FASB Exposure Draft

Proposed Accounting Standards Update

Issued: August 13, 2018
Comments Due: September 12, 2018

Leases (Topic 842)

Narrow-Scope Improvements for Lessors

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 842 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-260, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until September 12, 2018. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2018-260
- Sending a letter to "Technical Director, File Reference No. 2018-260, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

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. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Narrow-Scope Improvements for Lessors

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed 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 lease requirements.

Since the issuance of Update 2016-02, lessor stakeholders have informed the Board about certain issues that they are experiencing on the following when applying Topic 842:

1. Sales taxes and other similar taxes collected from lessees
2. Certain lessor costs paid directly by lessees
3. Recognition of variable payments for contracts with lease and nonlease components.

Sales Taxes and Other Similar Taxes Collected from Lessees

The guidance in Topic 842 requires lessors to analyze sales taxes and other similar taxes on a jurisdiction-by-jurisdiction basis to determine whether those taxes are the primary obligation of the lessor as owner of the underlying asset being leased or whether those taxes are collected by the lessor on behalf of third parties. When a sales (or other similar) tax is collected from a lessee on behalf of third parties (that is, the lessor is acting as an agent), a lessor would exclude that amount from (lease) revenue. When the lessor is primarily obligated for payment of the tax, the lessor would include that amount in (lease) revenue and costs.

Lessor stakeholders observed that evaluating whether sales taxes and other similar taxes are collected on behalf of third parties would be costly and complex because of the number of jurisdictions and the variation of, and changes in, tax laws among those jurisdictions. Those lessor stakeholders also observed that users of financial statements would be provided with limited financial reporting benefits because the net effect of recording those taxes would be zero in the income statement. They also noted that the Board provided stakeholders with relief for a similar requirement in the new revenue guidance in the amendments in Accounting Standards Update No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients,* whereby an entity can make an accounting policy election to exclude amounts collected from customers for all sales (and other similar) taxes from the transaction price.

The amendments in this proposed Update would provide an accounting policy election for lessors similar to that provided in Update 2016-12.

Certain Lessor Costs Paid Directly by Lessees

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 on behalf of the lessor or as a reimbursement to the lessor, does not transfer a good or service to the lessee separately from the right to use the underlying asset. The new leases guidance requires a lessor to report those amounts as revenue and expenses.

Lessor stakeholders observed that reporting lessor costs paid by lessees directly to third parties on behalf of the lessor would be costly and complex, and, perhaps, not possible, in some situations. For example, determining the amount of revenue could be affected by numerous factors, some of which are lessee-specific and unknown to the lessor. Lessor stakeholders also contended that recording these amounts would provide users of financial statements with limited financial reporting benefits for several reasons. First, because the amounts reported would be based on estimates that are affected by lessee-specific factors and unknown to the lessor, the estimated amounts may not be readily determinable and, therefore, not reliable. Consequently, reporting these amounts may not provide users of financial statements with meaningful financial information. Second, because the amounts would be reported as both revenue and expenses by the lessor for the same amount, the net effect would be zero in the income statement. Those lessor stakeholders also noted that similar application relief was discussed by the Board during deliberations of Accounting Standards Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* for variable payments when an entity is considered a principal but the uncertainty upon which the variable payments are based is not expected to ultimately be resolved.

The amendments in this proposed Update would address stakeholders' concerns about the operability challenges encountered in determining certain lessor costs paid by lessees directly to third parties on behalf of the lessor by requiring lessors to not report those amounts when certain conditions are met.

Recognition of Variable Payments for Contracts with Lease and Nonlease Components

The guidance in paragraph 842-10-15-40 requires lessors to recognize certain variable payment amounts in profit or loss in the period when the changes in facts and circumstances on which the variable payment is based occur, regardless of whether the payment partially relates to nonlease components.

Some stakeholders observed that this guidance might result in a lessor recognizing revenue for a nonlease component in a period in advance of the period in which the nonlease component is transferred to the customer under another Topic, such as Topic 606. Therefore, those stakeholders requested amendments (or clarification) surrounding that paragraph's intent.

The amendments in this proposed Update would clarify the accounting by lessors for variable payments that relate to both a lease component and a nonlease component.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update related to sales taxes and other similar taxes collected from lessees would affect all lessors that elect the accounting policy election.

The amendments in this proposed Update related to certain lessor costs paid directly by lessees on behalf of the lessor would affect all lessor entities that have lease contracts that require lessees to pay certain costs on behalf of a lessor.

