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FASB — final guidance

How the new leases standard affects consumer products and retail entities

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What you need to know

- Identifying a complete population of leases to be accounted for during transition and after the effective date has been one of the more challenging aspects of implementing the new standard.
- After adoption, lessees need to focus more on monitoring contracts to identify new leases. Existing leases also need to be monitored for modifications and reassessment events that could change the accounting.
- Entities that elect the package of practical expedients will need to have two sets of processes and controls — one to account for leases that commenced before adoption and another to account for new leases and those that are modified or reassessed after adoption.
- An entity's controls may evolve during the year of adoption as it implements changes necessary to address the risks associated with ASC 842, especially if the entity implemented a new IT system that wasn't fully functional on the adoption date.
- This publication has been updated to reflect certain amendments the FASB has made to the standard and to address lessee considerations for the impairment of right-of-use assets.

Overview

While many companies have already adopted the new leases standard[1] issued by the Financial Accounting Standards Board (FASB or Board), some off-calendar-year public business entities (PBEs)[2] and other entities are still working on implementation.

Building a better working world

Accounting Standards Codification (ASC) 842 is effective for PBEs and certain not-for-profit entities and employee benefit plans[3] for annual periods beginning after 15 December 2018, and interim periods within those years. For all other entities, it is effective for annual periods beginning after 15 December 2019 (i.e., 1 January 2020 for a calendar-year entity), and interim periods the following year. However, the Board issued a proposal to defer ASC 842's effective date by one year for entities whose effective date is currently annual periods beginning after 15 December 2019.[4] These entities should monitor the FASB's standard-setting activity. Early adoption is permitted for all entities.

While lessees with significant operating leases are most affected by the requirement to record assets and liabilities for most of these leases, generally lessees and lessors have made or will need to make changes to their accounting policies, processes, systems and internal controls to implement the standard.

This publication summarizes the standard and describes key industry considerations for entities in the consumer products and retail subsectors. Entities should consider these industry-specific issues when implementing and applying the standard. Like all entities, consumer products and retail entities need to apply the standard to leases of office space, office equipment and all other leased assets.

This publication complements our Financial reporting developments (FRD) publication, ***Lease accounting: Accounting Standards Codification 842, Leases*** (SCORE No. 00195-171US), which provides an in-depth discussion of ASC 842. We refer to that publication as our ASC 842 FRD.

Key considerations

Scope and scope exceptions

The scope of ASC 842 is limited to leases of property, plant and equipment (i.e., land and depreciable assets), including subleases of those assets. ASC 842 does not apply to any of the following:

- Leases of intangible assets
- Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources, including the intangible right to explore for those natural resources and rights to use the land in which those natural resources are contained (unless those rights to use include more than the right to explore for natural resources), but not equipment used to explore for the natural resources
- Leases of biological assets, including timber
- Leases of inventory (i.e., assets held for sale in the ordinary course of business, assets in the process of production for sale, and assets to be currently consumed in the production of goods or services to be available for sale)
- Leases of assets under construction

Definition of a lease

A lease is a contract (i.e., an agreement between two or more parties that creates enforceable rights and obligations), or part of a contract, that conveys the right to control the use of identified property, plant or equipment (i.e., an identified asset) for a period of time in exchange for consideration. See the appendix for a flowchart from ASC 842 of how to determine whether an arrangement is or contains a lease.

Identified asset

The requirement that there be an identified asset is fundamental to the definition of a lease. Under ASC 842, an identified asset could be either implicitly or explicitly specified in a contract. An identified asset also can be a physically distinct portion of a larger asset. Examples of identified assets include a floor of a building or a store-within-a-store (e.g., a coffee shop in a grocery store). Even if an asset is specified, a customer does not have the right to use an identified asset if, at inception of the contract, a supplier has the substantive right to substitute the asset throughout the period of use (i.e., the total period of time that an asset is used to fulfill a contract with a customer, including the sum of any nonconsecutive periods of time). A substitution right is substantive when both of the following conditions are met:

- The supplier has the practical ability to substitute alternative assets throughout the period of use.
- The supplier would benefit economically from the exercise of its right to substitute the asset.

Right to control the use of the identified asset

A contract conveys the right to control the use of an identified asset for a period of time if, throughout the period of use, the customer has both of the following:

- The right to obtain substantially all of the economic benefits from the use of the identified asset
- The right to direct the use of the identified asset

If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

In some cases, evaluating whether the customer has the right to direct the use of an identified asset requires judgment.

A customer can obtain economic benefits either directly or indirectly (e.g., by using, holding or subleasing the asset). Economic benefits include the asset's primary outputs (i.e., goods or services) and any by-products (e.g., renewable energy credits that are generated through use of the asset), including potential cash flows derived from these items. Economic benefits also include benefits from using the asset that could be realized from a commercial transaction with a third party. However, economic benefits arising from ownership of the identified asset (e.g., tax benefits related to excess tax depreciation and investment tax credits) are not considered economic benefits derived from the use of the asset and therefore are not considered when assessing whether a customer has the right to obtain substantially all of the economic benefits.

A customer has the right to direct the use of an identified asset throughout the period of use when either:

- The customer has the right to direct how and for what purpose the asset is used throughout the period of use.
- The relevant decisions about how and for what purpose the asset is used are predetermined and the customer either (1) has the right to operate the asset, or direct others to operate the asset in a manner it determines, throughout the period of use without the supplier having the right to change the operating instructions or (2) designed the asset, or specific aspects of the asset, in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

When evaluating whether a customer has the right to direct how and for what purpose the asset is used throughout the period of use, the focus should be on whether the customer has the decision-making rights that will most affect the economic benefits that will be derived from the use of the asset. The decision-making rights that are most relevant are likely to depend on the nature of the asset and the terms and conditions of the contract.

Under ASC 842, determining whether certain contracts, particularly those involving a significant service component (e.g., contract manufacturing, supply agreements, transportation arrangements), contain a lease is more important for lessees than it is under ASC 840, *Leases,* because lessees are now required to account for most leases on their balance sheet.

While evaluating whether the customer directs the use of an identified asset will be straightforward in many arrangements, evaluating other arrangements — particularly those with a significant service component — may require more consideration.

