**Post-Implementation Review of Topic 842, Leases**
**Public Roundtable**

**September 12, 2025**
**10:00 a.m. to 3:00 p.m. EST**

**Financial Accounting Standards Board**
**801 Main Avenue**
**Norwalk, Connecticut**

## Agenda

| | |
|---|---|
| **10:00 a.m.** | **Public Roundtable Begins** |
| 10:00–10:10 a.m. | **Welcome and Introductions** |
| 10:10–11:00 a.m. | **Topic 1: Benefits**<br>Questions 1 through 3 |
| 11:00 a.m.–12:00 p.m. | **Topic 2: Costs**<br>Questions 4 through 5 |
| 12:00–1:00 p.m. | **Lunch** |
| 1:00–2:00 p.m. | **Topic 3: Specific Application Challenges**<br>Questions 6 through 7 |
| 2:00–2:55 p.m. | **Topic 4: Standard-Setting Process**<br>Questions 8 through 13 |
| 2:55–3:00 p.m. | **Closing Remarks** |
| **3:00 p.m.** | **Public Roundtable Adjourned** |

FINANCIAL ACCOUNTING STANDARDS BOARD

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## FASB Participants

| Participants | Title |
|---|---|
| Rich Jones | Board Chair |
| Hillary Salo | Board Vice Chair |
| Christine Botosan | Board Member |
| Fred Cannon | Board Member |
| Sue Cosper | Board Member |
| Marsha Hunt | Board Member |
| Joyce Joseph | Board Member |
| Jackson Day | FASB Technical Director |
| Nellie Debbeler | FASB Deputy Technical Director |
| Alicia Manders | FASB Assistant Director |
| Chandy Smith | FASB Senior Investor Liaison |
| Chris Roberge | FASB Senior Project Manager |
| Jenifer Wyss | FASB Supervising Project Manager |
| Lauren Mottley | FASB Supervising Project Manager |
| Ashley Allen | FASB Practice Fellow |
| John Schomburger | FASB Post-Doctoral Fellow |
| Connor Wilson | FASB Postgraduate Technical Assistant |
| Elizabeth Dietlein | FASB Postgraduate Technical Assistant |

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

## External Participants

| **Participants** | **Affiliation** |
|---|---|
| *Practitioners* | |
| Kristin Bauer | Deloitte LLP |
| Ryan Brady | Grant Thornton LLP |
| Mike Cheng | Frazier & Deeter (Private Company Council) |
| Blake Collins | Connor Group LLC |
| Thomas Faineteau | BDO PC |
| Tom Groskopf | Barnes Dennig (AICPA CPEA) |
| Scott Muir | KPMG LLP |
| Jeremy Simons | EY LLP |
| Chad Soares | PwC LLP |
| *Preparers* | |
| Chris Drula | Nareit |
| William Gough | NextEra |
| Shawn Husband | Walmart |
| Stephen Rivera | Johnson & Johnson *(retired)* |
| Nate Zeigler* | Bank of America |
| *Users* | |
| Todd Castagno | Morgan Stanley |
| David Gonzales | Moody's Investors Service |
| Ron Graziano* | LSV Asset Management |
| Brad Rexroad* | Assay Research |
| *Academic* | |
| Derek Christensen* | University of Oregon |
| *Official Observers* | |
| Rahul Gupta | AICPA FinREC Chair |
| Heather Jossem | PCAOB – Assistant Chief Auditor, Office of the Chief Auditor |
| Chauncey Martin | SEC Office of the Chief Accountant – Senior Associate Chief Accountant |
| Bob Uhl | IASB Member |

**Participating virtually*

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

# Post-Implementation Review of Topic 842, Leases
# Public Roundtable

## September 12, 2025

## Project Background and Objective of the Roundtable

1. The post-implementation review (PIR) process is part of the Financial Accounting Foundation's (FAF) Board of Trustees' oversight responsibilities for the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). The PIR process assists the Trustees in evaluating the effectiveness of the standard-setting process for both the FASB and the GASB.

2. The PIR process is an evaluation of whether a standard is achieving its objective by providing investors with relevant information in ways that justify the cost of providing it. It is an important quality-control mechanism built into the FASB's standard-setting process that begins after the issuance of select standards. During the PIR process, the Board solicits and considers diverse stakeholder input and other research to evaluate a selected standard that is issued and whether there are areas of improvements for the Board's consideration.[1]

3. The PIR process has three main objectives:[2]
   (a) To determine whether a standard is accomplishing its stated purpose
   (b) To evaluate the selected standard's implementation and continuing compliance costs and related benefits
   (c) To provide feedback to improve the standard-setting process.

4. To determine whether a standard is accomplishing its stated purpose, the PIR team assesses whether:
   (a) The standard resolved the issues underlying its need
   (b) Decision-useful information is being reported to, and used by, investors, creditors, and other users of financial statements (hereinafter referred to as investors)

[1] This paragraph is from https://www.fasb.org/pir#section-1.
[2] https://www.fasb.org/pir#section-4.



The staff prepares meeting handouts to facilitate the audience's understanding of the issues to be addressed at the meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

(c) The standard is operable; that is, stakeholders can apply the standard as intended, the standard is understandable, and preparers are able to report the information reliably

(d) Any significant unexpected changes to financial reporting or operating practices resulted from applying the standard

(e) Any significant unanticipated consequences resulted from applying the standard.

5. To evaluate the selected standard's implementation and continuing compliance costs and related benefits, the PIR team assesses whether:

   (a) Implementation and continuing compliance costs are consistent with the costs that the Board considered and stakeholders expected

   (b) Benefits are consistent with what the Board intended and stakeholders expected.

6. To provide feedback to improve the standard-setting process, the PIR team assesses whether the results of the review suggest that improvements are needed.

7. The PIR of Accounting Standards Update No. 2016-02, *Leases (Topic 842),* began after the Update was issued (hereinafter referred to as the Leases standard). At issuance, the Leases standard was to be effective for fiscal years beginning after December 15, 2018, for public business entities and for fiscal years beginning after December 15, 2019, for all other entities.

8. Although a transition resource group (TRG) for the Leases standard was not created, the Board and staff assisted stakeholders during the implementation of the Leases standard by proactively seeking feedback on implementation issues arising from those efforts, which led to the Board issuing eight Accounting Standards Updates for clarification or simplification in various areas and two Accounting Standards Updates that deferred the effective date for nonpublic entities. In addition, the Board provided ongoing implementation support through the FASB's technical inquiry service, a FASB Staff Question and Answer (Q&A) paper, interactions with stakeholders through advisory group meetings, outreach discussions with individual and group stakeholder meetings during the transitional periods, surveys, conferences, and review of academic literature. Additional details on PIR activities and a list of Updates issued related to the Leases standard are included in Appendix B.

9. The purpose of this roundtable is to obtain feedback from stakeholders on (a) whether the Leases standard achieved its stated objectives, (b) how the benefits and costs that were expected upon issuance of the Leases standard align with the benefits and costs of applying the standard, and (c) whether there are areas of improvement to the standard-setting process.

10. These materials are organized as follows:

    (a) Topic 1: Benefits

    (b) Topic 2: Costs

(c) Topic 3: Specific Application Challenges

(d) Topic 4: Standard-Setting Process

(e) Appendix A: Summarized History of the Leases Project

(f) Appendix B: PIR Activities Performed to Date.

Discussion questions are included at the end of each Topic.

## Topic 1: Benefits

11. The purpose of Topic 1 is to summarize what the Board expected the benefits of the Leases standard to be at issuance (as articulated in the basis for conclusions of Update 2016-02), provide an overview of what the staff has learned about the benefits of the Leases standard during outreach conducted as part of the PIR process, and obtain feedback from roundtable participants on the expected and actual benefits of the Leases standard.

### Expected Benefits at Issuance

12. Paragraph BC8 of Update No. 2016-02 outlines the benefits expected by the Board at the time of its issuance.

> BC8. On the basis of extensive due process and significant input received from financial statement users, the Board concluded that Topic 842 provides users with more relevant information on and a more faithful representation of leasing arrangements for both lessees and lessors than previous GAAP. The Board developed Topic 842 principally to improve users' understanding about lessees' obligations under lease contracts. Topic 842 provides transparent and economically neutral information about the assets and liabilities that arise from leases, which is in contrast to the incomplete information provided about leases in previous GAAP that did not recognize the assets and liabilities that arise from most leases. Topic 842 also provides improved financial information about a lessor's leasing activities. As such, Topic 842 results in more useful information being provided to users of financial statements. The requirements in Topic 842 will:
>
> a. Result in a more faithful representation of the rights and obligations arising from leases by requiring lessees to recognize the lease assets and lease liabilities that arise from leases in the statement of financial position and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases
> b. Improve understanding and comparability of lessees' financial commitments regardless of the manner they choose to finance the assets used in their businesses
> c. Clarify the definition of a lease to address practice issues that were raised about the previous definition of a lease and to align the concept of control, as it is used in the definition of a lease, more closely with the control principle in both Topic 606, Revenue from Contracts with Customers, and Topic 810, Consolidation

d. More closely align the lessor accounting and sale and leaseback transactions guidance to the comparable guidance in Topic 606 and Topic 610, Other Income
e. Provide users with additional information about lessors' leasing activities and lessors' exposure to credit and asset risk as a result of leasing
f. Result in fewer opportunities for entities to structure leasing transactions to achieve a particular accounting outcome on the statement of financial position.