The amendments in this proposed Update related to recognition of variable payments for contracts with lease and nonlease components would affect all lessor entities with variable payments that partially relate to a nonlease component.

What Are the Main Provisions?

Sales Taxes and Other Similar Taxes Collected from Lessees

The amendments in this proposed Update would permit lessors, as an accounting policy election, to not evaluate whether certain sales taxes and other similar taxes are costs of the lessor (as described in paragraph 842-10-15-30(b)) or costs of the lessee. Instead, lessors would account for those amounts as if they were costs of the lessee. Consequently, a lessor making this election would exclude from the consideration in the contract and from variable payments not included in the consideration in the contract all collections from lessees of taxes within the scope of the election and would provide certain disclosures.

Certain Lessor Costs Paid Directly by Lessees

The amendments in this proposed Update related to certain lessor costs paid directly by lessees to third parties on behalf of the lessor would require lessors to exclude those costs from variable payments, and, therefore, from variable (lease) revenue, when the amount of those costs is not readily determinable by the lessor.

Recognition of Variable Payments for Contracts with Lease and Nonlease Components

The amendments in this proposed Update related to recognizing variable payments for contracts with lease and nonlease components would require lessors to *allocate* (rather than *recognize* as currently required) certain variable payments to the lease and nonlease components when the changes in facts and circumstances on which the variable payment is based occur. After the allocation, the amount of variable payments allocated to the lease component would be recognized as income in profit or loss in accordance with Topic 842, while the amount of variable payments allocated to nonlease components would be recognized in accordance with other Topics, such as Topic 606.

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

The amendments in this proposed Update would amend Update 2016-02, which are not yet effective but can be early adopted. The effective date and transition requirements for the amendments in this proposed Update for entities that have not adopted Update 2016-02 by the time this proposed Update is finalized would be the same as the effective date and transition requirements in Update 2016-02. The Board will determine the effective date and transition of this proposed Update for entities that have adopted Update 2016-02 before the issuance of this proposed Update after it considers stakeholders' feedback on this proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Sales Taxes and Other Similar Taxes Collected from Lessees

Question 1: Should a lessor's accounting for sales taxes and other similar taxes collected from lessees be aligned with Topic 606? If not, please explain why.

Question 2: Is the proposed accounting policy election, as written in this proposed Update, operable? If not, please explain why.

Question 3: Would the proposed accounting policy election result in a reduction of decision-useful information to users of a lessor's financial statements? If so, please explain why.

Question 4: Should a lessor's accounting policy election for sales taxes and other similar taxes collected from lessees be applied to new lease contracts only or to all existing and new lease contracts? Please explain your rationale.

Certain Lessor Costs Paid Directly by Lessees

Question 5: Should a lessor be required to exclude certain lessor costs paid directly by lessees to third parties on behalf of a lessor as variable payments when the uncertainty in the amount is not expected to ultimately be resolved? If not, please explain why.

Question 6: Are the proposed amendments for the accounting for certain lessor costs operable? If not, please explain why.

Question 7: Would the proposed requirement for a lessor to not report certain lessor costs paid directly by a lessee to a third party on behalf of the lessor result in a reduction of decision-useful information to users of a lessor's financial statements? If so, please explain why.

Question 8: Should the proposed amendment in paragraph 842-10-15-40A to exclude certain lessor costs paid directly by lessees on behalf of a lessor as variable payments be applied to new lease contracts only or to all existing and new lease contracts? Please explain your rationale.

Recognition of Variable Payments for Contracts with Lease and Nonlease Components

Question 9: Would the proposed amendments clarify the application of paragraph 842-10-15-40? If not, please explain why.

Question 10: Are the proposed amendments for the accounting for certain variable payments for contracts with lease and nonlease components operable? If not, please explain why.

Transition and Effective Date for Early Adopters

Question 11: How much time would be needed to implement the amendments in this proposed Update for an entity that early adopts Update 2016-02 before these proposed amendments are finalized? What transition method and transition disclosures should those entities be required to apply (provide)? Please explain your reasoning.

Question 12: Should the effective date for the amendments in this proposed Update be aligned with that of Update 2016-02? If not, please explain why.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification. The amendments are organized by area.

Area	**Paragraphs**
Issue 1: Sales Taxes and Other Similar Taxes Collected from Lessees	3 and 4
Issue 2: Certain Lessor Costs Paid Directly by Lessees	5 and 6
Issue 3: Recognition of Variable Payments for Contracts with Lease and Nonlease Components	7

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–7. 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 <u>underlined</u>, and deleted text is ~~struck out~~.