For example, consumer products and retail entities commonly have arrangements with third parties that provide manufacturing, warehousing, transportation, advertising, information technology (IT) and other services. Retail entities also commonly have contracts that allow them to purchase goods and give them the right to use the vendor's assets (e.g., shelving, fixtures). Evaluating whether these arrangements contain a lease may require judgment.

Illustration 1 — Contract manufacturing

Consumer products entity (CP) enters into a contract with Vendor for a dedicated production line to manufacture one of its store-brand household products for a two-year period. The contract states that CP has the exclusive use of the production line (that is, Vendor cannot use the production line for other customer orders).

The type of household product is specified in the contract. CP issues instructions to Vendor about the quantity and timing of products to be delivered. If the production line is not producing the household product for CP, it does not operate.

Vendor operates and maintains the production line on a daily basis.

Analysis

This contract contains a lease. CP has the right to use the dedicated production line for two years.

There is an identified asset. The dedicated production line is an implicitly identified asset because Vendor has only one line that can fulfill the contract, and Vendor does not have the right to substitute the specified production line.

CP has the right to control the use of the dedicated production line (i.e., the identified asset) throughout the two-year period of use because:

- CP has the right to substantially all of the economic benefits from use of the dedicated production line over the two-year period of use. CP has exclusive use of the dedicated production line; it has rights to all the household product produced throughout the two-year period of use.
- CP has the right to direct the use of the dedicated production line. CP makes the relevant decisions about how and for what purpose the production line is used because it has the right to determine whether, when and how much the production line will produce (that is, the timing and quantity, if any, of household products produced) throughout the period of use. Because Vendor is prevented from using the production line for another purpose, CP's decision-making rights about the timing and quantity of household products produced, in effect, determine when and whether the production line produces product.

Although the operation and maintenance of the production line are essential to its efficient use, Vendor's decisions in this regard do not give it the right to direct how and for what purpose the production line is used. Consequently, Vendor does not control the use of the production line during the period of use. Instead, Vendor's decisions are dependent on CP's decisions about how and for what purpose the production line is used.

Determining whether a customer has the right to direct the use of an asset throughout the period of use may require significant judgment. Changes in facts and circumstances may result in a different conclusion.

Examples 8 and 9 in the standard[5] provide contract manufacturing illustrations of the evaluation of whether a customer controls the use of an asset throughout the period of use.

The supplier may retain certain rights, such as the rights to make certain decisions to protect its investment in the asset (e.g., determining whether conditions are safe for operation), known as protective rights. However, a supplier's protective rights, in isolation, do not prevent the customer from having the right to direct the use of the underlying asset.

How we see it

Because the accounting for operating leases under ASC 840 is similar to the accounting for service contracts, entities may not have always focused on determining whether an arrangement is a lease or a service contract. For entities that have not yet adopted, they may need to revisit assessments of existing leases and service arrangements because, under ASC 842, most operating leases are recognized on lessees' balance sheets, and the effects of incorrectly accounting for a lease as a service may be material.

The FASB noted in the Background Information and Basis for Conclusions of Accounting Standards Update (ASU) 2016-02 (BC393(a)) that the practical expedient that permits entities not to reassess whether any expired or existing contracts contain leases does not grandfather incorrect assessments made under ASC 840 (i.e., the practical expedient applies only to arrangements that were appropriately assessed under ASC 840).

Payments for insurance and real estate taxes are not separate components of the contract.

Identifying and separating components of a contract and allocating contract consideration

For contracts that contain the rights to use multiple assets but not land (e.g., a building and equipment, multiple pieces of equipment), the right to use each asset is considered a separate lease component if both of these conditions are met:

- The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee.
- The right of use is neither highly dependent on, nor highly interrelated with, the other right(s) to use underlying assets in the contract.

If one or both of these criteria are not met, the right to use multiple assets is considered a single lease component.

For contracts that involve the right to use land and other assets (e.g., land and a retail store), ASC 842 requires an entity to classify and account for the right to use land as a separate lease component, unless the accounting effect of not separately accounting for land is insignificant.

Many contracts contain a lease coupled with an agreement to purchase or sell other goods or services (non-lease components). For example, a retailer may lease space in a shopping mall where the landlord provides common area maintenance (CAM) services (e.g., cleaning services, landscaping). CAM is considered a non-lease component. The non-lease components are identified and accounted for separately from the lease component in accordance with other US GAAP (except when a lessee or lessor applies the practical expedients to not separate lease and non-lease components). For example, the non-lease components may be accounted for as executory arrangements by lessees (customers) or as contracts subject to ASC 606, *Revenue from Contracts with Customers,* by lessors (suppliers).

In some leases, a lessee also may reimburse the lessor, or make certain payments on behalf of the lessor, that relate to the leased asset such as payments for insuring the lessor's asset and real estate taxes associated with such asset. Insurance that protects the lessor's interest in the underlying asset and taxes related to such asset (e.g., real estate taxes on the underlying asset) are not separate components of the contract because they do not represent payments for goods or services (i.e., the payments are for the use of the leased asset and are attributable to the lease component or allocated between the lease and non-lease components). For lessees, if an arrangement does not contain a non-lease component, fixed and variable payments for insuring the lessor's asset and real estate taxes associated with such asset are attributable to the lease component. If the same arrangement contains a lease and a non-lease component (e.g., maintenance), fixed payments are included in the consideration in the contract and allocated between the lease and non-lease components on a relative standalone price basis, regardless of how the contract was negotiated (e.g., as a net lease rather than a gross lease).

Illustration 2 — Allocating contract consideration if a lessee does not elect the practical expedient to combine the lease and non-lease components

On 1 January 20X0, Retailer (lessee) enters into a three-year lease with the owner of a shopping center (Lessor). Under the terms of the agreement, Retailer agrees to pay the following for the right to use one of the spaces in Lessor's shopping center:

- A fixed payment payable on 31 December of each year starting at $300,000 and increasing 10% each year
- A variable payment per year based on an allocated portion (e.g., by square footage of tenants) of the actual costs Lessor incurs for Lessor's property taxes and insurance related to the leased asset and CAM (e.g., cleaning services). Amounts incurred are payable on 31 December of each year.

