FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: December 19, 2018
Comments Due: January 15, 2019

Leases (Topic 842)

Codification 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. 2018-310, 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 January 15, 2019. 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. 2018-310
- Sending a letter to "Technical Director, File Reference No. 2018-310, 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®

Proposed Accounting Standards Update

Leases (Topic 842)

Codification Improvements for Lessors

December 19, 2018

Comment Deadline: January 15, 2019

CONTENTS

Page Numbers

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 essential information about leasing transactions.

The Board has an ongoing annual improvements project on its agenda to clarify the Codification more generally and/or to correct unintended application of guidance. Items included in that project are not expected to have a significant effect on current accounting practice or create a significant administrative cost for most entities. The amendments in this proposed Update are of a similar nature to the items typically addressed in the Codification improvements project. However, the Board decided to issue a separate proposed Update for the improvements related to Update 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements.

The Board did not create a transition resource group (TRG) to address the leases guidance because many of the concepts used in Topic 842, Leases, are similar to those currently used in Topic 840, Leases. Although a formal TRG was not created, the Board and staff have been assisting stakeholders during this transitional period by responding to inquiries received and proactively seeking feedback on potential implementation issues that could arise as organizations implement Topic 842. The amendments in this proposed Update include the following items brought to the Board's attention through those interactions with stakeholders:

1. Determining the fair value of the underlying asset by lessors that are not manufacturers or dealers
2. Presentation on the statement of cash flows—sales-type and direct financing leases.

Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers

Topic 840 provides an explicit exception for lessors who are not manufacturers or dealers (generally financial institutions and captive finance companies) for determining fair value of the leased property (underlying asset under Topic 842). For those entities, fair value is ordinarily the underlying asset's cost, reflecting any volume or trade discounts that may apply, instead of fair value as defined in Topic 820, Fair Value Measurement. Topic 842 did not carry forward this exception. Therefore, lessors previously qualifying for the exception in Topic 840 are now required to apply the definition of *fair value* in Topic 820, which is defined as the price that would be received to sell the underlying asset in an orderly transaction between market participants at the measurement date (exit price). Those lessors are concerned that this change in determining fair value will not provide decision-useful financial information because, unlike current practice, acquisition costs (for example, sales taxes and delivery charges) would be expensed at lease commencement and subsequently recognized through increased interest income for sales-type and direct financing leases. Those lessors noted their belief that it was neither the Board's intent to change those lessors' financial reporting nor its intent to eliminate the exception.

The amendments in this proposed Update would reinstate the exception in Topic 842 for lessors that are not manufacturers or dealers. Specifically, those lessors would use their cost, reflecting any volume or trade discounts that may apply, as the fair value of the underlying asset. However, if a significant lapse of time occurs between the acquisition of the underlying asset and lease commencement, those lessors would be required to apply the definition of *fair value* (exit price) in Topic 820.

Presentation on the Statement of Cash Flows—Sales-Type and Direct Financing Leases

Topic 840 does not provide guidance on how cash received from leases by lessors from sales-type and direct financing leases should be presented in the cash flow statement. The Board was informed that lessors within the scope of Topic 942, Financial Services—Depository and Lending, have been presenting "principal payments received under leases" within investing activities on the basis of an illustrative example in Topic 942. Those lessors expressed a preference for continuing this presentation, which is consistent with the presentation of principal payments received on loans more generally. Topic 842 introduced guidance that requires all lessors to present all cash receipts from leases within operating activities. The illustrative example in Topic 942 was not eliminated when Topic 842 was issued. Consequently, conflicting guidance exists on the presentation of "principal payments received from leases" under sales-type and direct financing leases.

The amendments in this proposed Update would address the concerns of lessors within the scope of Topic 942 about where "principal payments received under leases" should be presented. Specifically, lessors that are depository and lending institutions within the scope of Topic 942 would present all "principal payments received under leases" within investing activities.

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

The amendments in this proposed Update on determining the fair value of the underlying asset by lessors that are not manufacturers or dealers would affect all lessors that are not manufacturers or dealers (generally financial institutions and captive finance companies).

The amendments in this proposed Update on the presentation on the statement of cash flows—sales-type and direct financing leases would affect all lessors that are depository and lending entities within the scope of Topic 942.

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

The amendments in this proposed Update would amend Topic 842. That Topic has different effective dates for public business entities and entities other than public business entities. The effective date of a final Update of these proposed amendments would be for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years for any of the following:

1. A public business entity
2. 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
3. An employee benefit plan that files financial statements with the U.S. Securities and Exchange Commission (SEC).

For all other entities, the effective date would be for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Early application would be permitted. The proposed amendments would be applied at the date that an entity first applied Topic 842, using the same transition methodology in accordance with paragraph 842-10-65-1(c).

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.

Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers

Question 1: Should a lessor that is not a manufacturer or dealer establish fair value of the underlying asset as its cost, subject to any trade or volume discounts that apply (acknowledging that if a significant lapse of time occurs between the acquisition of the underlying asset and lease commencement, the definition of *fair value* must be used)? If not, please explain why.

Question 2: Are the proposed amendments operable? If not, please explain why.

Question 3: Would the proposed amendments result in a reduction of decision-useful information to users of financial statements? If so, please explain why.

Presentation on the Statement of Cash Flows—Sales-Type and Direct Financing Leases

Question 4: Should lessors that are depository and lending institutions present "principal payments received under sales-type leases and direct financing leases" in investing activities? If not, please explain why.

Question 5: Are the proposed amendments operable? If not, please explain why.

Question 6: Would the proposed amendments result in a reduction of decision-useful information to users of financial statements? If so, please explain why.

Effective Date and Transition

Question 7: Should the effective date for all lessors within the scope of the proposed amendments be for fiscal years beginning after December 15, 2019, with early application permitted? If no, what effective date should be established and why?

Question 8: Should the proposed amendments be applied at the date that an entity first applied Topic 842 using the same transition methodology in accordance with paragraph 842-10-65-1(c)? 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: Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers	3
Issue 2: Presentation on the Statement of Cash Flows—Sales-Type and Direct Financing Leases	4 and 5

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–6. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Issue 1: Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers

3. Add paragraph 842-30-55-17A and its related heading, with a link to transition paragraph 842-10-65-4, as follows:

Leases—Lessor

Implementation Guidance and Illustrations

> Implementation Guidance

> > Fair Value of the Underlying Asset

842-30-55-17A Notwithstanding the definition of **{add glossary link to 2nd definition}fair value{add glossary link to 2nd definition}**, if a lessor is not a manufacturer or a dealer, the fair value of the **underlying asset** at lease commencement is its cost, reflecting any volume or trade discounts that may apply. However, if there has been a significant lapse of time between the acquisition of the underlying asset and lease commencement, the definition of fair value shall be applied.

Issue 2: Presentation on the Statement of Cash Flows—Sales-Type and Direct Financing Leases

4. Amend paragraph 842-30-45-5, with a link to transition paragraph 842-10-65-4, as follows:

Leases—Lessor

Other Presentation Matters

> Sales-Type and Direct Financing Leases

> > Statement of Cash Flows

842-30-45-5 In the statement of cash flows, a **lessor** shall classify cash receipts from **leases** within operating activities. However, if the lessor is within the scope of Topic 942 on financial services—depository and lending, it shall follow the guidance in paragraph 942-230-45-4 for the presentation of principal payments received from leases.

5. Add paragraph 942-230-45-4, with a link to transition paragraph 842-10-65-4, as follows:

Financial Services—Depository and Lending—Statement of Cash Flows

Other Presentation Matters

942-230-45-4 Entities within the scope of this Subtopic shall classify principal payments received under sales-type leases and direct financing leases within investing activities.

6. Add paragraph 842-10-65-4 and its related heading, as follows:

Leases—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2019-XX, *Leases (Topic 842): Codification Improvements for Lessors*

842-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2019-XX, *Leases (Topic 842): Codification Improvements for Lessors*:

a. All 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 those fiscal years for those entities within the scope of paragraph 842-10-15-1(a). 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. Early application is permitted.
b. An entity shall apply the pending content that links to this paragraph at the date that an entity first applied 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 in accordance with paragraph 842-10-65-1(c).

The amendments in this proposed Update were approved for publication by the unanimous vote of the six 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. Individual Board members gave greater weight to some factors than to others.

BC2. 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 essential information about leasing transactions.

BC3. The Board has an ongoing annual improvements project on its agenda to clarify the Codification more generally and/or to correct unintended application of guidance. Items included in that project are not expected to have a significant effect on current accounting practice or create a significant administrative cost for most entities. The amendments in this Update are of a similar nature to the items typically addressed in the Codification improvements project. However, the Board decided to issue a separate proposed Update for the improvements related to Update 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements.

BC4. The FASB did not create a transition resource group (TRG) to address the leases guidance because many of the concepts used in Topic 842, Leases, are similar to those currently used in Topic 840, Leases. Although a formal TRG was not created, the Board and staff have been assisting stakeholders during this transitional period by responding to inquiries received and proactively seeking feedback on potential implementation issues that could arise as organizations implement Topic 842. The amendments in this proposed Update include the following items brought to the Board's attention through those interactions with stakeholders:

1. Determining the fair value of the underlying assets by lessors that are not manufacturers or dealers
2. Presentation on the statement of cash flows—sales-type and direct financing leases.

BC5. A discussion of those issues and the Board's basis for conclusions for addressing those issues are provided below.

Benefits and Costs

BC6. 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.

BC7. Overall, the Board decided that the amendments in this proposed Update would simplify the implementation and ongoing application of Topic 842 for certain lessors by allowing those lessors to continue to apply certain existing guidance. The Board also decided that the amendments would not compromise the decision usefulness of information provided to present and potential investors, creditors, donors, and other users.