Issue 1: Sales Taxes and Other Similar Taxes Collected from Lessees

3. Add paragraph 842-10-15-39A, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Scope and Scope Exceptions

> Separating Components of a Contract

> > Lessor

842-10-15-39A A lessor may make an accounting policy election to exclude from the consideration in the contract and from variable payments not included in the consideration in the contract all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific lease revenue-producing transaction and collected by the lessor from a lessee (for example, sales, use, value added, and some excise taxes). Taxes assessed on a lessor's total gross receipts or on the lessor as owner of the underlying asset shall be excluded from the scope of this election. A lessor that makes this election shall exclude from the consideration in the contract and from variable payments not included in the consideration in the contract all taxes within the scope of the election and shall comply with the disclosure requirements in paragraph 842-30-50-14.

4. Add paragraph 842-30-50-14 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Lessor

Disclosure

> Separating Components of a Contract

842-30-50-14 A lessor that makes the accounting policy election in paragraph 842-10-15-39A to exclude from the consideration in the contract and from variable payments not included in the consideration in the contract all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific lease revenue-producing transaction and collected by the lessor from a lessee shall disclose its accounting policy election and comply with the disclosure requirements in paragraphs 235-10-50-1 through 50-6.

Issue 2: Certain Lessor Costs Paid Directly by Lessees

5. Add paragraph 842-10-15-40A, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Scope and Scope Exceptions

> Separating Components of a Contract

> > Lessor

<u>**842-10-15-40A** The guidance in paragraph 842-10-15-40 notwithstanding, a lessor shall exclude from variable payments lessor costs paid by a lessee directly to a third party when the amount of lessor costs paid by the lessee is not readily determinable by the lessor.</u>

6. Amend paragraphs 842-10-55-141 through 55-142, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Illustration of Allocating Consideration to Components of a Contract

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

> > > > Case A—Payments for Taxes and Insurance Are Variable

842-10-55-141 Lessor and Lessee enter into a five-year lease of a building. The contract designates that Lessee is required to pay for the costs relating to the asset, including the real estate taxes and the insurance on the building. The real estate taxes would be owed by Lessor regardless of whether it leased the building and who the lessee is. Lessor is the named insured on the building insurance policy (that is, the insurance protects Lessor's investment in the building, and Lessor will receive the proceeds from any claim). The annual lease payments are fixed at $10,000 per year, while the annual real estate taxes and insurance premium will vary and be billed <u>by Lessor</u> to Lessee each year.

842-10-55-142 The real estate taxes and the building insurance are not components of the contract. The contract includes a single lease component—the right to use the building. Lessee's payments of those amounts solely represent a reimbursement of Lessor's costs and do not represent payments for goods or services in addition to the right to use the building. However, because the real estate taxes and insurance premiums during the lease term are variable, those payments are variable lease payments that do not depend on an index or a rate and are excluded from the measurement of the lease liability and recognized by Lessee in profit or loss in accordance with paragraph 842-20-25-5 or 842-20-25-6. Lessor also recognizes those payments as variable lease payments in accordance with paragraph 842-10-15-40 because paragraph 842-10-15-40A does not apply in this Example. In other words, because the amounts are initially paid by the lessor and not the lessee, the amounts are readily determinable by the lessor.

Issue 3: Recognition of Variable Payments for Contracts with Lease and Nonlease Components

7. Amend paragraph 842-10-15-40, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Scope and Scope Exceptions

> Separating Components of a Contract

> > Lessor

842-10-15-40 If the terms of a variable payment amount other than those in paragraph 842-10-15-35 relate to a lease component, even partially, the lessor shall not recognize the lease and nonlease components related to those payments ~~as income in profit or loss in the period when~~ before the changes in facts and circumstances on which the variable payment is based occur (for example, when the **lessee's** sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and nonlease components of the contract on the same basis as the initial allocation of the consideration in the contract or the most recent modification not accounted for as a separate contract. Variable payment amounts allocated to the lease component shall be recognized as income in profit or loss in accordance with this Topic, while variable payment amounts allocated to nonlease components shall be recognized in accordance with other Topics (for example, Topic 606 on revenue from contracts with customers).

The amendments in this proposed Update were approved for publication by five members of the Financial Accounting Standards Board. Mr. Buesser abstained.