In this example, the right to use the retail space for three years is a lease component, with a standalone price of $800,000. The lease is classified as an operating lease. The CAM services are a non-lease component, with a standalone price of $123,000. Retailer's payments for Lessor's real estate taxes and insurance related to the leased asset are not components of the contract because they do not represent payment for goods or services, in addition to the right to use the space, transferred to the lessee.

Assume that Retailer incurs no initial direct costs, and its incremental borrowing rate at lease commencement is 4%.

Also, Retailer does not elect the practical expedient to combine the lease and non-lease components.

In this example, Retailer allocates the fixed consideration in the contract as follows:

Component	**Relative %**	**Allocation of fixed consideration**			
		Year 1	**Year 2**	**Year 3**	**Total**
Lease	86.7% (a)	$ 260,000	$ 286,000	$ 315,000	$861,000
CAM	13.3% (b)	40,000	44,000	48,000	132,000
	100%	$ 300,000	$ 330,000	$ 363,000	$993,000

(a) 800,000 / (800,000 + 123,000) = 86.7%

(b) 123,000 / (800,000 + 123,000) = 13.3%

The initial measurement of the right-of-use asset and lease liability is $794,000 using the allocated consideration in the contract of $861,000 discounted using Retailer's incremental borrowing rate at lease commencement of 4%.

At the end of year one, Retailer pays the annual rental payment of $300,000, of which $260,000 is allocated to the lease component and $40,000 is allocated to CAM services.

Lessee prepares financial statements on an annual basis at the end of the year. At the end of year one, Retailer records the following for the fixed consideration:

Lease liability	$ 228,000 (a)	
Lease expense	$ 287,000 (b)	
Maintenance expense	$ 44,000 (c)	
Right-of-use asset		$ 255,000 (d)
Cash		$ 300,000 (e)
CAM accrual		$ 4,000 (f)

(a) Difference between the initial measurement of the lease liability (and right-of-use asset) at lease commencement ($794,000) and the present value of remaining lease payments at the end of year one ($566,000)

(b) Payments allocated to the lease component recognized on a straight-line basis (total consideration in the contract of $861,000 over three years)

(c) Expense attributable to the non-lease component (total CAM expense of $132,000 over three years)

(d) Adjustment in (a) of $228,000 plus accrued rent of $27,000, which is the difference between the cash paid for the lease component of $260,000 and straight-line lease rent expense of $287,000

(e) Cash payment

(f) CAM accrual for the difference between the straight-line expense allocated to the CAM component ($44,000) and the CAM payment ($40,000)

Lessees can make a policy election to not separate a lease component from its associated non-lease components.

Retailer makes a variable payment of $50,000 at the end of year one based on Lessor's costs incurred for property taxes, property insurance and CAM services. Retailer allocates variable payments to the lease and non-lease component (i.e., CAM) on the same basis as the initial allocation of the consideration in the contract.

In this example, Retailer allocates the variable payment in the contract as follows:

Component	Relative %	Allocation of variable payment
Lease	86.7%	$ 43,350
CAM	13.3	6,650
	100%	$ 50,000

At the end of year one, Retailer records the following for the variable payment:

Lease expense	$ 43,350	
Maintenance expense	$ 6,650	
Cash		$ 50,000

Immaterial differences may arise in the recomputation of amounts in the example above due to rounding.

Practical expedient to not separate non-lease and associated lease components – lessees

ASC 842 provides a practical expedient that permits lessees to make an accounting policy election (by class of underlying asset) to account for each separate lease component of a contract and its associated non-lease components as a single lease component.

Lessees that do not make an accounting policy election to use this practical expedient are required to allocate the consideration in the contract to the lease and non-lease components on a relative standalone price basis. Lessees are required to use observable standalone prices (i.e., prices at which a customer would purchase a component of a contract separately) when readily available. If observable standalone prices are not readily available, lessees estimate standalone prices, maximizing the use of observable information. A residual estimation approach may be appropriate when the standalone price for a component is highly variable or uncertain.

Illustration 3 — Allocating contract consideration if a lessee elects the practical expedient to combine lease and non-lease components

Assume the same facts as in Illustration 2 except Retailer elects the practical expedient to combine lease and non-lease components. Retailer has concluded that the lease is an operating lease.

In this example, Retailer allocates all of the consideration to the lease component. Therefore, it recognizes all of the fixed consideration in the contract ($993,000) as lease payments.

The initial measurement of the right-of-use asset and lease liability is $916,000 using Retailer's incremental borrowing rate at lease commencement of 4%.

At the end of year one, Retailer pays the annual rental payment of $300,000 and makes a variable payment of $50,000 based on Lessor's actual costs incurred for property taxes, property insurance and CAM.

Lessee prepares financial statements on an annual basis at the end of the year. At the end of year one, Retailer records the following for the fixed and variable consideration:

Lease liability	$ 263,000 (a)	
Lease expense	$ 381,000 (b)	
Right-of-use asset		$ 294,000 (c)
Cash		$ 350,000 (d)

(a) Difference between the initial measurement of the lease liability (and the right-of-use asset) at lease commencement ($916,000) and the present value of remaining lease payments at the end of year one ($653,000)

(b) Fixed and variable payments allocated to the lease component; fixed payments recognized on a straight-line basis (total consideration in the contract of $993,000 over three years) plus the variable payment of $50,000 in year one

(c) Adjustment in (a) of $263,000 plus accrued rent of $31,000, which is the difference between the cash paid of $350,000 and straight-line lease rent expense of $381,000

(d) Cash payment

Immaterial differences may arise in the recomputation of amounts in the example above due to rounding.

How we see it

For many lessees in the consumer products and retail industry, identifying non-lease components of contracts has been a change in practice. As discussed earlier, entities may not have focused on identifying lease and non-lease components because their accounting treatment (e.g., the accounting for an operating lease and a service contract) was often the same. However, because most leases are recognized on lessees' balance sheets under ASC 842, lessees have had to put more robust processes in place to identify the lease and non-lease components of contracts.

Lessees that make the policy election to account for a lease component of a contract and its associated non-lease components as a single lease component allocate all of the contract consideration to the lease component. Therefore, the initial and subsequent measurement of the lease liability and right-of-use asset is greater than if the policy election was not applied, which could have an effect on a lessee's impairment analysis.

