, allocate the consideration in the contract to the combined component and the nonlease components that do not qualify). However, the Board did not provide comprehensive guidance in the proposed Update on those aspects of applying the practical expedient.

BC38. Because several respondents requested that the Board clarify whether the presence of a nonlease component that is ineligible for the expedient precludes a lessor from electing the practical expedient for the lease component and the nonlease component or components that meet the criteria to be combined, the Board decided to provide explicit guidance in paragraph 842-10-15-42C, consistent with its intent described in paragraph BC37.

BC39. Specifically, a lessor that elects the practical expedient in paragraph 842-10-25-42A must combine all nonlease components that qualify for the practical expedient with the associated lease component and must account for the combined component in accordance with paragraph 842-10-15-42B. Nonlease components that do not qualify for the practical expedient must be accounted for separately under other accounting guidance (not the new leases standard). To account for the components separately, the lessor must allocate the consideration in the contract to the combined component and the nonlease component or components that do not qualify for the practical expedient in accordance with paragraph 842-10-15-38.

Effective Date and Transition

BC40. The amendments in this Update related to separating components of a contract affect the amendments in Update 2016-02, which are not yet effective but can be early adopted. The effective date and transition requirements for the amendments in this Update related to separating components of a contract are the same as the effective date and transition requirements in Update 2016-02, except for an entity that has already adopted Update 2016-02. An entity that has adopted Update 2016-02 before the issuance of this Update can apply the amendments in this Update related to separating components of a contract either in the first reporting period following the issuance of this Update or at the original effective date of Topic 842 for that entity. In addition, the entity may apply the practical expedient either retrospectively or prospectively. All entities applying the amendments in this Update related to separating components of a contract also must apply the practical expedient, by class of underlying asset, to all leases existing at the date that the expedient is elected.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those improvements, which will be incorporated into the proposed 2019 Taxonomy, are available through Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.