Members of the Financial Accounting Standards Board:

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

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed 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 FASB issued Update 2016-02 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 new leases standard in February 2016, the FASB has been educating and assisting stakeholders with implementation questions and issues as organizations prepare to adopt the new guidance.

BC3. In recent months, some lessor stakeholders have informed the Board about certain issues with the requirements in Topic 842 for the following:

a. Sales taxes and other similar taxes collected from lessees
b. Certain lessor costs paid directly by lessees
c. Recognition of variable payments for contracts with lease and nonlease components.

BC4. A discussion of these issues and the Board's basis for conclusions 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.

BC6. Overall, the Board concluded that the amendments in this proposed Update would simplify the implementation and continued application of Topic 842 by lessors and that the expected cost reduction to present investors would justify the reduction in expected benefits that would accrue to present and potential investors, creditors, donors, and other users.

Basis for Conclusions

Sales Taxes and Other Similar Taxes Collected from Lessees

BC7. Topic 842 requires that a lessor analyze sales (and other similar) tax laws on a jurisdiction-by-jurisdiction basis to determine whether those taxes are costs of the lessor (as described in paragraph 842-10-15-30(b)) or costs of the lessee. This analysis is important because it affects how those amounts in the income statement are measured and reported. When a sale (or other similar) tax collected from a lessee is a lessee cost (that is, the lessor is acting as an agent), a lessor would not report that amount in profit or loss. When a sale (or other similar) tax is a lessor cost, the lessor would include any amount collected by the lessor from a lessee for this tax in the measurement of (lease) revenue and costs. This typically would result in recording revenue and expense for the same amount in a lessor's income statement with zero net effect on profit or loss.

BC8. Lessor stakeholders informed the Board about the cost and complexity of assessing tax laws in each jurisdiction. Many entities operate in numerous jurisdictions, and the laws in some jurisdictions are unclear about which party to the transaction is primarily obligated for payment of the taxes. Stakeholders also stated that the variation of, and changes in, tax laws among jurisdictions contributes to that complexity. The challenges may be further complicated for mobile assets for which the lessee controls the location of the leased asset and, therefore, the jurisdictions in which those taxes are assessed. Consequently, some preparers requested that the Board add to Topic 842 an accounting policy election, similar to one already existing in paragraph 606-10-32-2A for sales (and other similar) tax presentation, to reduce the complexity and practical difficulties in assessing whether a tax is collected on behalf of a third party.

BC9. On the basis of stakeholders' feedback, the Board deliberated this issue at its March 28, 2018 meeting and decided to add a project that would provide lessors with an accounting policy election for sales (and other similar) taxes in Topic 842, consistent with the accounting policy election already existing in Topic 606. The accounting policy election would permit a lessor to elect to exclude from the measurement of (lease) revenue and the associated expense taxes assessed by a governmental authority that are both imposed on and concurrent with a specific lease revenue-producing transaction and collected by the lessor from a lessee. If a lessor elects to exclude sales taxes and other similar taxes from the measurement of (lease) revenue, the lessor would make that election for all sales (and other similar) taxes within the scope of the policy election.

BC10. In proposing this accounting policy election on sales (and other similar) taxes, the Board recognized that lessors face the same operability issues that led to its providing the accounting policy election in paragraph 606-10-32-2A. Therefore, the reasoning to permit a similar accounting policy election for lessors is consistent with the reasoning behind why the Board permitted the accounting policy election in Topic 606. The Board also recognized that permitting a similar accounting policy election would eliminate costs and complexities for lessors in implementing Topic 842 when the financial reporting effect of the requirement is likely to result in no effect to net income. The Board also noted that when a contract includes one or more lease components and one or more nonlease components, it would be counterintuitive that the amounts for sales (and other similar) taxes attributable to the nonlease component(s) are permitted to follow the accounting policy election provided in Topic 606 while the amounts for sales (and other similar) taxes attributable to the lease component(s) are not provided with a similar treatment. This outcome would result in additional system implementation challenges and could cause confusion for users of financial statements.

Certain Lessor Costs Paid Directly by Lessees

BC11. A lessor may incur various costs in its role as a lessor or as owner of the underlying asset, such as the property taxes and insurance costs illustrated in Example 12—Case A of Subtopic 842-10 (paragraphs 842-10-55-141 through 55-142). A requirement for the lessee to pay those lessor costs does not transfer a good or service to the lessee in addition to the right to use the underlying asset. The new leases guidance, therefore, requires that the lessor report those amounts as revenue and expenses (that is, gross) regardless of whether the lessee pays those lessor costs directly to a third party or as a reimbursement to the lessor.