Lease term

The lease term begins at the lease commencement date and is determined on that date based on the noncancelable term of the lease, together with all of the following:

- Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
- Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- Periods covered by an option to extend (or not terminate) the lease in which the exercise of the option is controlled by the lessor

Determining whether the reasonably certain threshold has been met requires significant judgment.

Commencement date

The commencement date is the date on which the lessor makes an underlying asset (i.e., the property, plant or equipment that is subject to the lease) available for use by the lessee. In some cases, the commencement date of the lease may be before the date stipulated in the lease agreement (e.g., the date rent becomes due and payable). This often occurs when the leased space is modified by the lessee prior to commencing operations in the leased space (e.g., during the period a lessee uses the leased space to construct its own leasehold improvements). In making the assessment of lease commencement, it will often be necessary to distinguish between lessee and lessor assets.

At the commencement date of a lease, a lessee recognizes an asset representing the right to use the underlying asset during the lease term and a liability to make lease payments.

Illustration 4 — Determining the lease commencement date
Assume that Entity A leases office space from Entity B, and both parties execute the lease on 1 December 20X6. Entity B makes the space available for use by Entity A on 1 February 20X7 so that Entity A can begin to construct leasehold improvements. On 1 June 20X7, following completion of construction of the leasehold improvements, Entity A begins to use the office space for its operations and makes its first rental payment to Entity B.
Analysis: The lease commencement date is 1 February 20X7, the date on which Entity B made the underlying asset available for use by Entity A. On the commencement date (i.e., 1 February 20X7), the lessee would generally recognize a right-of-use asset and a lease liability and the lessor (for direct financing and most sales-type leases) recognizes its net investment in the lease.

Lease payments[6]

Lease payments are payments made by a lessee to a lessor, relating to the right to use an underlying asset during the lease term and are used to measure a lessee's lease assets and liabilities.

Some lease agreements include payments that are described as variable or may appear to contain variability but are in-substance fixed payments because the contract terms require the payment of a fixed amount that is unavoidable. Such payments are included in the lease payments at lease commencement and, thus, are used in the classification test and to measure entities' lease assets and lease liabilities.

For lessees, variable lease payments that are not based on an index or rate are not included in lease payments and are recognized when the achievement of the specified target that triggers the variable payments is considered probable.

Entities need to analyze their contracts carefully to determine whether the payments must be included in lease payments (e.g., fixed or variable payments based on an index or rate) or whether the payment is excluded from lease payments (variable payments not based on an index or rate). Significant judgment may be required.

Lease incentives

A lease agreement with a lessor might include incentives for the lessee to sign the lease, such as an up-front cash payment to the lessee, payment of costs for the lessee (such as moving expenses) or the assumption by the lessor of the lessee's preexisting lease with a third party.

For lessees, lease incentives that are paid or payable to the lessee are deducted from lease payments and affect the lease classification test and reduce the initial measurement of a lessee's right-of-use asset. Lease incentives that are payable to the lessee at lease commencement reduce a lessee's lease liability.

Illustration 5 — Noncontingent lease incentives

A lessee (Retailer) leases retail space in a shopping center for 10 years. Retailer agrees to pay a fixed payment per year of $100,000, due in arrears. The present value of the lease payments is $772,000 using a discount rate of 5%. Retailer incurs no initial direct costs.

Scenario 1

To incentivize Retailer to enter into the lease, the lessor pays Retailer $100,000 on the commencement date of the lease.

Retailer records the right-of-use asset, lease liability and lease incentive on the commencement date as follows:

Right-of-use asset	$ 672,000	
Cash	$ 100,000	
Lease liability		$ 772,000

Scenario 2

To incentivize Retailer to enter into the lease, the lessor agrees to pay Retailer $100,000 one year after the commencement date of the lease. There is no contingency associated with Retailer's right to receive the payment.

In this scenario, the lease incentive receivable reduces Retailer's lease payments by the $100,000 when initially measuring the right-of-use asset and lease liability:

Right-of-use asset	$ 677,000	
Lease liability		$ 677,000 (a)

(a) The ten $100,000 payments less the $100,000 receivable from the lessor due in one year discounted at 5%

When the payment is received, Retailer records the lease incentive as follows:

Cash	$ 100,000	
Lease liability		$ 100,000

ASC 842 does not specifically address the recognition of lease incentives that are neither paid nor payable at lease commencement. We believe the following approaches to recognition would be acceptable:

- If a lease specifies a maximum level of reimbursement and the lessee is reasonably certain to incur costs equal to or exceeding this level, the amount would be deemed payable by the lessor at the commencement date and it would be included in the measurement of the consideration in the contract at commencement. Therefore, the amount would be recognized as a reduction in the right-of-use asset and lease liability.

- Once a lessee has incurred costs and the amounts qualify for reimbursement by the lessor, the lessee would reduce the right-of-use asset and lease liability by the costs incurred. The reduction to the right-of-use asset would be recognized prospectively over the remainder of the lease term.
- Once a lessee has incurred costs and the amounts qualify for reimbursement by the lessor, the lessee would reduce the right-of-use asset and lease liability by the costs incurred. The reduction to the right-of-use asset would be recognized as a cumulative catch-up adjustment to expense, as if the incentive were paid or payable at the lease commencement date.

Refer to Illustration 2-7 in our ASC 842 FRD for an example of the accounting for lease incentives not paid or payable at commencement.

Other considerations

Key money

Tenants sometimes pay what is called key money to either a landlord or another tenant to secure a prime retail location, typically in regions outside of the US. If the lessee pays key money to the lessor, the payment is a lease payment used to measure a lessee's lease assets and liabilities and classify the lease. We believe that when a lessee pays key money to an existing tenant as an inducement for the tenant to terminate the lease, such payment might meet the definition of an initial direct cost of the lease.

Co-tenancy clause

A co-tenancy clause is a clause in a lease contract that could result in changes in a tenant's lease payments if certain events involving other tenants occur (e.g., if key tenants or a certain number of tenants leave a retail shopping center). A co-tenancy clause, if triggered, may temporarily reduce a lessee's lease payments or contractually change the lease payments from fixed lease payments to variable lease payments (e.g., payments that were previously fixed are changed to a percentage of sales). Generally, when the co-tenancy clause is resolved (e.g., the anchor tenant is replaced or occupancy levels return a stated percentage), the lease payments will revert back to the previous amounts.