## PIR Activities

### *Lessee*

13. The primary objective of the Leases standard was to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements.

14. Investor outreach conducted throughout the development of the Leases standard indicated that investors had various strategies to evaluate an entity's leasing activities. The Board acknowledged that investors' informational needs about entities' leasing activities may vary depending on the type of investor they are (for example, credit analyst or equity analyst) and the industry in which the entity operates or that the investor principally follows, among other reasons. The Board further acknowledged that some investors would continue to adjust the reported right-of-use (ROU) assets and lease liabilities (for example, to produce a "whole asset" view of the entity).

15. As part of the PIR process, the staff conducted outreach with both public company and nonpublic company investors to determine whether the Leases standard met its objective.

#### Overall

16. Many investors generally agreed that the financial reporting information resulting from the application of the Leases standard provides decision-useful information and achieved its expected benefits.

#### Operating Lease Liability

17. Feedback from investors on the usefulness of reported operating lease liabilities was mixed. Many investors indicated that they use the reported operating lease liability in their analyses of an entity's financial position (for example, when determining leverage, covenant ratios, cash outflow forecasts, and return on equity/investment ratios) with minimal to no adjustments. While some of those investors disagree with certain aspects of the measurement of the liability, they consider the amounts reported to be useful. Those investors noted that using the reported amount is simpler than the legacy methodologies of either estimating the lease liability using a rent expense multiple (such as six to eight times rent expense) or discounting the future minimum rental payments using a standard discount rate.

18. Other investors indicated that they use the reported operating lease liability along with other factors or adjustments to determine an estimated lease liability to include in their analyses. For example, many investors benchmark the reported lease liability to an estimated lease liability using a legacy calculation based on a multiple of total rent expense approach. Those investors adjust the reported lease liability in their analyses if there is a significant difference.

19. Many other investors indicated that they do not consider the reported operating lease liability in their analyses and continue to estimate the lease liability using another method, such as a rent multiple approach. Some private company investors noted that the Leases standard did not change their analyses or decision making and that the standard unnecessarily increased the complexity of lease accounting for lessees.

20. Investors that stated that they do not use the reported operating lease liability commented that the measurement of the lease liability requires significant management judgment in determining both the discount rate and the lease term (such as whether to include renewal periods). They observed that if they used the reported lease liability, those judgments may distort their estimation of an entity's future cash outflows, which would affect their valuation models. In addition, some investors observed that excluding variable lease payments from the lease liability understates an entity's reported obligation.

**ROU Asset**

21. While some investors indicated that they include the reported ROU asset in their models to analyze metrics such as return on assets or return on investment, most other investors stated that they have minimal, if any, use of ROU assets in their analyses. Those investors emphasized not having context for what the ROU asset amount represents.

**Income Statement**

22. Many investors stated that they prefer the single lease cost expense recognition pattern for operating leases under the Leases standard (as compared with interest and amortization recognized for operating leases under IFRS 16, *Leases*) and noted that they use the reported operating lease expense with no adjustments. Those investors indicated that they consider operating leases to represent an operating activity and not a financing activity and that they support different income statement recognition patterns for operating and finance leases.

23. Some investors noted that the lack of convergence results in costs and complexity for analysts that follow both GAAP and IFRS reporting entities.

**Disclosures**

24. Investors generally agreed that the disclosures provided under the Leases standard are an improvement to those provided under legacy guidance and provide better information about lessees' leasing activities. Some investors specifically highlighted that the following disclosures are helpful in their analyses.

    (a) *Components of lease cost.* Investors observed that understanding the components of lease costs (operating, variable, and short-term) enables them to understand how lease payments are structured, project future cash outflows, understand the total ("all-in") rent expense, and develop their estimates of the lease liability amount when using a rent multiple approach.

    (b) *Weighted-average discount rate and weighted-average remaining lease term*. Some investors observed that while these disclosures are not an input into their models, they are informative data points. Investors in the retail and airline industry indicated that the weighted-average remaining lease term disclosure is particularly useful because it helps them to understand flexibility in a real estate portfolio or aircraft fleet, respectively. Other investors noted that they do not use or monitor the weighted-average discount rate or lease term.

### *Lessor*

25. While feedback from investors on lessor reporting under the Leases standard has been more limited because the financial reporting under the Leases standard is largely consistent with that under legacy guidance, investors generally agreed that lessor financial statement information represents the economics of those entities' leasing arrangements.

### *Other Benefits*

26. Some preparers observed that implementing the Leases standard resulted in establishing more robust internal controls and contract management systems, which enabled them to better understand the magnitude of their lease contracts and the associated terms and conditions.

| Questions for Participants |
| --- |
| **Question 1:** Do you think the expected benefits outlined by the Board at the time of issuance have been achieved? |
| **Question 2:** Do you have observations on the feedback the staff has received on the benefits of the Leases standard? Do you have any additional feedback? |
| **Question 3:** What other benefits have been realized that were not expected by the Board or are not discussed here? |

## Topic 2: Costs

27. The purpose of Topic 2 is to summarize what the Board expected the costs of the Leases standard to be at issuance (as articulated in the basis for conclusions in Update 2016-02), provide an overview of what the staff has learned from its PIR activities performed to date on the implementation and ongoing costs associated with applying the Leases standard, and obtain feedback from roundtable participants on the expected and actual costs of the Leases standard.

### Expected Costs at Issuance—Lessee Accounting

28. Paragraph BC10 in Update 2016-02 provides details about the costs that the Board expected to be incurred as a result of implementing the Leases standard.

> BC10. The Board understands that certain reporting entities will incur additional costs as a result of Topic 842. For example, entities will, in general, incur initial costs to educate employees about how to apply the new requirements, as well as how to explain the effects of the changes in accounting for leases on the entity's financial statements to users of financial statements. In addition, many entities will need to undertake activities to ensure they have appropriately identified all of their leases and implement more robust processes and controls to ensure that they capture all material leasing activity going forward. However, the Board noted that once these implementation activities are completed, the ongoing costs for most entities of providing the information in Topic 842 are unlikely to be significantly higher than the costs of complying with the accounting model in previous GAAP. In previous GAAP, entities were similarly required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including meeting the ongoing disclosure requirements about cash flows from leases. Topic 842 will not substantially change this level of effort, and the Board concluded that, based on substantial outreach with preparers of financial statements, many entities will be able to apply the requirements in Topic 842 using similar systems and processes to what they used in previous GAAP to meet those reporting and disclosure requirements.

29. In addition, paragraph BC420 states:

> BC420. Topic 842 classifies leases as either finance or operating on the basis of a lease classification approach that is substantially similar to that in previous GAAP and previous IFRSs. This, combined with the recognition and subsequent measurement guidance applicable to lessees in Topic 842 for each type of lease, means that the effect of leases in the statement of comprehensive income and the statement of cash flows will be substantially the same as in previous GAAP and that most lessees will not have to implement significant new systems or processes to adopt the new guidance. The FASB's decisions on lease classification, as well as recognition and measurement for each type of lease, was significantly influenced by the following feedback from the FASB's stakeholders:
>
> a. Determining lease classification, in a manner substantially similar to previous GAAP, would not be difficult and was not a significant area of cost or complexity in previous GAAP.

b. Retaining lease classification criteria substantially similar to that in previous GAAP, as well as recognition provisions of the nature included in Topic 842, would significantly reduce costs for U.S. preparers as compared with the previous proposals because it would preserve the alignment that existed in previous GAAP between GAAP and tax/regulatory reporting. Many U.S. stakeholders communicated that the Boards' earlier proposals would have broken that alignment and, therefore, required them to maintain multiple sets of books and records when they previously only maintained a single set.
c. The most significant cost of adopting new leases guidance on the basis of the Boards' previous proposals would be implementing new accounting systems (for example, to track and account for a significant number of new financial liabilities) and processes. Many U.S. stakeholders communicated that a lessee accounting model of the nature included in Topic 842 would significantly reduce or eliminate those costs because lessees would be able to substantially retain their existing systems for tracking finance and operating leases (even if unsophisticated) and processes (that is, because the lease classification guidance is substantially the same and the effect of leases in the statement of comprehensive income and the statement of cash flows would be minimal).

