FASB|IASB Joint Education Meeting

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Project	**Leases**
Topic	**Topic 842 Post-Implementation Review**
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Purpose

1. The objective of this meeting is to discuss the purpose and progress of the FASB's post-implementation review (PIR) of Accounting Standards Update No. 2016-02, *Leases (Topic 842),* and related guidance (collectively, the leases standard). The discussion will consider the application of the FASB's leases standard by all types of entities that have adopted that standard.

2. This paper is organized as follows:

   (a) Background on the FASB's Leases Standard

   (b) The FASB's Leases PIR Process and Activities

   (c) Expected Benefits and Expected Costs of the FASB's Leases Standard

   (d) PIR Feedback: Benefits and Costs of the FASB's Leases Standard

   (e) Next Steps.

Background on the FASB's Leases Standard

3. Update 2016-02 was issued in February 2016 and was the result of the FASB's and the International Accounting Standards Board's (IASB's) efforts 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. The primary change in the FASB's leases standard and IFRS 16 *Leases* to legacy lease accounting requirements was the recognition of lease assets and lease liabilities by lessees for operating leases. That change was made in response to long-standing requests from investors and other stakeholders to change the accounting requirements so that lessees would be required to recognize the rights and obligations resulting from *all* leases as assets and liabilities.

Although many of the requirements in Topic 842, Leases, are the same as the requirements in IFRS 16, the main difference relates to GAAP distinguishing between finance leases and operating leases in a lessee's financial statements. IFRS 16 requires that all leases be accounted for consistent with the Topic 842 approach for finance leases. Consequently, leases classified as operating leases under Topic 842 are accounted for differently under GAAP than under IFRS 16. See Appendix B of IASB Staff Paper 7A for a detailed list of key differences between Topic 842 and IFRS 16.

4. The accounting for sale and leaseback transactions was an area of significant change in the FASB's leases standard and now relies heavily on the transfer of control guidance in Topic 606, Revenue from Contracts with Customers. The revenue recognition guidance in Topic 606 is different from the guidance on determining whether a sale occurred in a sale and leaseback transaction in previous GAAP. In particular, there could be circumstances in which a transaction would have qualified for a sale under Topic 840, Leases, but does not qualify for a sale under Topic 606, or vice versa. Specifically, many sale and leaseback transactions involving real estate that now qualify for sale and leaseback accounting would not have qualified for that accounting under the FASB's legacy leases guidance. Separately, the FASB's leases standard simplified the accounting for costs of a lessee related to the design or construction of an underlying asset (previously referred to as "built to suit").

5. Lessor accounting was not fundamentally changed in Topic 842 and IFRS 16, respectively.

The FASB's Leases PIR Process and Activities

6. The FASB's PIR process is an evaluation of whether a standard is accomplishing its stated purpose by providing investors, lenders, creditors, and other allocators of capital (collectively, investors) with relevant information in ways that justify the costs of providing it. During the leases PIR process, the FASB solicits and considers diverse stakeholder input and other research to evaluate the FASB's leases standard and whether there are areas of improvement that the FASB should address. The FASB's PIR process comprises three stages, as follows:

   (a) *Stage 1:* Post-issuance date implementation monitoring

   (b) *Stage 2:* Post-effective date evaluation of benefits and costs

   (c) *Stage 3:* Summary of research and reporting.

7. The leases post-issuance date implementation monitoring (Stage 1) began after the issuance of Topic 842 in February 2016. That stage will continue until at least three years after the latest effective date of the leases standard, which had different effective dates depending on the type of entity, as follows:

   (a) *Public entities*[1]*:* For fiscal years beginning after December 15, 2018, and interim periods within those fiscal years

   (b) *Private entities*[2]*:* For fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022.

8. During the post-issuance date implementation monitoring stage, the FASB actively monitored practice as stakeholders prepared for initial implementation of the FASB's leases standard, developed and disseminated implementation guidance and educational material, and communicated and performed outreach with stakeholder organizations, including outreach with the academic community to generate interest in research activities associated with the standard.

9. The leases post-effective date evaluation of benefits and costs stage (Stage 2) began after the effective date (December 15, 2018, and December 15, 2022, for public and private entities, respectively) and will continue for approximately three to five years. During that stage, the FASB conducts activities to (a) understand the benefits of the FASB's leases standard to investors as well as to entities, (b) understand the costs that entities incurred in applying the FASB's leases standard as well as the costs that investors incurred in analyzing and interpreting the information about leases, and (c) monitor the ongoing application of the FASB's leases standard.