BC12. When payments made by a lessee directly to a third party for lessor costs (on behalf of the lessor) are variable, those payments are not part of the consideration in the contract and are accounted for as variable payments subject to the allocation guidance in Topic 842. That is, the lessor allocates those payments to the lease and nonlease components of the contract (generally on the same basis as the initial allocation of the consideration in the contract or the latest modification not accounted for as a separate contract). The lessor then recognizes the amounts allocated to the lease components in accordance with paragraph 842-10-15-40.

BC13. For certain lessor costs paid directly by lessees to third parties on behalf of the lessor, lessor stakeholders informed the Board about operability challenges in obtaining or otherwise determining those amounts to meet the requirement for including those amounts in the measurement of variable (lease) revenue and related expenses. Lessor stakeholders noted that the costs of complying would be significant and would outweigh the benefits of providing such information primarily because those amounts could be affected by numerous factors, some of which are lessee-specific and unknown to the lessor. Determining those amounts often would be challenging and potentially could result in users of financial statements being provided with information that is unreliable. For example, insurance costs paid by a lessee directly to the insurance provider may be affected by numerous factors, some of which are lessee specific, such as deductibles, or when the underlying asset is insured under an umbrella policy.

BC14. Stakeholders requested that the Board provide a practical expedient for lessors to not recognize variable (lease) revenue (and the corresponding cost as an expense) for certain lessor costs under Topic 842 that are paid directly by the lessee to third parties (Lessee-Paid). These stakeholders highlighted the following discussions summarized in paragraph BC38(c) of Update 2016-08:

> A key tenet of variable consideration is that at some point the uncertainty in the transaction price ultimately will be resolved. When the uncertainty is not expected to ultimately be resolved, the guidance indicates that the difference between the amount to which the entity is entitled from the intermediary and the amount charged by the intermediary to the end customer is not variable consideration and, therefore, is not part of the entity's transaction price.

BC15. For consistency, those stakeholders stated that if the Board provides a practical expedient to exclude Lessee-Paid costs for the reasons described in paragraph BC14, then the Board also should consider providing a practical expedient for lessor costs when those costs are first paid by the lessor and subsequently reimbursed by the lessee to the lessor (Lessee-Reimbursed). They asserted that the economics between Lessee-Paid and Lessee-Reimbursed costs are the same and, therefore, should not result in different financial reporting outcomes. Those stakeholders noted that a practical expedient on Lessee-Reimbursed costs in addition to a practical expedient on Lessee-Paid costs would provide greater consistency among different types of lease arrangements across different entities, thereby providing more meaningful financial reporting for users of the financial statements to appropriately analyze.

BC16. The Board deliberated those requests at its March 28, 2018 meeting and decided to add a project that would require (not permit as an accounting policy election) that concepts similar to those described in paragraph BC38(c) of Update 2016-08 on variable consideration similarly apply to lessors with variable payments for which there is uncertainty in the amounts of the variable payments and that uncertainty is not expected to ultimately be resolved. Specifically, the Board discussed that a reasoning similar to that described in paragraph BC38(c) of Update 2016-08 should be applied by lessors because leasing is fundamentally a revenue-generating activity for a lessor. In addition, the issue raised in Topic 606 on the requirement to recognize variable consideration for which the uncertainty will ultimately not be resolved also exists in Topic 842.

BC17. The amendments in this proposed Update are not specific about the type of Lessee-Paid costs to which the amendments would apply because the facts and circumstances will dictate whether there is uncertainty about the amounts and whether that uncertainty is expected to ultimately be resolved. However, at its July 25, 2018 meeting, the Board decided that when a contract is or contains a lease, the uncertainty in the amount of the variable payments would not be expected to ultimately be resolved when the lessor costs paid by the lessee are not *readily determinable* by the lessor. Therefore, the Board clarified in paragraph 842-10-15-40A that a lessor would exclude from variable payments lessor costs paid by a lessee directly to a third party when the amount of the lessor costs paid by the lessee is not *readily determinable* by the lessor.