If after lease commencement a co-tenancy clause is triggered, we believe a lessee generally would not consider the event a lease payment remeasurement event. ASC 842 requires a lessee to remeasure lease payments when a contingency upon which some or all of the variable lease payments that will be paid over the remainder of the lease term are based is resolved and those payments now meet the definition of lease payments. A co-tenancy clause would typically result in the inverse scenario because it would temporarily lower the lease payment or temporarily cause fixed payments to become variable. Therefore, we believe any temporary change in lease payments that results from a co-tenancy clause being triggered should be recognized as period lease cost similar to variable lease payments.

However, in certain circumstances, when it is likely the co-tenancy clause will not be resolved (e.g., the lease space is an aging strip mall with a low likelihood of locating replacement tenants that comply with the clause), we believe a lessee may reasonably conclude that the change in its lease payments is a lease payment remeasurement event. In that scenario, the lease payments would be remeasured resulting in a reduction to the existing lease liability. Therefore, the effect of a co-tenancy clause when reassessing lease payments will depend on an entity's facts and circumstances.

Lease classification

At lease commencement, a lessee classifies a lease as a finance lease and a lessor classifies a lease as a sales-type lease if the lease meets **any one** of the following criteria:

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- The lease term is for a major part of the remaining economic life of the underlying asset. This criterion is not applicable for leases that commence at or near the end of the underlying asset's economic life.
- The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already included in the lease payments equals or exceeds substantially all of the fair value of the underlying asset.
- The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

A lessee classifies a lease as an operating lease when it does not meet any of the criteria above.

A lessor classifies a lease as a direct financing lease when none of the criteria above are met but the lease meets **both** of the following criteria:

- The present value of the sum of lease payments and any residual value guaranteed by the lessee and **any other third party unrelated to the lessor** equals or exceeds substantially all of the fair value of the underlying asset.
- It is probable that the lessor will collect the lease payments plus any amount necessary to satisfy a residual value guarantee.

A key difference between the sales-type lease and direct financing lease classification tests is the treatment of residual value guarantees provided by unrelated third parties other than the lessee. Those third-party guarantees are excluded from the evaluation of the "substantially all" criterion in the sales-type lease test. However, they are included in the evaluation in the direct financing lease test. In addition, the evaluation of the collectibility of lease payments and residual value guarantees affects direct financing lease classification, whereas it does not affect sales-type lease classification. However, the evaluation of collectibility does affect sales-type lease recognition and measurement.

For lessors, all leases not classified as sales-type leases or direct financing leases are classified as operating leases.

Lessees and lessors reassess lease classification as of the effective date of a modification (i.e., a change to the terms and conditions of a contract that results in a change in the scope of or consideration for the lease) that is not accounted for as a separate contract. Lessees also are required to reassess lease classification when there is a change in their assessment of either the lease term or whether they are reasonably certain to exercise an option to purchase the underlying asset.

How we see it

Under the new leases standard, reassessing whether a modified contract is or contains a new lease has resulted in changes to financial reporting from ASC 840. In addition to analyzing their facts and circumstances, entities need to update their accounting policies, processes, internal controls and other documentation to reflect the analysis required by the new standard.

Lessee accounting

At the commencement date of a lease, a lessee recognizes an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset) and a liability to make lease payments (i.e., the lease liability).

The initial recognition of the right-of-use asset and the lease liability is the same for operating leases and finance leases, as is the subsequent measurement of the lease liability. However, the subsequent measurement of the right-of-use asset for operating leases and finance leases differs under ASC 842.

For finance leases, lessees are required to separately recognize the interest expense on the lease liability and the amortization expense on the right-of-use asset. This generally results in a front-loaded expense recognition pattern. The periodic lease expense for operating leases is generally recognized on a straight-line basis.

Short-term leases recognition and measurement exemption

Lessees can make an accounting policy election (by class of underlying asset to which the right of use relates) to apply accounting similar to ASC 840's operating lease accounting to leases that meet ASC 842's definition of a short-term lease (i.e., the short-term lease exemption). A short-term lease is defined as a lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise. The short-term lease election can only be made at the commencement date.

A lessee that makes this accounting policy election does not recognize a lease liability or right-of-use asset on its balance sheet. Instead, the lessee recognizes lease payments as an expense on a straight-line basis over the lease term and variable lease payments that do not depend on an index or rate as expense in the period in which the achievement of the specified target that triggers the variable lease payments becomes probable. Any recognized variable lease expense is reversed if it is probable that the specified target will no longer be met.

How we see it

The ASC 842 lessee disclosure requirements apply to all leases, including leases for which the entity has elected the short-term lease exception. The disclosure requirements have impacted whether some entities elected to apply the short-term lease exception. For example, a lessee that makes this election needs to have systems, processes and controls that can track total lease costs, including amounts that relate to short-term leases.

Impairment of right-of-use assets in operating leases (updated June 2019)

A lessee's right-of-use asset in an operating or finance lease is subject to the impairment guidance in ASC 360, *Property, Plant, and Equipment*.

ASC 360 requires three steps to identify, recognize and measure the impairment of a long-lived asset (asset group) to be held and used:

- Indicators of impairment (Step 1) — Consider whether impairment indicators are present.

- Test for recoverability (Step 2) — If indicators of impairment are present, perform a recoverability test by comparing the sum of the estimated undiscounted cash flows attributable to the long-lived asset (asset group) in question to the carrying amount of the long-lived asset (asset group).
- Measurement of an impairment (Step 3) — If the undiscounted cash flows used in the test for recoverability are less than the carrying amount of the long-lived asset (asset group), determine the fair value of the long-lived asset (asset group) and recognize an impairment loss if the carrying amount of the long-lived asset (asset group) exceeds its fair value.

ASC 360 defines an asset group as "the unit of accounting for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities."

Determining the appropriate level for grouping long-lived assets will require consideration of the facts and circumstances and an understanding of the entity's business. We believe the impairment test for right-of-use assets often will be performed at an asset-group level with any impairment allocated among the long-lived asset or assets of the group in accordance with ASC 360.