Implementation of the FASB's Leases Standard

10. Unlike for its PIR activities related to Topic 606, the FASB did not create a transition resource group (TRG) to address the FASB's leases standard, primarily because many of the concepts in Topic 842 are similar to those previously used in Topic 840. Although a formal TRG was not created, the FASB and its staff assisted stakeholders during the transition to Topic 842 and sought feedback on potential issues that may have arisen as organizations implemented that Topic.

11. In monitoring implementation and gathering feedback to evaluate the benefits and costs of the FASB's leases standard, the PIR activities performed by the FASB and staff to date include the following:

    (a) Responded to almost 400 technical inquiries. A significant portion of those inquiries were related to lessee accounting and transition.

    (b) Discussed leases implementation and application issues at 20 public FASB meetings.

[1] These entities comprise (a) public business entities (as defined in the Master Glossary of the Codification), (b) 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 (c) employee benefit plans that file financial statements with the U.S. Securities and Exchange Commission (SEC).
[2] These entities comprise all entities other than those in footnote 1 and generally include private companies and not-for-profit organizations.

(c) Issued eight Accounting Standard Updates (Updates) to clarify and/or modify Topic 842.

(d) Issued two Updates to defer Topic 842 for private companies and certain not-for-profit (NFP) organizations.

(e) Provided a Staff Q&A in April 2020 on accounting for lease concessions in response to COVID-19. That Q&A was issued by the staff to address immediate concerns about modification accounting and provide relief for certain lease concessions related to the effects of the COVID-19 pandemic.

(f) Developed educational materials and created an implementation website as a single place to house all implementation resources.

(g) Performed public webcasts upon issuance of the Update and throughout the adoption period (including industry-specific webcasts, private-company-focused webcasts, and investor education podcasts).

(h) Held a public roundtable in 2020.

(i) Performed a public company cost survey in 2021.

(j) Engaged with stakeholders from the academic community to generate interest in research activities associated with the FASB's leases standard. Additionally, participated in Accounting for an Ever-Changing World, which was a joint conference of the FASB, IASB, and The Accounting Review, in 2022.

(k) Continued discussions on implementation with advisory and liaison groups and with preparers, practitioners, investors, and regulators.

12. The following is a list of Updates issued to clarify and/or modify Topic 842 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. • 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 minor Codification improvements to clarify Topic 842 and to correct unintended application of guidance.

Name of Update	Objective of Update
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. • 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. • 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). • 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. • 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. • 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. 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: o The lease would have been classified as a sales-type lease or a direct financing lease. 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. • Specified for all entities (public and private entities) that leasehold improvements associated with common control leases are to be: 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

Name of Update	Objective of Update
	group, the amortization period should not exceed the amortization period of the common control group. 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.

Expected Benefits and Expected Costs of the FASB's Leases Standard

13. To evaluate the FASB's leases standard's implementation and continuing compliance costs and related benefits, the FASB staff assesses whether (a) benefits are consistent with what the FASB intended and stakeholders expected and (b) implementation and continuing compliance costs are consistent with the costs that the FASB considered and stakeholders expected. The expected benefits and expected costs of the FASB's leases standard are described below.

Expected Benefits of the FASB's Leases Standard

14. The basis for conclusions in the FASB's leases standard provides details about the expected benefits of the FASB's leases standard to investors. Paragraph BC8 states:

> The [FASB] developed Topic 842 principally to improve [investors'] 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 [investors]. 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 [investors] 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.

Expected Costs of the FASB's Leases Standard

Implementation Costs

15. The basis for conclusions in the FASB's leases standard provides details about the anticipated costs of implementing the leases standard. Paragraph BC10 states:

> BC10. The [FASB] 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 [investors]. 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 [FASB] 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 [FASB] 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.

Compliance Costs

16. Paragraphs BC11 and BC14 describe the anticipated compliance costs for preparers of financial statements:

> BC11. The [FASB] 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 [FASB] 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. The [FASB] decided that a modified retrospective approach for transition, as opposed to a full retrospective approach, provides an appropriate balance between minimizing costs of transition and providing [investors] with comparable financial information. The practical expedients related to transition, if elected, should further significantly reduce the costs associated with transitioning to the new requirements.