## Expected Costs at Issuance—Lessor Accounting

30. Because lessor accounting was intended to be largely unchanged from legacy GAAP, the Board expected that lessors would incur minimal costs to implement the Leases standard. Paragraph BC11 in Update 2016-02 states in part:

> BC11. The Board considered an entity's initial costs to comply with the requirements in Topic 842, and this affected its conclusions both on the lessee and lessor accounting requirements and on transition to the new requirements. Regarding the lessee and lessor accounting requirements, as outlined in paragraph BC10, the Board concluded that a substantial portion of all entities will be able to apply the new requirements using systems and processes similar to those used in previous GAAP.

## PIR Activities

### *Lessee*

31. The Board and staff had a significant number of interactions from February 2016 through August 2025 with preparer and practitioner stakeholders representing public entities and nonpublic entities from after the issuance of the Leases standard (see further details in Appendix B). Those interactions provided robust feedback on various stakeholders' views (primarily preparers and practitioners) on the overall costs and processes employed to implement and apply the Leases standard on an ongoing basis.

32. Before the issuance of the Leases standard, many lessee stakeholders communicated that their existing systems and software were adequate to adopt the requirements of the standard, particularly if the Board retained a dual classification model (that is, distinguished operating leases from finance leases). However, stakeholders indicated (starting shortly after the issuance of the Leases standard)

that initially applying the lessee requirements of the standard as of the beginning of the earliest comparative period presented in the financial statements, including applying the disclosure requirements, was significantly more difficult than anticipated.

33. Many stakeholders indicated that their abilities to effectively adopt the Leases standard by its effective date was inhibited by resource constraints, such as limited accounting staff and newly developed lease accounting systems that were not ready or available to the market at the time of the effective date (or in a sufficient amount of time to prepare for adoption). In addition, stakeholders observed that significant effort was needed to gather documentation to:

    (a) Identify all lease contracts, including embedded leases

    (b) Document lease terms and conditions in a centralized system

    (c) Develop reasonable and supportable inputs such as the discount rate and judgments about renewal options to implement the standard.

34. Many public company preparers incurred some costs related to needing additional accounting personnel to implement the Leases standard, noting that some of those costs will be ongoing. Many public and private company preparers also incurred costs to engage third-party consultants and experienced higher audit fees related to implementation efforts.

35. Stakeholders acknowledged that while legacy GAAP required lessees to disclose their future minimum lease payments at the balance sheet date (in the aggregate) and for each of the five succeeding years, preparing that disclosure was often done annually as part of the financial statement close process and was often decentralized. Stakeholders also commented that recognizing operating leases on the balance sheet brought enhanced rigor to fundamental aspects of the Leases standard that were relatively unchanged from legacy GAAP, resulting in preparers establishing more robust internal controls and processes to comply with the recognition and measurement requirements of the Leases standard.

36. Consistent with the outreach feedback obtained by the FASB staff, certain academic studies reviewed by the staff as part of their academic review demonstrated that many entities updated their systems and processes to comply with the Leases standard. Those studies observed that entities with leases were more likely to disclose investments or updates to their internal information systems during the transition period to the Leases standard (that is, fiscal years 2016 to 2018) as compared with entities without leases. Similarly, some of those entities disclosed a material change in their internal controls over financial reporting because of the changes in accounting under the Leases standard.

37. In addition, nonpublic entity stakeholders communicated that the challenges of adopting the Leases standard were magnified for those entities, noting that the following factors affected their adoption of the Leases standard:

(a) Availability of resources (both internal and external). Nonpublic entities often have fewer dedicated internal resources and less access to external resources (primarily because of financial constraints) than many public companies.

(b) Timing and sources of education. Many nonpublic entities and their auditors acquire valuable knowledge from observing implementation experiences of public entities.

(c) Comprehensive transition requirements. The lengthy and detailed transition approaches require time to understand and apply.

(d) Understanding and applying guidance from post-issuance standard-setting activities.

(e) Developing or acquiring sufficient information technology and expertise in creating and implementing new systems or affecting system changes.

### *Lessor*

38. Lessor stakeholders indicated that they have generally not experienced significant challenges or incurred significant overall costs to comply with the Leases standard.

| **Questions for Participants** |
| --- |
| **Question 4:** In addition to the expected costs outlined by the Board at the time of issuance, and the feedback received on costs actually incurred, have you observed other costs of applying the Leases standard? If so, what other costs were incurred and were they only upon initial implementation or recurring? Did they (or do they) exceed what was originally expected?<br><br>**Question 5:** Do you have observations on the feedback that the staff has received on the costs of implementing the Leases standard? Do you have any additional feedback? |

## Topic 3: Specific Application Challenges

39. The purpose of Topic 3 is to solicit feedback from roundtable participants on areas of the Leases standard that resulted in specific application challenges. As part of the PIR process, the staff identified several areas of the guidance that were described as challenging or required clarification either as part of the implementation of the Leases standard or as part of stakeholders' ongoing application of the guidance. The staff notes that some of these challenging areas result from fundamental changes to lease accounting as part of the Leases standard, while others relate to areas of the guidance that were largely unchanged from legacy GAAP.

40. The following areas were identified for lessee accounting:

(a) Identification of a lease, including embedded leases

(b) Discount rate

(c) Specific recognition and measurement issues

(d) Allocating consideration between lease and nonlease components

(e) Lease modifications[3]

(a) Sale and leaseback transaction, including built-to-suit[4]

(b) Related party leases.

41. The following areas were identified for lessor accounting:

(a) Interaction with revenue recognition guidance in Topic 606

(b) Specific recognition and measurement issues

(c) Allocating consideration between lease and nonlease components.

## Lessee Areas

### *Identification of a Lease, Including Embedded Leases*

42. Stakeholder feedback indicated that greater emphasis has been placed on identifying embedded leases as a result of the Leases standard because operating lease liabilities and assets are required to be recognized on a lessee's balance sheet. Stakeholders noted significant costs and complexities associated with identifying embedded leases and questioned whether additional or amended guidance is needed to reduce the effort of identifying embedded leases. Nonpublic entity stakeholders continue to highlight embedded leases as an area that the Board may consider simplifying, with some suggesting that nonpublic entities should be excluded from identifying and accounting for embedded leases.

43. The Leases standard defines a lease as "a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration" (paragraph 842-10-15-3). Under the Leases standard, an entity has the right to control an identified asset if it has both the right to (a) obtain substantially all of the economic benefits of the identified asset and (b) direct the use of the identified asset.

44. Entities were similarly required to determine whether a contract is or contains a lease under legacy GAAP. Under legacy GAAP, a lease was defined as "an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time." Additionally, legacy GAAP provided criteria for determining whether a customer (the lessee) has the

[3] Although this area is applicable to both lessee and lessor accounting, most of the interactions on this area were raised from the lessee perspective.
[4] See footnote 3.

right to control the use of the property, plant, and equipment. Although those definitions are similar, it was expected that fewer arrangements would be leases under the Leases standard than under legacy GAAP, primarily because the Leases standard includes a requirement that a customer have the ability to direct the use of the identified asset for a lease to exist.

### *Discount Rate*

45. Preparer and practitioner feedback indicated that it was difficult for lessees to determine the incremental borrowing rate (IBR) in order to apply the Leases standard. In particular, this feedback was provided frequently during the implementation of the Leases standard. Stakeholders provided the following reasons:

    (a) The IBR is more closely scrutinized under the Leases standard because all leases are required to be recognized on a lessee's balance sheet. Under legacy GAAP, a lessee could often substantiate that a lease should be classified as an operating lease without performing a present value calculation and, thus, without determining the incremental borrowing rate (for example, by comparing the undiscounted sum of its lease payments with the fair value of the leased asset at the inception of a lease).

    (b) Requiring that a lessee determine and substantiate a secured borrowing rate, which was not previously required, involves significant costs for establishing repeatable processes for determining that rate.

46. However, stakeholders generally observed that after implementing repeatable processes for determining the IBR when implementing the Leases standard, the costs and complexities related to making that determination were substantially reduced. Therefore, some stakeholders indicated that lessees generally can determine their IBRs on an ongoing basis without significant cost and complexity.