Test for recoverability (Step 2)

ASC 360 provides principles for evaluating long-lived assets for impairment, but it does not specifically address how operating lease liabilities and future cash outflows for lease payments should be considered in the recoverability test. Under ASC 360, financial liabilities (e.g., long-term debt) generally are excluded from an asset group and operating liabilities (e.g., accounts payable) generally are included. Financial liabilities generally are excluded because when the FASB was deliberating Statement 144 (later codified in ASC 360), it indicated that how an entity capitalizes or finances its operations should not influence the recognition of an impairment loss (see B34 of Statement 144). ASC 360 requires an entity to exclude asset retirement obligation (ARO) liabilities from an asset group and to exclude estimated future cash outflows associated with ARO liabilities from both the recoverability test (Step 2) and the measurement of an impairment (Step 3).

ASC 842 characterizes operating lease liabilities as operating liabilities. In the Basis for Conclusions (BC264) of ASU 2016-02, the FASB noted that while both operating and finance lease liabilities are financial liabilities, finance lease liabilities are the equivalent of debt, and operating lease liabilities are operating in nature and not "debt like."

Because operating lease liabilities may be viewed as having attributes of finance liabilities as well as operating liabilities, we believe it is acceptable for a lessee to either include or exclude operating lease liabilities from an asset group when testing whether the carrying amount of an asset group is recoverable. A lessee should apply its approach (i.e., include or exclude operating lease liabilities) consistently for all operating leases and when performing Steps 2 and 3 of the impairment model in ASC 360.

In some cases, including operating lease liabilities in an asset group may result in the long-lived asset (asset group) having a zero or negative carrying amount. For example, this may occur if a lessee receives lease incentives or has back-loaded lease payments, both of which would result in reductions to the lessee's right-of-use assets. In these cases, a lessee is still required to test whether the carrying amount of the asset group is recoverable and, if not recoverable, measure the asset group for impairment.

Undiscounted future cash flows

The FASB staff said in response to a technical inquiry that if a lessee includes an operating lease liability as part of the carrying amount of the asset group, only the principal component of future lease payments would be included as an outflow in the undiscounted future cash flows used to test recoverability of the asset group. That is, the lessee would include the future cash lease payments for the lease, excluding the component that effectively represents the accretion of the lease liability (even though interest expense is not recognized separately for an operating lease). As a result, we believe a lessee's decision to include or exclude operating lease liabilities from an asset group generally should not affect the outcome of its recoverability test (refer to Illustration 6).

In summary, if a lessee includes operating lease liabilities in its asset group, it should include only the principal component of future cash lease payments in the undiscounted future cash flows. If it excludes operating lease liabilities from its asset group, it should exclude all future cash lease payments for the lease.

The standard requires lessees to exclude certain variable lease payments from lease payments and, therefore, from the measurement of a lessee's lease liabilities. Because these payments do not reduce a lessee's lease liability, we believe the variable payments a lessee expects to make should be included in a lessee's estimate of undiscounted cash flows in the recoverability test (Step 2) regardless of whether the lessee includes or excludes operating lease liabilities from the asset group. How these payments are included in the lessee's estimate of future cash flows will depend on the cash flow estimation approach (e.g., probability-weighted, best estimate) it uses. We also believe such variable payments should be included when determining the fair value in Step 3 if the lessee uses a discounted cash flow approach.

As a reminder, a lessee uses its own assumptions to develop estimates of future cash flows in Step 2. This differs from the approach in Step 3 where the lessee measures fair value of the asset group based on market participant assumptions.

Illustration 6 — Recoverability test for an asset group that is held and used

On 1 January 20X1, a retailer (Lessee) leases space from the owner of a shopping center (Lessor) for 10 years. Under the terms of the agreement, Lessee agrees to pay fixed payments payable on 31 December of each year starting at $10,000 and increasing 2% each year.

Assume, the lease is classified as an operating lease, and Lessee's incremental borrowing rate is 4%. Lessee determines that the appropriate level at which to group assets to test for and measure impairment of long-lived assets is at the store level.

On 1 January 20X4, Lessee identifies a change in circumstances that indicates the carrying amount of the asset group may not be recoverable and performs a recoverability test. On this date, assume that the carrying amount of the asset group, excluding the operating lease liability, is $500,000 and the carrying amount of the operating lease liability is $67,436 (calculation not shown). Also, assume that the cash flow estimation period is seven years and that the undiscounted future expected cash flows per year, excluding lease payments, is $75,000 per year.

Scenario 1

Lessee excludes the operating lease liability from the asset group when determining the carrying amount of the asset group and, therefore, excludes the cash outflows for lease payments in determining the undiscounted future expected cash flows of the asset group.

Year	Undiscounted future expected cash flows (before lease payments)	Total
1	$ 75,000	$ 75,000
2	$ 75,000	$ 75,000
3	$ 75,000	$ 75,000
4	$ 75,000	$ 75,000
5	$ 75,000	$ 75,000
6	$ 75,000	$ 75,000
7	$ 75,000	$ 75,000
	$ 525,000	$ 525,000

Carrying amount of asset group (excluding operating lease liability)	$ 500,000
Total undiscounted future expected cash flows	$ 525,000
Excess	$ 25,000
Recoverable? (Yes or No)	Yes

Scenario 2

Lessee includes the operating lease liability in the asset group when determining the carrying amount of the asset group and, therefore, includes the cash outflows for the principal portion of the lease payments in determining the undiscounted future expected cash flows of the asset group.

Year	Undiscounted future expected cash flows (before lease payments)	Lease payments	Add back portion related to accreted interest	Total undiscounted future expected cash flows
1	$ 75,000	(10,612)	2,697	$ 67,085
2	$ 75,000	(10,824)	2,381	$ 66,557
3	$ 75,000	(11,041)	2,043	$ 66,002
4	$ 75,000	(11,262)	1,683	$ 65,421
5	$ 75,000	(11,487)	1,300	$ 64,813
6	$ 75,000	(11,717)	893	$ 64,176
7	$ 75,000	(11,950)	460	$ 63,510
	$ 525,000	(78,893)	11,457	$ 457,564

Carrying amount of asset group (excluding operating lease liability)	$ 500,000
Carrying amount of operating lease liability	(67,436)
Carrying amount of asset group (including operating lease liability)	$ 432,564
Total undiscounted future expected cash flows	$ 457,564
Excess	$ 25,000
Recoverable? (Yes or No)	Yes

As shown in Scenario 2, including the operating lease liability in the asset group results in the same outcome as the recoverability test in Scenario 1. This is because by excluding accreted interest from the undiscounted future cash flows both the carrying amount of the asset group and the undiscounted future cash flows are reduced by the existing discounted lease obligation (i.e., $67,436).