BC18. The Board decided to propose using the term *readily determinable* because there already is guidance in Topic 842 using that term (paragraph 842-20-30-3 requires a lessee to use the rate implicit in the lease whenever that rate is readily determinable) and using that term for Lessee-Paid costs would appear to address the operability challenges raised by lessor stakeholders. Specifically, the rate implicit in the lease generally is not readily determinable by the lessee because that rate is based on lessor-specific assumptions or factors (such as deferred initial direct costs paid by the lessor to third parties unrelated to the lessee for which the amount generally will not be known to the lessee). Similarly, the amount of lessor costs paid by a lessee directly to third parties generally would not be readily determinable by a lessor when such costs are affected by lessee-specific factors (such as insurance costs paid by a lessee directly to the insurance provider when such costs are affected by lessee-specific factors such as deductibles or whether the underlying asset is insured under an existing and broader umbrella policy). An entity should apply reasonable judgment in determining whether the proposed amendments discussed in paragraph BC17 could be applied to its facts and circumstances.

BC19. Because the Board's intent was to align the basis for the amendments in this proposed Update with the discussion in paragraph BC38(c) of Update 2016-08, the Board did not extend the proposed amendments to Lessee-Reimbursed costs. The Board believes that the reasoning in paragraph BC38(c) of Update 2016-08 cannot be applied to Lessee-Reimbursed costs because there is no uncertainty about the amount of those costs. Therefore, those amounts are readily determinable and, thus, the reimbursements are recognized as variable lease payments in accordance with Topic 842. Although the economics of an arrangement with Lessee-Paid costs may be very similar to an arrangement with similar terms as Lessee-Reimbursed costs, the key difference between the two arrangements is that the lessor knows the amount of its costs that is reimbursed by the lessee and the amount of those costs is not subject to lessee-specific factors. Because Topic 842 requires lessor costs to be included as variable (lease) revenue, the Board believes that when there is no uncertainty in those amounts, the guidance in Topic 842 should be applied. Extending the request to transactions involving Lessee-Reimbursed costs would have been a significant change in the leases guidance and would not have been supported by the same basis for the Lessee-Paid costs. The Board decided to propose amendments to Example 12—Case A of Subtopic 842-10 to clarify that there is no uncertainty in the amount of variable payments for Lessee-Reimbursed costs because the lessor bills the lessee for the amounts it initially paid and, therefore, the amounts are readily determinable. Therefore, the example concludes that the lessor recognizes amounts billed to the lessee as variable lease payments in accordance with Topic 842.

Recognition of Variable Payments for Contracts with Lease and Nonlease Components

BC20. As part of the Board's separate project on Codification improvements to the leases guidance, some stakeholders requested amendments to (or clarifications on) a lessor's accounting for variable payments for contracts with lease and nonlease components when applying paragraph 842-10-15-40 to payments that relate partially to a nonlease component. Specifically, those stakeholders noted that the guidance in paragraph 842-10-15-40 on contracts with lease and nonlease components may result in a lessor recognizing revenue for variable payment amounts allocated to a nonlease component in a period in advance of the period in which control is transferred to the customer for the nonlease component in accordance with guidance in other Topics (for example, Topic 606). At its January 24, 2018 meeting, the Board clarified its intent with respect to the application of paragraph 842-10-15-40. Specifically, the Board clarified that after variable payments are allocated between lease and nonlease components under Topic 842, other relevant guidance such as Topic 606 is applied for recognizing the amount allocated to the nonlease component(s).

BC21. At its July 25, 2018 meeting, the Board decided to formalize these clarifications by proposing amendments to paragraph 842-10-15-40. The proposed amendments clarify that variable payment amounts related to lease and nonlease components should not be recognized before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depend occur). The Board further clarified that when the changes in facts occur, variable payment amounts would then be allocated between the lease and nonlease components. After this allocation, the lease component would be recognized in profit or loss in accordance with Topic 842, while the nonlease component(s) would be recognized in accordance with other Topics (for example, Topic 606).

Effective Date and Transition

BC22. Because the amendments in this proposed Update affect the new leases standard, which is not yet effective (but for which early adoption is permitted), the Board decided that the effective date and transition requirements for the amendments in this proposed Update should be the same as those for the amendments in Update 2016-02 (and any other Topic amended by Update 2016-02) for entities that have not adopted Update 2016-02 by the time this proposed Update is finalized. The effective date and transition requirements for the amendments in Update 2016-02 are detailed in paragraph 842-10-65-1 of that Update. The Board will determine the effective date and transition of this proposed Update for entities that have adopted the amendments in Update 2016-02 before the issuance of this proposed Update after it considers stakeholders' feedback on this proposed Update.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed improvements to the Taxonomy through Proposed Taxonomy Improvements provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the Taxonomy will be finalized as part of the annual release process.