47. Under the Leases standard, a lessee is required to use the rate implicit in the lease whenever that rate is readily determinable for classifying and accounting for its leases. If that rate is not readily determinable, a lessee uses its IBR. A nonpublic entity lessee is permitted to use a risk-free discount rate instead of its IBR. Because the rate implicit in the lease is a lessor specific rate that is usually not readily determinable by a lessee, a lessee often uses its IBR to classify and account for its leases. Under the Leases standard, IBR is defined as "the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment" (Master Glossary). The definition of IBR in legacy GAAP did not reference "a collateralized basis" and a lessee was able to use an unsecured rate as its IBR.[5]

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[5] Under legacy GAAP, IBR was defined as "the rate that, at lease inception, the lessee would have incurred to borrow over a similar term the funds necessary to purchase the leased asset. This definition does not prescribe the lessee's use of a secured borrowing

48. Although the Leases standard permitted nonpublic entity lessees to use a risk-free rate instead of the IBR, the election was originally required to be made entity-wide and applied to all of a nonpublic entity's leases. Many nonpublic entity stakeholders indicated that nonpublic entity lessees were reluctant to use the risk-free rate election for all leases. Those stakeholders observed that at the time that nonpublic entities were implementing the Leases standard, a risk-free rate (for example, a U.S. Treasury rate) was low compared with the average IBR. Therefore, nonpublic entity stakeholders were concerned that using the risk-free rate election for all leases would result in recognizing lease liabilities and ROU assets that could be significantly greater than those recognized using the IBR. Furthermore, those stakeholders observed that a lower discount rate could cause leases that otherwise would be classified as operating leases to be classified as finance leases. In response to the feedback, the Board amended the risk-free rate election to allow nonpublic entity lessees to make the election by class of underlying asset.

### *Specific Recognition and Measurement Issues*

49. Stakeholders provided feedback throughout the PIR process about recognition and measurement issues related to applying the Leases standard. Although the Leases standard significantly changed lessee accounting by requiring that all leases be recognized on the balance sheet, stakeholder feedback and interactions during the PIR process were largely related to specific or nuanced elements of the guidance. Some of the topics raised by stakeholders during the PIR process include the following.

   (a) *Lessee accounting for costs associated with shipping and installation*. Stakeholders requested clarification about how a lessee should account for shipping, delivery, and installation costs paid to an unrelated third party before lease commencement.

   (b) *ROU asset impairment requirements. S*takeholders highlighted challenges with applying the Topic 360, Property, Plant, and Equipment, impairment requirements to ROU assets, including when ROU assets are abandoned.

   (c) *Business combinations.* Stakeholders noted certain challenges with accounting for leases assumed in a business combination accounted for in accordance with Topic 805, Business Combinations, such as the accounting for leases assumed in a business combination that have above or below market lease payments as of the acquisition date.

   (d) *Nonpublic entity specific issues*. Nonpublic entity stakeholders highlighted certain issues, including challenges with accounting for lease incentives and the accounting for leases that have lease payments that are below the market rate.

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rate as its incremental borrowing rate if that rate is determinable, reasonable, and consistent with the financing that would have been used in the particular circumstances."

### *Allocating Consideration Between Lease and Nonlease Components*

50. Some stakeholders provided feedback that allocating the consideration in the contract between a lease component and a nonlease component using a relative standalone price basis is often difficult and may result in amounts allocated to the components that do not reflect the economics of the lease contract, particularly when the lease contract involves fixed and variable payments.

51. Under the Leases standard, the consideration in the contract is allocated to the separate lease and nonlease components of the contract on a relative standalone price basis. That accounting was similarly required under legacy GAAP. To alleviate operability burdens associated with the lessee allocation guidance, the Leases standard allows lessees to elect, by class of underlying asset, to combine lease and the associated nonlease components and account for them as a single lease component. A lessee electing that expedient accounts for all payments, fixed and variable, as lease payments. Similar accounting was required under legacy GAAP. However, separating lease and nonlease components has a more significant effect under the Leases standard because lease components have significantly different accounting than other components such as service arrangements.

### *Lease Modifications*[6]

52. Stakeholders provided feedback that the lease modification guidance under the Leases standard can be complex and challenging to apply. Some stakeholders also acknowledged that the guidance is more straightforward and clearer than the lease modifications guidance under legacy GAAP. However, stakeholders observed that the lease modification guidance under the Leases standard requires that an entity evaluate multiple steps and, in many cases, update its inputs and assumptions for lease accounting (such as the discount rate), which can be costly or burdensome. One specific situation that stakeholders identified as challenging was the accounting for a master lease when certain rights were terminated early; the accounting requires that an entity reassess lease classification and adjust accounting for all components of the contract, even those that are not affected by the change. Also, nonpublic entity stakeholders emphasized that the lease modification guidance is especially challenging when evaluating simple or straightforward changes to a lease, such as an extension to the lease term (that was not covered by a renewal option in the original contract).

53. Accounting for lease modifications under the Leases standard is significantly different from the accounting under legacy GAAP. Under the Leases standard (for both lessees and lessors), modifications to existing lease contracts are accounted for as separate contracts if (a) the modification grants the lessee with additional rights of use (for example, the right to use an additional asset) and (b) the lease payments increase commensurate with the standalone price for those

[6] The issues discussed on accounting for Lease modifications also are applicable to lessors.

additional rights. When a modification is a separate contract, it does not affect the accounting for the lease in the original contract. In contrast, if a modification is not considered a separate contract, the existing lease is accounted for as if it was a new lease. Therefore, an entity is required to reassess lease classification and to remeasure the lease as of the effective date of the modification. Doing so requires that an entity update key assumptions such as discount rate, the fair value of the underlying asset (and estimated residual value), and lease term. Accounting for lease modifications under the Leases standard is significantly different from the accounting under legacy GAAP.

54. During March 2020, many stakeholders communicated that it would be costly and complex for both lessees and lessors to apply the lease modification requirements in the Leases standard to each contract for which concessions related to the effects of the COVID-19 pandemic were made. In responses to those concerns, the FASB staff issued a Q&A paper stating that it was acceptable for entities to elect to account for lease concessions related to the effects of the COVID-19 pandemic by applying or not applying the lease modification guidance in the Leases standard or under legacy GAAP.

55. In response to stakeholder feedback about lease modifications, the Board added a project to seek to simplify the accounting requirements. The Board issued proposed amendments in October 2020 that would have exempted an entity (lessee and lessor) from applying modification accounting to the remaining lease components within a lease contract for transactions in which one or more lease components are terminated before the end of the lease term and that early termination does not economically affect the remaining lease components. The Board decided not to finalize this proposed amendment to the modification requirements primarily because stakeholder feedback indicated that (a) determining whether the payments for the total lease term are substantially the same both before and after considering the effects of the modification would be overly complex, and (b) reassessing whether multiple lease components existed at lease commencement for a contract that was originally accounted for as a single lease component may be impracticable. More broadly, stakeholders indicated that if the Board wanted to address issues with applying the modification requirements, then it should consider other issues with applying those requirements, including accounting for termination penalties, reductions in the lease term, and reconsideration of lease classification that solely results from the passage of time.

56. In response to the feedback, in 2021 the Board directed the staff to research potential improvements and broader solutions to the lease modification requirements. However, in 2022 the Board removed the project from its technical agenda for various reasons, including (a) investors did not indicate that modification accounting should be a high priority and (b) preparers and practitioners broadly communicated that the modification guidance in the Leases standard was a significant improvement from legacy GAAP.

### *Sale and Leaseback, Including Built-to-Suit*[7]

57. Stakeholders generally indicated that the sale and leaseback guidance in the Leases standard is an improvement over the legacy GAAP. In particular, stakeholders supported the changes to the requirements for determining whether a lessee controls the underlying asset while it is being constructed (built-to-suit transactions). However, stakeholders observed that substantial judgment is often still necessary in making that determination. Additionally, stakeholders cited challenges with determining whether control has been transferred to the buyer (lessor) in certain situations in which the lessee has a repurchase option. Stakeholders also provided feedback about certain specific transactions and scenarios in which sale and leaseback accounting is complex.

58. The Leases standard significantly changed the accounting for sale and lease back transactions, including for built-to-suit transactions. Under the Leases standard, a seller (lessee) recognizes the transfer of an asset as a sale and the leaseback as a lease if it is determined that the buyer (lessor) is considered to have obtained control of the asset. In those instances, the buyer (lessor) recognizes the transaction as a purchase and a lease. The seller (lessee) is considered to have transferred control if the leaseback would be classified as an operating lease and, in certain circumstances, the seller does not have an option to repurchase the asset. The Leases standard also provides requirements for determining whether a lessee controls an underlying asset that is under construction before the commencement date of a lease and did not retain the detailed built-to-suit guidance in legacy GAAP. Legacy GAAP included specific requirements on sale and leaseback transactions involving only real estate assets to determine whether an entity should account for the transaction as a sale and leaseback or account for the entire transaction as a financing arrangement. Practice developed such that sale and leaseback transactions involving assets other than real estate were generally accounted for as sale and leaseback transaction unless the arrangement provided the seller-lessee with a bargain option to repurchase the asset. Legacy GAAP generally required that most gains or losses were deferred at the time of the sale of the asset and recognized over the term of the leaseback.