> BC14. The [FASB] further considered the concern that the additional lease liabilities recognized as a result of adopting Topic 842 will cause some entities to violate debt covenants or may affect some entities' access to credit because of the potential effect on the entity's GAAP-reported assets and liabilities. Regarding access to credit, outreach has demonstrated that the vast majority of [investors], including private company [investors], presently adjust an entity's financial statements for operating lease obligations that are not recognized in the statement of financial position under previous GAAP and, in doing so, often estimate amounts significantly in excess of what will be recognized under Topic 842.

PIR Feedback: Benefits and Costs of the FASB's Leases Standard

17. The following summarizes the PIR feedback received from investors, preparers, and practitioners (for both public and private entities) during the post-issuance date implementation monitoring (Stage 1) and post-effective date evaluation of benefits and costs (Stage 2).

PIR Feedback from Investors

18. During 2020 and after public entities implemented the FASB's leases standard, the staff conducted outreach with investors of public entity financial statements. The objective of that outreach was to understand whether reported lease assets and lease liabilities and the related disclosures provide investors with decision-useful information. The staff and FASB members spoke with 26 investors from 13 organizations (the investor group). Those investors comprised sell-side and buy-side analysts, credit rating analysts, analysts from an outsourced forensic accounting research firm, and an analyst from a risk management consulting firm. The analysts in the investor group follow a wide range of industries and sectors, including airlines, energy, pharmaceuticals, restaurants, financial services, and a variety of retailers. Certain analysts in that group follow large industry-agnostic portfolios of companies.

19. Additionally, the staff continues to conduct outreach with investor members from various advisory groups, including the FASB's Investor Advisory Committee and Private Company Council (PCC).

20. Specific to the investor group, the staff observed the following broad categories of how investors are currently using financial information reported under the FASB's leases standard:

    (a) *Extensive use:* Investors within this category include the reported lease liability in their models with no (or rare) adjustments. Although the degree to which those investors use other information varies, the staff observes that these investors indicated broader use of that information compared with investors in other categories.

    (b) *Moderate use:* Investors within this category include the reported lease liability in their models with routine adjustments. The staff observes that those investors generally place greater reliance on disclosures (for example, weighted-average discount rate and the components of lease cost) to calculate adjustments.

(c) *Limited use:* Investors within this category do not include the reported lease liability in their models (that is, reported amounts are backed out of financial data). However, the staff observes that some investors use certain disclosures in narrow/targeted ways in their models.

Feedback from Investors That Indicated Extensive Use

21. Several investors (sell-side, buy-side, and other) stated that they include the reported operating lease liability in their models with no (or rare) adjustments. While some disagree with certain aspects of the measurement of the liability, they ultimately concluded that the reported amount is materially accurate for their analyses. Furthermore, they noted that using the reported amount is simpler than the legacy methodologies of either five to eight times base rent or discounting future minimum lease commitments using a standardized discount rate.

22. Investors within this category provided the following feedback about how reported amounts are used in their models:

(a) Almost all investors stated that their models include income statement amounts with no adjustments made. Those investors indicated that the dual classification model and the resulting income statement treatment for operating and finance leases remains appropriate.

(b) Some investors include right-of-use (ROU) assets in their models to evaluate performance metrics such as return on assets.

(c) A few investors highlighted that when comparing IFRS Accounting Standards and GAAP filers, they convert an IFRS Accounting Standards filer's income statement to align with Topic 842.

(d) Many investors within this category stated that they use amounts presented on the statement of cash flows with no adjustments.

23. Generally, investors within this category stated that the disclosures under Topic 842 are an improvement over Topic 840, particularly the disaggregation of the components of lease cost. Additionally, while those investors do not capitalize variable, short-term, and low-value asset (IFRS Accounting Standards only) lease costs, most investors indicated that they monitor those disclosures and find them useful. For example, those disclosures may help them understand, among other items, the all-in rent expense for retailers or to identify outliers for further investigation.

Feedback from Investors That Indicated Moderate Use

24. Investors that indicated moderate use of information reported under Topic 842 were generally analysts from credit rating agencies. Those analysts said that they place greater reliance on the disclosure of weighted-average discount rate and the components of lease cost to calculate the adjustments. Additionally, they said that they view all leases as having financing characteristics and, therefore, noted that a single classification model more accurately reflects the economics of leasing

transactions. Those investors reclassify the reported operating lease liability to debt. Similarly, they recast the income statement to convert all leases to finance leases.