Basis for Conclusions

Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers

BC8. Topic 840 provides an explicit exception for lessors that are not manufacturers or dealers (generally financial institutions and captive finance companies) for determining fair value of the leased property (underlying asset under Topic 842). For those entities (qualifying lessors), fair value is ordinarily its cost, reflecting any volume or trade discounts that may apply, as opposed to fair value as defined in Topic 820, Fair Value Measurement. Topic 842 did not carry forward this exception. Therefore, lessors previously qualifying for this exception (the fair value exception) are now required to apply the definition of *fair value* in Topic 820, which is the price that would be received to sell the underlying asset in an orderly transaction between market participants at the measurement date (exit price).

BC9. Under Topic 840, qualifying lessors capitalize acquisition and delivery costs associated with the underlying asset (qualifying costs). This capitalized amount is considered the fair value of the underlying property under the fair value exception in Topic 840. Because fair value equals the qualifying lessor's cost, no selling profit or loss is recognized at lease commencement.

BC10. For operating leases, the carrying value of the underlying asset, including capitalized costs, is generally amortized on a straight-line basis over the lease term, such that at the end of the lease term the carrying value of the underlying asset approximates its estimated residual value. For direct financing leases and sale-type leases, the net investment in the lease, which is equal to the cost of the underlying asset, is amortized over the lease term using the effective interest method, such that the net investment in the lease at the end of the lease term approximates the estimated residual value of the asset.

BC11. Qualifying lessors and large practitioners communicated to the Board that practice is consistent in its application of the fair value exception and the types of costs capitalized (for example, sales taxes and delivery charges), primarily because the exception has been applied since the issuance of FASB Statement No. 13, *Accounting for Leases,* in November 1976.

BC12. Qualifying lessors expressed concern that if the fair value exception is not reinstated, they will be required to expense otherwise qualifying costs at lease commencement only to then “recover” the costs by recognizing interest income for direct financing leases and sales-type leases that is significantly greater than that being recognized under Topic 840. Those lessors communicated that this result does not provide investors with relevant information and does not faithfully represent the economics of their business model, which involves financing the total cost of the underlying asset for the lessee. Additionally, qualifying lessors noted their belief that it was neither the Board’s intent to change the application of fair value for those lessors’ financial reporting nor its intent to eliminate the fair value exception.

BC13. At its December 4, 2018 meeting, the Board considered the elimination of the fair value exception in Topic 842 and the repercussions on the financial reporting of qualifying lessors, particularly for direct financing leases and sales-type leases. After performing research, the Board noted that eliminating the fair value exception for qualifying lessors was not explicitly deliberated during the project leading up to the issuance of Topic 842. The Board concluded that it was not its intent to eliminate the fair value exception or affect classification and measurement for qualifying lessors. Therefore, the Board chose to reinstate the fair value exception by adding paragraph 842-30-55-17A.

BC14. The Board chose to not significantly change the wording of the fair value exception from that currently provided in Topic 840 because it has existed and been applied since the issuance of Statement 13. The Board expects that lessors will apply the exception in a similar manner under Topic 842 as it has been applied under Topic 840.

Statement of Cash Flows—Sales-Type and Direct Financing Leases

BC15. Topic 840 does not provide guidance on how cash received from leases by lessors from sales-type and direct financing leases should be presented in the statement of cash flows. Lessors within the scope of Topic 942 informed the Board that in accordance with that Topic, they have been presenting "principal payments received under leases" within investing activities on the basis of an illustrative example in Topic 942. Those lessors expressed a preference for continuing this presentation, which is consistent with the presentation of principal payments received on loans more generally. Topic 842 introduced guidance that requires that all lessors present all cash receipts from leases within operating activities. The illustrative example in Topic 942 was not eliminated upon the issuance of Topic 842. Consequently, conflicting guidance exists on the presentation of "principal payments received from leases" under sales-type and direct financing leases.

BC16. At its December 4, 2018 meeting, the Board discussed what would be the appropriate presentation of "principal payments received under leases" under direct financing and sales-type leases for entities within the scope of Topic 942. The Board decided that depository and lending lessors should continue to present those payments within investing activities. Therefore, it amended paragraph 842-30-45-5 and added paragraph 942-230-45-4.

Effective Date and Transition

BC17. The amendments in this proposed Update would amend Topic 842. That Topic has different effective dates for public business entities and entities other than public business entities. The effective date of a final Update of these proposed amendments would be for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years for any of the following:

1. A public business entity
2. 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
3. An employee benefit plan that files financial statements with the U.S. Securities and Exchange Commission (SEC).

For all other entities, the effective date would be for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Early application would be permitted. The proposed amendments would be applied at the date that an entity first applied Topic 842, using the same transition methodology in accordance with paragraph 842-10-65-1(c).

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.