### *Related Party Leases*

59. The Leases standard requires that leases between related parties be classified and accounted for in the same manner as all other leases on the basis of the legally enforceable terms and conditions of the related party lease. Nonpublic entity stakeholders (mostly private companies) cited concerns that determining the legally enforceable terms and conditions of a common control arrangement to determine if a lease exists and, if so, accounting for that lease is often difficult and costly. Those stakeholders observed that determining the enforceable terms and conditions in common control

[7] The issues discussed on accounting for sale and leaseback transactions also are applicable to lessors.

arrangements often presents unique challenges, even when the terms and conditions are written. Private company stakeholders also indicated that common control arrangements often are unwritten or lack sufficient detail, for example, the agreements may not explicitly specify whether lessee-controlled renewal options exist. Additionally, the terms and conditions of the arrangements often are not negotiated at arm's length.

60. Private company stakeholder feedback highlighted that it is typical for private company common control leases to have short lease terms (for example, one year), even in situations in which the commonly controlled lessee makes significant leasehold improvements with an estimated useful life that far exceeds the lease term. Those stakeholders were concerned that amortizing leasehold improvements over a period shorter than the estimated useful life of the improvements may result in financial reporting that does not faithfully represent the economics or the common control nature of those improvements.

61. In response to the feedback, the Board provided nonpublic entities with a practical expedient to use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, the classification of and accounting for that lease. Additionally, the Board provided separate requirements for accounting for leasehold improvements associated with common control leases for all entities (that is, including public business entities).

## Lessor Areas

### *Interaction with Revenue Recognition Guidance*

62. An objective of the Leases standard was to more closely align lessor accounting to comparable guidance in Topic 606 and Topic 610. However, stakeholders highlighted certain differences between the requirements in Topic 606 and the Leases standard that affect how amounts are recognized, including the following.

    (a) The collectibility threshold for recognizing revenue under Topic 606 for contract consideration (lease payments) is different from how the collectibility threshold is applied to leases that are classified as sales-type leases.

    (b) The existence of a repurchase option generally precludes an entity from recognizing revenue under Topic 606 and Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets. However, a selling profit may be recognized under the Leases standard for a sales-type lease with a repurchase option.

    (c) Variable consideration is estimated under Topic 606 but variable lease payments are not estimated for purposes of applying the Leases standard.

63. Under Topic 606, a seller does not reassess the collectibility of the consideration in the contract unless a customer's ability to pay the consideration deteriorates significantly. Rather, collectibility of receivables related to revenue transactions is considered as part of measuring credit losses under Topic 326, Financial Instruments—Credit Losses. That Topic does not apply to operating lease receivables. Rather, for operating leases, a lessor determines at lease commencement and on an ongoing basis whether collectibility of the lease payments, plus any amount necessary to satisfy a residual value guarantee provided by the lessee or any other unrelated third party, is not probable. In addition, when a lessor determines that collectibility of lease payments in an operating lease is not probable, including after lease commencement, the amount of revenue recognized is generally limited to the payments received, which requires that the lessor reverse any revenue recognized for which payment has not been received.

64. The staff received an inquiry communicating concerns about the application of those collectibility requirements for operating leases related to certain lessors (for example, REITs). Stakeholders observed that under the Leases standard lessors are prohibited from establishing a general impairment allowance for a portfolio of homogeneous operating lease receivables, which was a change from legacy GAAP. The staff acknowledged that, while it was not the Board's intent to significantly change existing practice for accounting for the impairment of operating lease receivables, the collectibility constraint established in the Leases standard could be interpreted as a significant change to legacy guidance. The staff also observed that multiple methods would be acceptable for evaluating the impairment of operating lease receivables.

### *Specific Recognition and Measurement Issues*

65. Feedback provided by stakeholders about the lessor recognition and measurement requirements largely centered around the application of the guidance to several targeted items.

66. Stakeholders requested clarification about whether the Board intended for lessors to account for sales taxes and other similar taxes collected on behalf of third parties as lease revenue (with an offsetting tax expense) or as a pass through to the taxing authority (no income statement recognition). To address this issue, the Board provided additional guidance that permits lessors to elect to forego their evaluations of whether certain sales taxes and other similar taxes collected by a lessor, and ultimately remitted to the taxing authority, are lessor costs or lessee costs. An entity that makes that election should not account for those costs as lessor costs.

67. Stakeholders recommended that the Board clarify whether it intended for certain costs, such as insurance in which the lessor is the beneficiary and property taxes in which the lessor is ultimately responsible, that the lessee pays directly to the third party to be accounted for as lessor costs. The Board clarified that lessors should exclude from variable payments (and, therefore, lease revenue) lessor costs such as insurance and property taxes paid by lessees directly to third parties. The Board

also specified that costs excluded from the consideration of a contract (fixed payments) that are paid by the lessor and reimbursed by the lessee should be accounted for as variable payments (revenue).

68. Stakeholders requested clarification about whether lessors should capitalize fulfillment costs incurred to ready an asset subject to a lease for its intended use before the lease commences or expense those costs as incurred.

69. Stakeholders requested that the Board amend the lessor accounting requirements for leases with variable payments that would have been sales-type leases for which a selling loss would be recognized at lease commencement because a lessor is not permitted to estimate variable payments. Stakeholders highlighted that the requirement in the Leases standard to recognize a day-one loss for sales-type or direct financing leases with variable payments that a lessor expects to be profitable overall was a change in practice from legacy GAAP and not reflective of the economics of the transaction. The Board agreed and amended the lease classification requirements to specify that lessors should classify and account for a lease with variable lease payments that do not depend on a reference index or a rate as an operating lease if certain criteria are met.

### *Allocating Consideration Between Lease and Nonlease Components*

70. Under the Leases standard, a lessor is required to separate lease components from nonlease components (for example, common area maintenance services) to the customer (lessee) in a contract. The lease components are accounted for in accordance with the Leases standard and the nonlease components in accordance with other Topics (such as Topic 606). A lessor allocates the consideration in the contract to the lease and nonlease components in accordance with the allocation guidance in Topic 606.

71. Some stakeholders requested that lessors be permitted 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 is a change from legacy GAAP that would have little, if any, meaningful accounting effect, except for presentation and disclosure. Those stakeholders also observed that any allocation method that 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.

72. In response to those concerns, the Board amended the Leases standard to permit lessors not to separate nonlease components from the associated lease component if certain criteria are met. The Board specified that under the lessor practical expedient, the lessor would account for the combined component under Topic 606 if the nonlease component (the service component) is the predominant

component(s) of the combined component; if not, the lessor should account for the combined component as an operating lease under the Leases standard.

| Questions for Participants |
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| **Question 6:** Do you have any feedback on the application challenges identified here? Do you think any of those areas require further action by the Board and, if so, do you have any suggested solutions or actions for the Board to consider or feedback on prioritization? |
| **Question 7:** Are you aware of any ongoing pervasive challenges in applying the Leases standard that have not been identified or discussed here? |

## Topic 4: Standard-Setting Process

73. The purpose of Topic 4 is to obtain feedback from roundtable participants on potential improvements to the standard-setting process.

### Improvements to the Standard-Setting Process

74. Feedback received from stakeholders of all types indicated that the following items may be potential opportunities for improvement to the standard-setting process:

(a) Convergence

(b) Systems and process assumptions

(c) Consideration of legacy guidance

(d) Transition guidance

(e) Setting and deferring the effective date.

#### *Convergence*

75. As detailed in the project history in Appendix A, the FASB and the IASB initiated a joint project to develop a converged leases standard in 2006. The FASB and the IASB collaborated and deliberated extensively to develop converged lease accounting requirements for both lessees and lessors. Although the FASB devoted a significant amount of time and effort to developing converged requirements, the Boards diverged in some key areas (in particular, lease classification), resulting in differences between the two standards.

76. The process to develop converged accounting requirements takes additional time and adds cost and complexity to the standard-setting process. Specifically, doing so necessitates additional efforts by stakeholders of all types to determine whether proposed requirements and the resulting financial reporting are operable and effective across many jurisdictions.

### *Systems and Process Assumptions*

77. During the development of the Leases standard, stakeholders provided feedback that lessees would be able to apply the requirements of the standard using similar systems and processes to what they used in previous GAAP on initial application and on an ongoing basis. The ability to use similar systems and processes for the Leases standard was an important consideration for the Board when deciding on certain fundamental aspects of the lessee model, including the following.