Feedback from Investors That Indicated Limited Use

25. Many investors (sell-side, credit rating agency, and other) indicated limited use of information reported under Topic 842, primarily because they already have well established models. For example:

    (a) Models that capitalize operating leases based on an estimated economic life of the underlying asset, regardless of lease term. Those investors also stated that while the disclosure of the nature of underlying assets is informative for the purposes of estimating the economic life, this disclosure often lacks the level of disaggregation necessary to make it useful.

    (b) Models that exclude the reported lease liability and, instead, estimate the liability using legacy calculations of the net present value of future minimum lease commitments, discounted using a standardized rate.

    (c) Models that exclude all reported lease information from their analyses. Those investors stated that off-balance-sheet accounting for operating leases under Topic 840 was not problematic and that a rent multiple approach (such as five to 8 times rent expense) to estimate the liability was simpler and logical.

Other Observations from Investors

26. The items discussed below include feedback from investors on areas of potential improvement to Topic 842 and comparability with IFRS Accounting Standards.

Statement of Cash Flows

27. Several investors noted that a lack of specific guidance for the statement of cash flows has resulted in diversity in the presentation of operating-lease-related activity in that statement. For example, while some entities present the change in the operating lease ROU asset in a separate line item as a noncash adjustment to net income (often described as noncash operating lease cost) and separately present the change in the lease liability as a change in working capital, other entities present the change in *both* the ROU asset and the lease liability (gross or net) as a change in working capital. Investors stated that the lack of consistency in presentation adds complexity to their analyses, particularly for commonly calculated cash flow metrics such as funds from operations. Therefore, investors indicated that reducing differences in cash flow presentation of operating leases would be useful.

Disclosures

28. Several investors stated that more robust disclosures about the nature of underlying assets, including the economic lives of those assets, would provide decision-useful information. For example, investors

stated that current disclosures are not specific enough and can include wide ranges of useful lives for a broad variety of assets. However, other investors stated that additional disclosure in this area is unnecessary because most investors covering an entity know the composition of assets being used in the business and investors can obtain additional information from investor relations.

Comparability with IFRS Accounting Standards

29. Several investors noted that the lack of convergence results in costs and complexity for investors that follow GAAP and IFRS Accounting Standards filers, particularly because of the effects on the statement of cash flows and EBITDA resulting from the dual lessee classification model in GAAP (operating leases and finance leases) and the IFRS 16 single lessee classification model (consistent with finance leases in GAAP). Some investors said that they impute interest on operating leases under GAAP for comparability with IFRS Accounting Standards.

PIR Feedback from Preparers and Practitioners

30. In conducting outreach with preparers and practitioners performed to date, the FASB and staff have sought to understand implementation and application issues associated with its leases standard, as well as whether the costs incurred to implement the leases standard were in line with the expected costs when Topic 842 was issued. Because the FASB's leases standard was deferred for private entities twice, much of the feedback received on implementation and ongoing application issues through 2022 was received from public entities and their practitioners. That feedback included a preliminary assessment of implementation and application costs received through ongoing outreach efforts with private entities.

2020 Public Roundtable

31. As part of its ongoing PIR, the FASB held a public roundtable (two sessions) in September 2020 on the implementation of Topic 842. Roundtable participants included representatives from 21 organizations (including investors, public entity preparers, private entity preparers, industry representatives, and practitioners). The roundtable discussions focused on broad technical issues that entities had found challenging when applying the leases standard and were centered on the following five areas of Topic 842:

    (a) *Lessee application of the rate implicit in the lease.*[3] Participants discussed whether additional or amended guidance was needed to apply the guidance in Topic 842 on a lessee's use of the discount rate implicit in the lease.

[3] At its October 21, 2020 agenda prioritization meeting, the FASB considered an agenda request to add a project to provide additional or amended guidance in Topic 842 on when a lessee should use the rate implicit in a lease (as opposed to its incremental borrowing rate) as its discount rate. The FASB decided not to add a project to its technical agenda, primarily because the issue was not considered pervasive and introducing additional guidance on lessee discount rates may result in unnecessary cost and complexity.

(b) *Lessee application of the incremental borrowing rate*. Participants discussed a lessee's application of the discount rate guidance on the incremental borrowing rate and the difficulties encountered in estimating that rate, particularly during the implementation of Topic 842.

(c) *Embedded leases.* Participants discussed challenges encountered with identifying leases in nonlease contracts (hereinafter referred to as embedded leases), such as service contracts. Participants also were asked whether current guidance should be amended to provide lessees with an option to exclude embedded leases that meet a certain threshold from the classification, recognition, and measurement requirements in Topic 842.

