

FASB Issues Targeted Improvements to New Lease Accounting Standard

The Financial Accounting Standards Board ("FASB") recently issued Accounting Standards Update ("ASU") No. 2018-11 with targeted improvements to ASC Topic 842, *Leases*, to:

- (1) add an optional transition method that would permit entities to apply the new requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption, and
- (2) provide a practical expedient for lessors regarding the separation of the lease and non-lease components of a contract.

Prior to the amendments in ASU No. 2018-11, the upcoming lease requirements in ASC 842 had to be initially applied using a modified retrospective transition method under which lessees were required to recognize lease assets and lease liabilities on the balance sheet for all leases and provide the new and enhanced disclosures for each comparative period presented.

In response to constituents' concerns about unanticipated costs and complexities, ASU No. 2018-11 now allows entities, upon initial adoption, to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Under the new optional transition method, reporting for comparative periods presented must continue to follow the guidance under existing U.S. GAAP.

Also, under ASC 842, lease components in a contract must be separated from non-lease components, with:

- a) the non-lease components accounted for in accordance with other applicable U.S. GAAP (e.g., ASC 606, *Revenue from Contracts with Customers*), and
- b) contract consideration allocated to the lease and non-lease components on a relative standalone price basis by lessees or in accordance with the allocation guidance in ASC 606 by lessors.

While the guidance in ASC 842, prior to the amendments in ASU No. 2018-11, provided lessees with a practical expedient that did not require separation of lease and non-lease components by class of underlying assets (and, thus, allowed accounting for the non-lease components together with the related lease component as a single component), a corresponding practical expedient was not available for lessors. ASU No. 2018-11 now provides that similar practical expedient for lessors (i.e., does not require the separation of lease and non-lease components by class of underlying assets).

Finally, ASU No. 2018-11 provides clarifying guidance regarding the treatment of the combined component, namely whether it is accounted for in accordance with ASC 842 or in accordance with ASC 606.

When is this effective?

Comparative Reporting at Adoption – Optional Transition Method

Entities that have already adopted ASC 842 are not affected. For entities that have not yet adopted the new lease accounting rules, the effective dates are the same as those for ASC 842, as follows:

Effective Dates	Entities Affected
Fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (i.e. January 1, 2019 for calendar-year entities)	<ul style="list-style-type: none"> • Public business entities • Not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market • Employee benefit plans that file financial statements with the SEC
Fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020 (i.e. January 1, 2020 for calendar-year entities)	<ul style="list-style-type: none"> • All other entities

Separating Components of a Contract by Lessors

Lessors that have already adopted ASC 842 may elect to apply the practical expedient retrospectively or prospectively either

- (1) in the first reporting period following the issuance of ASU No. 2018-11, or
- (2) as of the entity's original effective date of ASC 842. For lessors that have not yet adopted ASC 842, the effective dates are the same as those for ASC 842.

Clients should contact their engagement team to discuss these new releases, while friends of the firm and others can contact any member of the PKF Texas SEC Group for more information.

Full details on ASU 2018-11 can be found at:

www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498#2018

For additional information, visit www.PKFTexas.com/SECDesk.