    (a) *Retaining a dual classification for operating and financing leases.* The Board thought that the accounting for all leases as finance leases would have been more costly than the lessee accounting model included in Topic 842 (which retained lease classification) because significant new systems capabilities and process changes would be necessary to accommodate finance lease accounting.[8]

    (b) *Measurement of the ROU asset in an operating lease.* The Board decided to measure the ROU assets resulting from operating leases with reference to the associated lease liability because most of the data necessary to calculate the lease liability was already accumulated using the existing processes and systems.[9]

    (c) *Lessee disclosure requirements*. The Board's decisions on the lessee disclosure requirements were heavily influenced by the information that preparers were able to report using existing systems and processes. The Board decided not to require a reconciliation of opening to closing lease liabilities because preparers indicated that new systems would be necessary.[10]

    (d) *Modified retrospective approach for transition*. A modified retrospective approach was chosen in part because entities, including private companies, could use existing systems and processes to prepare that information in those comparative periods, which would be cost effective.[11]

    (e) *Effective date*. The Board's decisions on the original effective dates in the Leases standard considered extensive feedback from preparers and industry groups that the amendments could be implemented without any significant systems or process changes. The Board stated in the basis for conclusions, "that is not to say that no systems or process changes will be necessary but, rather, that those changes are not expected to be extensive or costly."[12]

78. There was a significant gap between what was communicated to the Board about the adequacy of systems and processes and what was experienced by preparers. Therefore, as part of the PIR

[8] Paragraphs BC49 and BC50
[9] Paragraph BC254
[10] Paragraph BC284
[11] Paragraphs BC11 and BC30
[12] Paragraph BC383

process, some stakeholders suggested the following be considered for future major changes in accounting requirements:

(a) *Limited field testing program before issuing a final standard*. A targeted field testing program with preparers could provide additional (and more detailed or nuanced) information about assumptions being made by the Board based on stakeholder feedback.

(b) *Outreach with accounting system providers before issuance*. Engaging with accounting software providers before issuing a standard could provide insight about whether the standard could be implemented without significant system and process modifications.

(c) *Outreach with accounting system providers after issuance*. Continued engagement with software providers after issuance could aid implementation efforts and ensure systems are updated to reflect ongoing changes to a standard. For example, establishing periodic stakeholder meetings with accounting software providers could help to support preparers in their ongoing application of the standard.

### *Consideration of Legacy Guidance*

79. The basis for conclusions of the Leases standard observes that many of the concepts in the Leases standard are similar to those in legacy GAAP. Therefore, the Board concluded that entities should be familiar with applying those concepts, which would reduce the overall cost of implementation. For example, the requirements related to the definition of a lease, lease classification, and determining the lease term are similar to legacy GAAP.

80. Stakeholder feedback indicated that many lessee entities may not have applied those concepts under legacy GAAP with the same rigor as currently applied, particularly for operating leases because operating leases were previously not recognized on the balance sheet. Specifically, moving from legacy GAAP for those leases to a comprehensive recognition and measurement model proved challenging despite similar fundamental concepts. In addition, the staff observed that many detailed manuals were published providing interpretative guidance on the application of the Lease standard and, in certain instances, differing interpretations of similar items are provided.

81. Entities developed more robust systems and processes to apply fundamental concepts of the Leases standard even if those concepts were largely unchanged from legacy GAAP. In particular, stakeholders indicated that identifying leases, determining the lease term, and determining the discount rate were often challenging because those items were evaluated in more detail as part of the recognition of operating leases on the balance sheet.

82. The Board did not create a TRG for the Leases standard because many of the key concepts in the standard were similar to those used in legacy GAAP.[13] Some stakeholders questioned the Board's decision not to provide a TRG, observing that a TRG was provided to facilitate the implementation of Topic 606 and was highly beneficial.

### *Transition Guidance*

83. When issued, the Leases standard required a modified retrospective transition method with the option to elect a package of practical expedients. Under that transition method, an entity would have initially applied 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. That meant that lessees would recognize lease assets and liabilities for all leases in comparative periods even though those leases may have expired before the effective date. Also, lessees would provide the new disclosures for each period presented, including the comparative periods.

84. The Board decided on this approach in part based on preparers' feedback that this transition method would allow them to adopt the Leases standard in a cost-effective manner with relatively limited changes to systems, while balancing the needs of users to have comparative period information. Further, the Board decided to require the modified retrospective transition method (with the option to elect a package of practical expedients) rather than a full retrospective approach to minimize the costs of implementation for preparers.

85. Stakeholder feedback provided during the PIR process indicated that the modified retrospective transition method was challenging to apply and added significant cost and complexity to implementing the standard. Applying the Leases standard in periods that were already "closed" created significant challenges in terms of time, cost, and resources. Because the IASB did not require retrospective reporting under IFRS 16, it was particularly challenging for multi-national entities to obtain detailed lease contracts and information for those comparative periods when it was not required for IFRS accounting. Even though the modified retrospective method was viewed as simpler than a full retrospective transition, the effect of that transition method was to recognize and measure a lease asset and lease liability in the comparative periods. Stakeholders indicated that greater resources were applied by reporting entities, consultants, and auditors to those prior periods to substantiate lease contracts and the recognized amounts. Stakeholders requested that the standard apply in the period of adoption to permit entities to direct their implementation resources more efficiently.

86. In 2018, the Board provided an additional transition approach, similar to that provided by the IASB, to permit an entity to initially apply the Leases standard to all leases that exist at the adoption date (and not the earliest comparative period presented) to simplify the implementation. Under this new

[13] See discussion at (among others): Summary of Update 2018-10; Remarks by Russell Golden at IMA 2019 Annual Conference; and Speech by Sagar Teotia, Deputy Chief Accountant, Office of the Chief Accountant.

transition approach, an entity would not be required to apply Topic 842 to prior comparative periods. This had a similar effect in practice as if the Board had delayed the effective date.

87. During the PIR process, some stakeholders suggested that additional emphasis should be placed on the expected costs and complexities of transition methods before a standard is issued to simplify implementation and ensure high-quality adoption.

### *Effective Date—Multiple Major Standards*

88. Upon its issuance in February 2016, the Leases standard was to be effective for fiscal years beginning after December 15, 2018, for public business entities and for fiscal years beginning after December 15, 2019, for all other entities.

89. From 2014 through 2019, the Board issued several other major standards (typically referred to at the time as “broad” projects on the Board’s technical agenda) that created additional implementation challenges and resource constraints for both public and nonpublic entities. Those standards included substantive amendments to requirements related to revenue recognition, derivatives and hedging, and financial instruments (including credit losses).

90. Feedback received from public entity and nonpublic entity stakeholders indicated that implementing multiple major accounting changes at the same time was costly and complex. In response to this feedback, the Board provided the additional transition method described in paragraph 86 above for the Leases standard and deferred the Leases standard twice for nonpublic entities.

91. Also in response to stakeholder feedback surrounding the effective dates of the Leases standard and other Updates, the Board implemented new processes to anticipate the length of time it will take for a final standard to be issued and applied and how that timing affects the selection of the effective date. The new policy is articulated in the Board’s internal policies and includes the following considerations:

    (a) Urgency for new guidance

    (b) Relationship between release date and quarterly and/or fiscal year-ends

    (c) Complexity of new guidance

    (d) Amount of time needed to update information systems and processes

    (e) Amount of time needed to engage third-party experts and to implement the new guidance

    (f) Effective dates of other Accounting Standards Updates

    (g) Transition method.

| Questions for Participants |
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| **Question 8:** Do you have feedback on the overall effectiveness of the standard-setting process related to the Leases standard? |
| **Question 9:** Do you have any feedback on the transition methods and the transition requirements, including the practical expedients, in the Leases standard? |
| **Question 10:** What factors should the Board consider when setting the effective date of new major standards to minimize the need for subsequent deferrals? |
| **Question 11:** Do you have any other suggestions for improvements to the standard-setting process? |
| **Question 12:** Do you have any observations or feedback on the PIR process for the Leases standard, including the activities performed to date (which are detailed in Appendix B)? |
| **Question 13:** Considering the discussion during this session, do you think that the benefits of the Leases standard justify its costs? |

## Appendix A: Summarized History of the Leases Project

1. The legacy accounting for leases in GAAP and International Financial Reporting Standards (IFRS) did not require a lessee to recognize the assets and liabilities arising from operating leases on its balance sheet, but it did require that recognition for capital leases (referred to in Topic 842 as finance leases). The FASB and the International Accounting Standards Board (IASB) (collectively, the "Boards") initiated a joint project in July 2006. The objective of that joint project was to improve the financial reporting of leasing activities in light of criticism that the legacy accounting for leases failed to meet the needs of investors. In particular, the U.S. Securities and Exchange Commission (SEC) in its *2005 Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers*, which was issued to the U.S. Congress, recommended that the accounting guidance for leases be reconsidered. The report observed that "the current accounting for leases takes an 'all or nothing' approach to recognizing leases on the balance sheet. This results in a clustering of lease arrangements such that their terms approach, but do not cross, the 'bright lines' in the accounting guidance that would require a liability to be recognized. As a consequence, arrangements with similar economic outcomes are accounted for very differently."

2. In addition, feedback, including findings from academic studies, indicated that because leases classified as operating leases were not recognized on a lessee's balance sheet, most investors adjusted a lessee's financial statements to capitalize operating leases. In doing so, some tried to estimate the present value of future lease payments using disclosures of future minimum rental payments (limited to contractually required "fixed" payments). Many other investors used techniques, such as multiplying the lessee's annual lease expense (included contractually required fixed and variable payments) by a factor (often in the range of six to eight) to approximate the fair value of the lessee's obligations. This adjustment was used, for example, to assess total leverage and the capital employed in operations. Other investors were unable to make adjustments and relied on other data sources, such as data aggregators, to make investing decisions.