(d) *Lease modifications.* Participants discussed the cost and complexities associated with the application of the lease modification guidance (for both lessees and lessors). Participants shared their views on the following items: (i) certain reductions within the scope of a lease contract, (ii) reassessment of lease classification upon a modification that does not create a separate contract, including updating assumptions, (iii) accounting for termination penalties, and (iv) minor modifications.

(e) *Lessee allocation of fixed and variable payments.* Participants discussed the complexities and outcomes associated with the lessee allocation guidance when a lease contract includes (i) lease and nonlease components along with (ii) fixed and variable payments.

32. The FASB considered the feedback on the areas noted in paragraph 31 and other more granular areas of Topic 842 at its December 2, 2020 meeting, and decided not to reconsider items (b), (c), and (e) at that time. (The FASB's consideration of items (a) and (d) are discussed further below.) The FASB directed the staff to continue to monitor the implementation and application of Topic 842, including for private companies.

Narrow Amendments to the Lease Modification Model

33. After considering stakeholders' feedback on certain targeted areas of the lease modification model, the FASB proposed narrow-scope amendments to that model in October 2020. Those amendments would have exempted entities from applying modification accounting to the remaining lease components within a lease contract (for example, a master lease agreement for a fleet of vehicles) for transactions in which both of the following conditions existed:

(a) One or more lease components in the contract was terminated before the end of the lease term

(b) That early termination did not economically affect the remaining lease components.

34. In February 2021, the FASB considered feedback on the proposed amendments and decided not to further consider the amendments until it determined whether other areas of the Topic 842 lease modification model warranted reconsideration. Feedback received on the June 2021 Invitation to

Comment, *Agenda Consultation*, generally suggested that lease modification accounting should not be a priority project for the FASB. Additionally, outreach with the large accounting firms and public company preparers, including those that had previously recommended changes to the Topic 842 lease modification model, indicated that the model was a major improvement over the lease modification guidance in Topic 840. Those preparers further noted that established lease software systems are mostly compatible with the Topic 842 modification requirements and, therefore, any significant changes would disrupt established processes. On the basis of that feedback, the FASB removed the lease modification project from its technical agenda in June 2022.

Public Entity Costs and Ongoing Application

35. To date, the FASB staff has engaged with public entities, including industry representatives, and large practitioners to ascertain (a) the extent and nature of implementation and ongoing application costs incurred by public entities and (b) whether those entities are experiencing ongoing application issues with Topic 842. Broadly, the staff learned that public entities incurred costs largely consistent with the FASB's expectations noted in paragraphs 15 and 16. In addition, feedback from stakeholders about areas of the guidance that were challenging during implementation was generally consistent with the topics discussed at the 2020 roundtable (see paragraph 31). However, inconsistent with feedback provided during the development of Topic 842, preparers and practitioners communicated that existing lease systems were often inadequate to apply the FASB's leases standard. Consequently, many preparers made significant enhancements to existing systems or purchased newly developed leases systems to comply with Topic 842.

36. Since the public roundtable held in September 2020, public entity preparers and large practitioners have not communicated concerns about the ongoing application of Topic 842. Specifically, the FASB staff has received a minimal number of questions for those stakeholders on fundamental areas of Topic 842 during that period.

37. In 2020, an industry group representing the energy industry requested that the FASB address an outcome in which a lessor was required to recognize a selling loss for a contract that was expected to be profitable, primarily because variable lease payments are not estimated and recognized in a lessor's lease receivable. The FASB addressed that issue in Accounting Standards Update No. 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments,* which was issued in June 2021.

Private Entity Implementation and Application

38. Private entity preparer and practitioner stakeholders (and many PCC members) have consistently indicated that certain fundamental areas of Topic 842 can be costly and complex to apply. In response to private entity feedback and concerns, the FASB issued several Updates to provide private companies

with deferred effective dates and practical expedients to assist those entities' implementation and ongoing application of Topic 842.

Deferred Effective Dates

39. The effective date of Topic 842 for private entities was originally for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The FASB deferred the effective date for private entities two times, providing an additional two years for those entities to adopt Topic 842.