Measurement of an impairment (Step 3)

If the undiscounted cash flows used in the recoverability test are less than the carrying amount of the long-lived asset (asset group), an entity is required to determine the fair value of the long-lived asset (asset group) and recognize an impairment loss when the carrying amount of the long-lived asset (asset group) exceeds its fair value.

We believe that if a lessee excludes operating lease liabilities from the asset group when performing the recoverability test, it also should exclude operating lease liabilities from the asset group when measuring the group's fair value. Alternatively, if a lessee includes operating lease liabilities in the asset group when performing the recoverability test, it also should include operating lease liabilities in the asset group when determining the group's fair value.

Regardless of which approach a lessee chooses, we generally do not expect significant differences in the measurement of an impairment loss because we would expect a lessee's estimate of the fair value of the asset group to appropriately reflect whether the asset group includes or excludes operating lease liabilities. For example, consistent with the guidance in ASC 360 for AROs, if a lessee excludes operating lease liabilities from the carrying amount of an asset group but the fair value of the asset group is based on a quoted market price that considers the lessee's obligation to make lease payments, the quoted market price should be increased by the fair value of the operating lease liabilities. Alternatively, if a lessee includes operating lease liabilities in the carrying amount of an asset group but the fair value of the asset group is based on a quoted market price that does not consider the lessee's obligation to make lease payments, the quoted market price should be decreased by the fair value of the operating lease liabilities.

If the fair value of the asset group is determined based on discounted cash flows, the market participant cash flows should be adjusted to align with an entity's decision to include or exclude operating lease liabilities in the carrying amount of the asset group. However, if the carrying amount of the asset group includes operating lease liabilities, the market participant discounted cash flows used to estimate fair value should include both principal and interest payments, unlike the cash flows used in the recoverability test.

While we may not expect including or excluding the lease liability to cause significant differences in the measurement of impairments, measurement differences could exist in some circumstances (e.g., due to decreases in the fair value of the lease liability relative to its carrying amount).

As a reminder, in accordance with ASC 360, an impairment loss for an asset group must reduce only the carrying amounts of a long-lived asset or assets of the group (including lease-related right-of-use assets). The loss must be allocated to the long-lived assets of the group on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the group must not reduce the carrying amount of that asset below its fair value whenever the fair value is determinable without undue cost and effort (ASC 360-10-35-28).

ASC 360 prohibits the subsequent reversal of an impairment loss for an asset held and used.

Illustration 7 — Measurement of impairment for an asset group that is held and used

On 1 January 20X2, Lessee enters into a five-year lease of an asset. Lease payments are fixed at $10,000 per year due on December 31 of each year. The lease is classified as an operating lease, and Lessee's incremental borrowing rate is 5%. Assume that the Lessee has no other assets or liabilities that should be grouped with the operating lease right-of-use asset and liability for purpose of testing for impairment.

On 1 January 20X4, Lessee identifies a change in circumstances that indicates the carrying amount of the right-of-use asset ($27,232) may not be recoverable and performs a recoverability test. Lessee determines that the right-of-use asset is not recoverable (i.e., the carrying amount of the right-of-use asset is greater than the related entity-specific gross cash flows) and, therefore, needs to determine whether the carrying amount of the asset exceeds its fair value and, if so, measure and recognize an impairment loss. Lessee determines that the fair value of the right-of-use asset is $20,000, based on its estimate of the amount a market participant would be willing to pay up front in one payment for the right to use the asset for three years in its highest and best use assuming no additional lease payments would be due.

Scenario 1

Lessee's approach for determining and measuring impairment in long-lived asset groups is to exclude operating lease liabilities from the asset group.

	Carrying amount	Fair value	Measurement impairment loss
ROU asset	$ 27,232	$ 20,000	
Lease liability	$ 0	$ 0	
	$ 27,232	$ 20,000	$ (7,232)

In Scenario 1, Lessee would recognize an impairment loss of $7,232, reducing the carrying amount of the right-of-use asset by that amount.

Scenario 2

Assume the same facts as in Scenario 1 except that the Lessee's approach for determining and measuring impairment in long-lived asset groups is to include operating lease liabilities in the asset group, which results in the asset group having a carrying amount of zero. Lessee determines that the right-of-use asset is not recoverable because the entity-specific gross cash receipts are negative. Also, assume there has not been a significant change in the lessee's credit quality or interest rates since 1 January 20X2 such that the fair value of the lease liability is determined to be the same as its carrying amount (i.e., $27,232).

	Carrying amount	Fair value	Measured impairment loss
ROU asset	$ 27,232	$ 20,000	
Lease liability	$ (27,232)	$ (27,232)	
	$ 0	$ (7,232)	$ (7,232)

In Scenario 2, Lessee would recognize an impairment loss of $7,232, reducing the carrying amount of the right-of-use asset by that amount.

Scenario 3

Assume the same facts as Scenario 1 except that the Lessee's approach for determining and measuring impairment in long-lived asset groups is to include operating lease liabilities in the asset group, which results in the asset group having a carrying amount of zero. Lessee determines that the right-of-use asset is not recoverable because the entity-specific gross cash receipts are negative. However, further assume that Lessee determines that the fair value of the lease liability is $30,000 due to a significant improvement in its credit quality since 1 January 20X2.

	Carrying amount	Fair value	Measured impairment loss
ROU asset	$ 27,232	$ 20,000	
Lease liability	$ (27,232)	$ (30,000)	
	$ 0	$ (10,000)	$ (10,000)

In Scenario 3, Lessee would recognize an impairment loss of $7,232, reducing the carrying amount of the right-of-use asset by that amount. Although the measured impairment loss for the asset group is $10,000, Lessee can reduce only the carrying amount of the long-lived assets in the group (i.e., the right-of-use asset) and cannot reduce the carrying amount of that asset below its fair value whenever the fair value is determinable without undue cost and effort.