3. When the Boards added the leases project to their agendas, they agreed that the project would consider both lessee accounting and lessor accounting. In 2006, the Boards set up their International Working Group on lease accounting (hereinafter referred to as "the Working Group") that included investors, preparers, and auditors of both lessees' and lessors' financial statements. The Working Group provided comments on the early proposals to improve lease accounting (in February 2007) and its members contributed informally to the development of lease accounting models during 2007 and 2008.

4. In April 2008, the Boards announced their intention to produce a revised standard for lessees by mid-2011 and, in July 2008, the Boards tentatively decided to defer consideration of lessor accounting and concentrate on developing an improved lessee accounting model. The Boards further determined that the timing of any new lessor standard would be decided after issuing the joint Discussion Paper, *Leases: Preliminary Views*, in March 2009.

<u>2009 Discussion Paper</u>

5. The Discussion Paper set out the Boards' preliminary views on lessee accounting, proposing a right-of-use accounting model. The Discussion Paper would have required lessees to account for all lease contracts as the acquisition of a right to use the leased item for the lease term. A lessee would have accounted for all leases by recognizing a lease liability and a related right-of-use asset, measured as the present value of the lease payments (fixed and variable). In addition, the lessee also would have

amortized the right-of-use asset typically over the lease term and recognized interest on the lease liability, consistent with the accounting for capital leases under legacy GAAP. The Discussion Paper did not discuss lessor accounting in any detail.

6. The Boards received 302 comment letters on the Discussion Paper. Feedback received generally supported the right-of-use model (recognition of assets and liabilities arising from a lease) for lessees. In addition, the following broad concerns were raised by respondents:

   (a) The existing guidance is well understood by both preparers and investors, and the Boards should address implementation issues relating to the existing model rather than abandon a model that is not fundamentally flawed.

   (b) A right-of-use model would lead to recognizing assets and liabilities for all executory contracts, including purchase orders and long-term sales and supply agreements, which would inappropriately gross up a lessee's balance sheet.

   (c) The right-of-use model is too complex and its benefits would not outweigh the costs.

7. In addition, many respondents suggested that the Boards develop a consistent accounting model for lessees and lessors.

<u>2010 Exposure Draft</u>

8. After considering the 2009 Discussion Paper feedback, as well as input obtained from the Working Group and from others who were interested in the financial reporting of leases, the Boards published a joint Exposure Draft, *Leases* (2010 Exposure Draft), in August 2010.

9. The proposed guidance in the 2010 Exposure Draft further developed the right-of-use accounting model for lessees in the Discussion Paper.

10. The 2010 Exposure Draft also proposed that lessors change their accounting to a dual model in which a lessor would recognize a lease receivable for all leases and, depending on the lessor's exposure to the risks and benefits of the underlying asset, lessors would either (a) derecognize a portion of the underlying asset or (b) continue to recognize the underlying asset and recognize a performance obligation liability. The Boards decided to include lessor accounting in the 2010 Exposure Draft in response to respondents' comments on the Discussion Paper and because the Boards saw merit in developing proposals on lessor accounting and the recognition of revenue at the same time.

11. The Boards received 786 comment letters in response to the 2010 Exposure Draft from entities and organizations from a range of industries, including both public business entities and private companies.

12. The Boards also consulted extensively on the proposals in the 2010 Exposure Draft. Roundtable discussions were held in Hong Kong, the United Kingdom, and the United States. Workshops were organized in Australia, Brazil, Canada, Japan, South Korea, the United Kingdom, and the United States. Members of the Boards also participated in conferences, Working Group meetings, discussion forums, and one-on-one discussions that were held across all major geographical regions. In 2011 and 2012, while redeliberating the proposals in the 2010 Exposure Draft, the Boards conducted targeted outreach on specific issues with more than 100 organizations. The targeted outreach meetings involved Working Group members, representatives from accounting firms, and local standard setters from other national and regional jurisdictions, investors, and preparers—particularly those from industries most affected by the lease accounting proposals.

13. The main feedback received on the 2010 Exposure Draft was as follows:

(a) There was general support for the recognition of assets and liabilities arising from a lease by lessees, which was consistent with comments received on the Discussion Paper.

(b) Some respondents said that leases are a source of financing for a lessee and should be accounted for accordingly. Consequently, they supported the proposed right-of-use model in which a lessee would recognize separately amortization of the right-of-use asset and interest on the lease liability.

(c) Others disagreed with the 2010 Exposure Draft stating that the approach would not properly reflect the economics of all lease transactions. In particular, some respondents referred to shorter term property leases as examples of leases that, in their view, were not financing transactions from either the lessee's or the lessor's perspective.

(d) Despite calls for consistency between lessor and lessee accounting, many respondents disagreed with the lessor accounting proposals. Some asserted that there are no significant issues with the legacy lessor accounting requirements, that they work well in practice, and, therefore, should be retained.

(e) Almost all respondents were concerned about the costs and complexity of the proposals. In particular, the respondents raised concerns about the proposed measurement of the lessee's lease liability and the lessor's lease receivable, which would have required that an entity estimate all variable lease payments to be made during the noncancelable period of a lease and during any optional extension periods that the entity considered more likely than not to occur.

(f) Many respondents also were concerned about the breadth of the proposed scope, indicating that the proposed definition of a lease had the potential to capture some arrangements that they considered to be service contracts rather than leases.

<u>2013 Exposure Draft</u>

14. The Boards considered all of the feedback received during the redeliberations of the proposals in the 2010 Exposure Draft and observed that it would not be possible to reflect the views of all stakeholders because stakeholders did not have a uniform view of the economics of leases. The Boards decided to expose for comment an alternative model that was intended to respond to those stakeholders who said that the economics vary among different types of leases. Consequently, in May 2013 the Boards published a second joint Exposure Draft, *Leases* (2013 Exposure Draft).

15. The 2013 Exposure Draft proposed two approaches to the recognition and measurement of expenses arising from a lease (along with still proposing that lessees be required to recognize a lease liability and right-of-use asset for all leases). The lessee model distinguished between different types of leases based on the level of the lessee's consumption of the economic benefits embedded in the underlying asset. That model was based on the view that the recognition of a single lease expense in a lessee's income statement would provide better information about leases for which the lessee (a) pays only for the use of the underlying asset and (b) is expected to consume only an insignificant amount of the economic benefits embedded in the underlying asset itself. A lessee would have accounted for those leases for which it consumes more than an insignificant amount of the benefits embedded in the underlying asset by amortizing the right-of-use asset typically over the lease term and recognizing interest on the lease liability, consistent with the accounting for capital leases under legacy GAAP. Unlike the 2010 Exposure Draft, the measurement of the lease liability and right-of-

use asset would have excluded variable lease payments (except for those based on an index or rate).

16. The 2013 Exposure Draft also proposed a lessor model that distinguished between different types of leases based on the lessee's level of consumption of the economic benefits embedded in the underlying asset. For leases in which the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, the lessor would have been required to recognize its residual interest in the underlying asset separately from its right to receive lease payments (that is, its lease receivable). A lessor would have accounted for all other leases in a similar manner to operating lease accounting in Topic 840 (that is, the lessor would have (a) continued to recognize the underlying asset and (b) recognized lease income over the lease term typically on a straightline basis). Consistent with the lessee model proposed in the 2013 Exposure Draft, the lease payments used for measuring the lease receivable or the total lease cost to be recognized over the lease term would have excluded most variable payments.

17. The Boards received 657 comment letters in response to the 2013 Exposure Draft from stakeholders from a range of industries. In addition, the Boards consulted extensively on the proposals in the 2013 Exposure Draft, including:

    (a) Consultations with more than 270 investors based in the United States, the United Kingdom, Sweden, Switzerland, Belgium, the Netherlands, France, Australia, New Zealand, Hong Kong, Japan, and Canada.

    (b) Meetings with individual preparers from various industries, including consumer goods, retail, aviation, oil and gas, telecommunications, and automotive. Those meetings were held in Germany, France, Spain, the United States, the United Kingdom, Japan, and Brazil and included detailed discussions about the costs of implementation for those companies.

    (c) Roundtables were held in London, Norwalk, Los Angeles, Singapore, and Brazil. They were attended by approximately 100 stakeholder representatives.

    (d) Meetings with all of the FASB's advisory groups—the Financial Accounting Standard Advisory Council (FASAC), the Investor Advisory Committee (IAC), the Not-for-Profit Advisory Committee (NAC), the Small Business Advisory Committee (SBAC), and the Private Company Council (PCC).

    (e) Outreach meetings with various other individual preparers and groups of preparers, standard setters, and regulators. Those meetings included presentations during accounting conferences, keynote presentations at industry forums, and meetings with individual organizations or groups.