40. The FASB issued Update No. 2019-10, *Financial Instruments—Credit Losses* (Topic 326), *Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates,* to defer the effective date for private entities for an additional year. Therefore, the guidance was effective for private companies for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. This deferral was provided primarily because of implementation challenges encountered by private entities related to many factors including:

    (a) Availability of resources (both internal and external)

    (b) Timing and source(s) of education

    (c) Knowledge or experience gained from implementation issues encountered by larger public companies

    (d) Comprehensive transition requirements

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

    (f) The development or acquisition of sufficient information technology and processes.

41. The FASB issued Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, to defer the effective date for an additional year for private companies that had not yet made their financial statements available for issuance. Therefore, the guidance was effective for those private companies for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. This deferral was provided by the FASB to support and assist private entity stakeholders during the COVID-19 pandemic.

Practical Expedients

42. Update 2016-02 provided private entity lessees with a practical expedient to use a risk-free rate as the discount rate for all leases. Stakeholders provided feedback that this practical expedient may not be as frequently applied as anticipated because it was required to be applied on an entity-wide basis. Furthermore, some entities expressed concerns about the financial statement effects of using a risk-free rate to account for their entire leasing portfolio. In October 2021, the FASB amended that guidance to

provide more flexibility for those private entity lessees. Accounting Standards Update No. 2021-09, *Discount Rate for Lessees That Are Not Public Business Entities*, allows lessees that are not public business entities to make the risk-free rate election as the discount rate by class of underlying asset, rather than at the entity-wide level.

43. More recently, private company stakeholders raised concerns about applying the leases guidance to related party arrangements between entities under common control. Accounting Standards Update No. 2023-01, *Leases (Topic 842), Common Control Arrangements*, provides a practical expedient for private companies 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. The amendments also require that leasehold improvements associated with common control leases be amortized by the lessee over the useful life of the leasehold improvements to the common control group as long as the lessee controls the use of the underlying asset though a lease. That leasehold improvement accounting amendment is applicable to all entities.

Consideration of Private Entity Costs

44. For entities with calendar year-end reporting periods, the FASB's leases standard became effective as of January 1, 2022, for the fiscal year ended December 31, 2022. Feedback received from private entities and their practitioners indicated that a minimal number of private entities adopted Topic 842 before its effective date. Rather, because many private entities do not have interim GAAP reporting requirements, most private companies began their adoption of Topic 842 in late 2022 or in 2023, before their first financial statements prepared in accordance with Topic 842 were issued. Because most private entities recently completed their adoption of Topic 842, the FASB is in the process of obtaining information on the implementation and ongoing application for those entities.

45. At its April 2024 meeting, the PCC indicated that it intends to consider whether additional simplifications to Topic 842 for private entities should be explored. Specific areas for potential simplification have not yet been identified by the PCC.

46. Throughout and since private companies' implementation of the FASB's leases standard, the FASB has engaged in ongoing discussions with the PCC, AICPA's Private Companies Practice Section Technical Issues Committee, and the AICPA Center for Plain English to further understand the incremental challenges of lease accounting arising from the changes in Topic 842. Those discussions helped support the FASB's decision to provide two deferrals of the Topic 842 effective date for private companies and the simplifications provided in Update 2021-09 and Update 2023-01. Furthermore, the FASB staff has held numerous discussions with private company stakeholders to provide education on the application of Topic 842 since its issuance, most recently with respect to the common control arrangements addressed by Update 2023-01.

Next Steps

47. Because of the differing effective dates for public and private entities noted in paragraph 7, Stage 1 of the PIR process is complete for public entities and nearing completion for private entities. The FASB plans to continue its Stage 2 leases PIR activities in the second half of 2024 and to assist stakeholders in their ongoing application of the FASB's leases standard.

48. In the coming months, the FASB staff will focus on obtaining feedback from private company preparer and practitioner stakeholders about the implementation of the FASB's leases standard, including any additional simplifications for private companies identified by the PCC. Additionally, the FASB has two open agenda requests related to leases. The first is about accounting for lease costs incurred during a construction period (expected to be discussed with the Board in the second quarter of 2024) and the second relates to when lease classification for a failed sale-leaseback should be reassessed.

49. Other activities that the FASB plans to complete as part of Stage 2 of its leases PIR process are as follows:

    (a) Continuing outreach with public and private entity preparers and practitioners about the ongoing application of the FASB's leases standard

    (b) Performing outreach with investors in public entities and in private entities

    (c) Conducting a survey for private companies about the initial and ongoing costs of implementation

    (d) Considering relevant academic research.

50. Following the completion of Stages 1 and 2 of the leases PIR, the FASB will summarize its PIR findings in a final report.