Scenario 4

Assume the same facts as Scenario 1 except that the Lessee's approach for determining and measuring impairment in long-lived asset groups is to include operating lease liabilities in the asset group, which results in the asset group having a carrying amount of zero. Lessee determines that the right-of-use asset is not recoverable because the entity-specific gross cash receipts are negative. However, further assume Lessee determines that the fair value of the lease liability is $15,000 due to a significant deterioration in the lessee's credit quality since 1 January 20X2.

	Carrying amount	Fair value	Measured impairment loss
ROU asset	$ 27,232	$ 20,000	
Lease liability	$ (27,232)	$ (15,000)	
	$ 0	$ 5,000	$ 0

In Scenario 4, Lessee would not recognize an impairment loss even though the carrying amount of the right-of-use asset exceeds its fair value by $7,232.

For additional guidance on impairment of right-of-use assets (including in finance leases) refer to our ASC 842 FRD.

Other considerations

Sale and leaseback transactions

Because lessees are required to recognize most leases on the balance sheet (i.e., all leases except for short-term leases if the lessee makes an accounting policy election to use this exemption), sale and leaseback transactions do not provide lessees with a source of off-balance sheet financing.

Both the seller-lessee and buyer-lessor are required to apply ASC 842 and certain provisions of ASC 606 to determine whether to account for a sale and leaseback transaction as a sale (seller-lessee) and purchase (buyer-lessor) of an asset. If control of an underlying asset passes to the buyer-lessor, the transaction is accounted for as a sale (seller-lessee) or purchase (buyer-lessor) and a lease by both parties. If not, the transaction is accounted for as a financing by both parties. Also, note that sale and leaseback transactions among entities under common control are subject to ASC 842-40's sale and leaseback guidance.

Lessee involvement in asset construction

ASC 842 makes significant changes to how lessees and lessors evaluate their involvement in asset construction. ASC 842 focuses on whether the lessee controls the asset being constructed to determine whether it is the accounting owner of an asset under construction, while ASC 840 focuses on whether the lessee has substantially all of the construction-period risk.

If the lessee controls the asset during the construction period, lessees and lessors will apply the sale and leaseback guidance when the construction of the asset is complete and the lease commences. If the lessee does not control the underlying asset being constructed, any payments made for the right to use the underlying asset are lease payments, regardless of the timing or form of those payments. Lease payments made prior to lease commencement are recognized as a prepaid asset and evaluated in the lease classification test. Costs incurred by the lessee (when the lessee does not control the asset during construction) that relate specifically to the construction or design of an asset that are not payments for the use of an asset to be leased are recognized in accordance with other US GAAP (e.g., ASC 330, *Inventory*; ASC 360).

For guidance on accounting for lessee involvement in construction and related transition guidance, refer to our ASC 842 FRD.

Lease modifications

ASC 842 defines a lease modification as a change to the terms and conditions of a contract that results in a change in the scope of or the consideration for a lease. For example, a modification may occur when a lessee and lessor agree to modify a lease to include additional square footage for a retail store or office space in the same building.

Lessees and lessors account for a lease modification as a separate contract (i.e., separate from the original lease) when certain conditions are met. How an entity accounts for modifications that do not result in a separate contract depends on whether the entity is a lessee or lessor, the nature of the modification and the classification of the lease before and after the modification.

Refer to our ASC 842 FRD for details on accounting for lease modifications.

Transition

Entities are required to adopt ASC 842 using a modified retrospective approach. Upon the adoption of ASC 842, an entity applies the standard's transition provisions at one of the following initial application dates:

- The later of (1) the beginning of the earliest comparative period presented in the financial statements and (2) the commencement date of the lease.
- The beginning of the period of adoption (i.e., on the effective date).

For transition guidance, refer to our ASC 842 FRD.

Other transition considerations

Impairment of long-lived store assets

Regardless of the date the entity first applies ASC 842, at the effective date, a lessee's right-of-use assets are subject to impairment guidance in ASC 360. As described above, ASC 360 requires an analysis of impairment indicators at each reporting period for assets held for use. The testing for and evaluation of impairment of a long-lived asset is performed at the asset or asset-group level depending on the facts and circumstances. If any indicators of impairment are present, a recoverability test using entity-specific undiscounted cash flows is performed. If the right-of-use asset (or asset group as applicable) fails the recoverability test, ASC 360 requires a fair value test. Under ASC 842, if an impairment loss is recognized for a right-of-use asset, the adjusted carrying amount of a right-of-use asset would be its new accounting basis. Consistent with ASC 360, the impairment test for right-of-use assets will often be performed at an asset-group level with any impairment allocated among the asset group in accordance with ASC 360.

How we see it

For consumer products and retail entities that elect to apply ASC 842's transition provisions at the beginning of the period of adoption (e.g., 1 January 2019 for a calendar-year public business entity), if an indicator of impairment exists at the effective date, and that indicator existed immediately prior to the effective date, we believe that any resulting impairment loss recognized for a newly recognized right-of-use asset at transition can be recorded as an adjustment to equity or to profit and loss at the beginning of the period of adoption.

Refer to our ASC 842 FRD for transition guidance.

Next steps

Entities that have not yet adopted the standard should consider the following:

- They will have to develop new processes, controls and/or systems to identify a complete population of leases and gather information necessary to perform the accounting and make the disclosures required by the standard.
- Off-calendar Securities and Exchange Commission (SEC) registrants should provide disclosures about the effects of the new leases standard on the financial statements, as required by Staff Accounting Bulletin Topic 11.M. The SEC staff expects a registrant's disclosures to evolve and become more specific as the effective date of a standard approaches and the registrant makes progress in its implementation plan.

Endnotes:

1 ASC 842, *Leases*.

2 See the ASC Master Glossary for the definition of a public business entity.

3 Not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market and employee benefit plans that file or furnish financial statements with or to the SEC.

4 This would mean the effective date for all other entities would be for annual periods beginning after 15 December 2020 (i.e., 1 January 2021 for a calendar-year entity), and interim periods the following year. A change in the effective date doesn't happen until the Board finalizes the change.

5 ASC 842-10-55-100 through 55-123.

6 See ASC 842-10-30-5 for a definition of lease payments that describes differences in lease payments for lessees and lessors.

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Appendix: How to determine whether an arrangement is or contains a lease

The following flowchart is included in ASC 842's implementation guidance and depicts the decision-making process for determining whether an arrangement is or contains a lease. Refer to our ASC 842 FRD for further guidance on these topics.