    (f) Project webcasts that were attended by more than 2,000 participants.

18. The main feedback received on the 2013 Exposure Draft was as follows:

    (a) Many stakeholders supported the recognition of a right-of-use asset and a lease liability by a lessee for all leases of more than 12 months (similar to feedback received on the 2010 Exposure Draft). Those stakeholders included most investors consulted.

    (b) Many stakeholders disagreed with the proposed lessee accounting model. Some of those stakeholders (a) said that the lessee accounting model in Topic 840 did not need to be changed or (b) supported expanding the lessee disclosure requirements instead of changing the recognition and measurement requirements. Other stakeholders disagreed with one or more of the specific lessee aspects in the 2013 Exposure Draft.

(c) Many stakeholders said that there were significant improvements to the measurement proposals in the 2013 Exposure Draft, as compared with the 2010 Exposure Draft, especially relating to simplifications of variable lease payments and payments under renewal options and purchase options. Nonetheless, the majority of stakeholders still had concerns about the costs and complexity of the proposals in the 2013 Exposure Draft.

(d) The majority of stakeholders disagreed with the proposed lessor accounting model because, in their view, it was not an improvement to the financial reporting for those transactions. Most of those stakeholders said that lessor accounting should not be changed substantially.

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19. After considering all of the feedback received throughout the leases project, the Board decided that a lessee should be required to recognize right-of-use assets and lease liabilities for all leases (except for short-term leases). However, the Board sought to address many of the stakeholders' concerns about the costs and complexity of the lessee and lessor proposals (in the 2010 and 2013 Exposure Drafts) when finalizing Topic 842. Specifically, the Board:

(a) Adopted a lessee accounting model that distinguishes between two lease types (finance leases and operating leases) using a classification approach that is substantially similar to legacy GAAP for distinguishing between operating leases and capital leases. The Board expected that this decision, along with other simplifications, would result in many lessees using their existing systems and processes to apply Topic 842. Conversely, the IASB decided to require a single lessee accounting model in which a lessee accounts for all leases as finance leases, with an exemption for leases of "small assets" that are considered underlying assets of approximately $5,000 or less.

(b) Largely retained the lessor accounting model from legacy GAAP, including recognizing and distinguishing between sales-type leases, direct financing leases, and operating leases. In addition, certain of the lessor accounting requirements were aligned with revenue recognition (Topic 606).

(c) Provided more robust guidance for identifying a lease, including determining whether a customer has the right to control the use of an underlying asset.

(d) Allowed a lessee to not recognize assets and liabilities for short-term leases (leases with a lease term of 12 months or less). The IASB provided a similar exception.

(e) Permitted a lessee to apply the leases standard at a portfolio level for leases with similar characteristics.

(f) Largely aligned the requirements for determining the lease term, including the consideration of renewal, termination, and purchase options, with legacy GAAP.

(g) Simplified the measurement of the lease liability by excluding variable payments other than those that depend on an index or a rate (initially measured using the index or rate at the commencement date).

(h) Simplified lessee expense recognition and the process for subsequently measuring the right-of-use asset in an operating lease as compared with the proposed guidance in the Exposure Drafts.

(i) Provided a practical expedient whereby a lessee may, as an accounting policy election by class of underlying asset, choose not to 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.

(j) Clarified the application of the sale guidance in revenue recognition (Topic 606) to sale and leaseback transactions and provided more robust guidance for determining when a lessee controls the underlying asset before the commencement date.

## Appendix B: PIR Activities Performed to Date

1. In monitoring implementation and ongoing application to evaluate the benefits and costs of the Leases standard, the PIR activities performed by the Board and staff to date include the following:

   (a) Responded to almost 400 technical inquiries, a significant portion of which related to lessee accounting and transition

   (b) Discussed leases implementation and application issues at 29 public FASB meetings

   (c) Discussed leases implementation and ongoing application issues at 74 advisory committee and council meetings

   (d) Had 278 stakeholder meetings to discuss leases implementation and ongoing application issues

   (e) Evaluated 12 agenda requests and 12 unsolicited comment letters related to the Leases standard

   (f) Issued eight Updates to clarify and/or modify Topic 842

   (g) Issued two Updates to defer the Leases standard for private companies and certain not-for-profit (NFP) organizations

   (h) Provided a Staff Q&A in April 2020 on accounting for lease concessions in response to COVID-19

   (i) Developed educational materials and created an implementation portal on the FASB's website (a single location for all implementation resources) to support stakeholders during the implementation of the Leases standard

   (j) Held public webcasts (including industry-specific webcasts, private-company-focused webcasts, and investor education podcasts) and gave presentations and speeches at conferences upon issuance of the Leases standard and throughout the adoption period

   (k) Held a public roundtable in 2020

   (l) Conducted a public company cost survey in 2021 and a nonpublic entity cost survey in 2025

   (m) Co-hosted the Accounting for an Ever-Changing World conference, which was a joint conference of the FASB, IASB, and The Accounting Review, in 2022

   (n) Held six joint meetings with the IASB.

2. The following is a list of Accounting Standards Updates issued since February 2016.

| Name of Update | Objective of Update |
|---|---|
| No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842* | • Provided an optional transition practical expedient allowing entities to continue applying their current accounting policy for land easements that existed or expired before the entity's adoption of Topic 842. After the adoption of Topic 842, an entity should apply the leases standard prospectively to all new (or modified) land easements to determine whether the arrangement should be accounted for as a lease.<br>• Amended Example 10 of Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, to clarify that an entity should determine whether land easements are leases in accordance with Topic 842 before applying the guidance in that example. |
| No. 2018-10, *Codification Improvements to Topic 842, Leases* | • Made several Codification improvements to clarify Topic 842 and to correct unintended application of guidance. |
| No. 2018-11, *Leases (Topic 842): Targeted Improvements* | • Provided an additional (and optional) transition method that allowed entities to apply Topic 842 at an entity's adoption date with a cumulative-effect adjustment to the opening balance of retained earnings (no comparative periods are required to be presented in accordance with Topic 842). Topic 840 disclosures are required for comparative periods.<br>• Provided a practical expedient that allows lessors to combine each separate lease component and the associated nonlease components into a single component if certain criteria are met. The practical expedient also clarifies which Topic (either Topic 842 or Topic 606) applies to the combined components. |
| No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors* | • Provided lessors with an accounting policy election to not evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs and, rather, account for them as lessee costs.<br>• Clarified that lessors should exclude from variable payment accounting all lessor costs paid directly by lessees to third parties. Therefore, the lessor should not report any lease revenue or expense for those costs. However, all costs paid by the lessor to third parties and subsequently reimbursed by the lessee are considered lessor costs and should be accounted for as variable payments (lease revenue and corresponding expense recognized).<br>• Clarified the timing of when a lessor is required to allocate variable payments that have lease and nonlease components to separate components. |
| No. 2019-01, *Leases (Topic 842): Codification Improvements* | • Reinstated an exception from Topic 840 for lessors that are not manufacturers or dealers. Those lessors should use their cost basis (reflecting any volume or trade discounts that may apply) as the fair value of the underlying asset.<br>• Clarified that lessors that are institutions within the scope of Topic 942, Financial Services—Depository and Lending, would present all "principal payments received under leases" for sales-type and direct financing leases within investing activities.<br>• Clarified that both lessees and lessors are exempt from having to provide certain interim disclosures in accordance with Topic 250, Accounting Changes and Error Corrections, in the fiscal year in which an entity adopts Topic 842. |
| No. 2019-10, *Financial Instruments—Credit Losses (Topic 326),* | • Deferred the effective date for nonpublic entities for an additional year. Therefore, the Leases standard was effective for those entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. |

| Name of Update | Objective of Update |
|---|---|
| *Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates* | |
| No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities* | • Deferred the effective date for an additional year for nonpublic entities that had not yet made their financial statements available for issuance. Therefore, the Leases standard was effective for those entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. |
| No. 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments* | • Specified that lessors should classify a lease with variable lease payments that do not depend on a reference index or a rate as an operating lease if both of the following criteria are met:<br>o The lease would have been classified as a sales-type lease or a direct financing lease.<br>o The lessor would have otherwise recognized a day-one loss. |
| No. 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities* | • Amended the risk-free rate accounting policy election for a lessee that is not a public business entity to allow those lessees to make the election by class of underlying asset, rather than at the entity-wide level. |
| No. 2023-01, *Leases (Topic 842): Common Control Arrangements* | • Provided a practical expedient permitting private entities to use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, how to classify and account for that lease.<br>• Specified for all entities (public and private entities) that leasehold improvements associated with common control leases should be:<br>o Amortized over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset through a lease. However, if the common control lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period should not exceed the amortization period of the common control group.<br>o Accounted for as an adjustment to equity (or net assets for not-for-profit entities) if, and when, the lessee no longer controls the use of the underlying asset. |