

Leases — FASB Discusses Feedback on Key Implementation Issues

At its meeting on May 10, 2017, the FASB continued¹ its discussion of inquiries and feedback related to the new leases standard ([ASU 2016-02](#)²). The FASB staff gave an update on implementation developments, noting that the inquiries have been:

- Primarily related to lessee accounting and reporting, scope, and transition.
- Received from a representative of a professional accounting association as well as from large accounting firms and the FASB's technical inquiry system.
- Consistent with the staff's expectations regarding type, nature, and significance and are similar to those discussed with the Board at its November 30, 2016, meeting.

The Board also discussed three implementation issues raised by the staff, as described below.³

Issue 1: Pipeline Laterals

The Board discussed “whether a pipeline lateral is an identified asset under [ASC 842], and, if so, how an entity determines whether the customer has the right to control the use of that pipeline lateral throughout the period of use (that is, whether there is a lease of the pipeline lateral).”

The Board agreed that under ASC 842-10-15-16, a pipeline lateral is an identified asset and that the assessment of whether it is a lease must be focused on whether the customer has the right to control the use of the identified asset in accordance with ASC 842-10-15-4. While highlighting that the specific facts and circumstances of each arrangement must be considered, the staff discussed two types of pipeline laterals:

- *Type 1* — These “typically are connected to an integrated pipeline system” and are the most common type of pipeline laterals. While they are not capable of operating on their own, they share “supply sources with the main line and other customers.” The pipeline owner retains both (1) the economic benefits from the asset use that is more than insignificant and (2) the right to direct the use of the asset over the term of use. Depending on the significance of retained rights, the Board agreed with the staff's analysis that Type 1 pipeline lateral contracts do not contain a lease.
- *Type 2* — These “are fully capable of operating using their own dedicated assets” and “the customer has the right to substantially all the pipeline lateral's capacity.” The Board agreed with the staff's analysis that in this case there is a lease since the customer has “the right to obtain substantially all the economic benefits . . . and the right to direct the use of the pipeline lateral throughout the period of use.”

The Board agreed with the staff's analysis and did not suggest any additional standard setting was required at this time.

Issue 2: Easements — Are Easements Within the Scope of ASC 842?

Some stakeholders consider a land easement to be an intangible asset that is not within the scope of ASC 842 in accordance with the definition of an intangible asset in the ASC master glossary. Further, they noted that Example 10 in ASC 350-30-55

¹ The FASB previously met on November 30, 2016, to discuss implementation issues; see Deloitte's December 5, 2016, [journal entry](#) for a summary.

² FASB Accounting Standards Update No. 2016-02, *Leases (Topic 842)*. For titles of ASC references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

³ Quoted material is from the Board's May 10, 2017, [meeting handout](#).

illustrates accounting for a perpetual land easement. Other stakeholders view the rights in an easement to be the right to use the tangible asset (land) and have historically accounted for such rights as a lease under ASC 840.

While some Board members agreed with the FASB staff's recommendation that land easements should first be evaluated under ASC 842 to assess whether an easement meets the definition of a lease, other Board members disagreed.

Several Board members acknowledged the current diversity in practice and did not believe that the issuance of ASC 842 resolved that diversity. While several Board members supported standard setting to resolve the diversity, others were less convinced of the urgency and significance of the need for standard setting, and believed the Board should obtain additional information before adding such a project to the agenda.

As a result, the Board directed the staff to conduct outreach with preparers, audit firms, and users of financial statements to understand and establish the scope of the potential future project by gathering feedback on the following:

- Current accounting practices for easements across various industries.
- Types and frequency of easements, including:
 - Land easements or other types of easements (e.g., air rights).
 - Perpetual or term based (including a 999-year term).
 - Fully prepaid or paid over time.
- Transition implications of any standard-setting activity.

Issue 3: Transition — Should the Entity Apply the Guidance in ASC 840 or ASC 842 During Transition?

The FASB staff highlighted that it had “received several specific transition inquiries.” Therefore, while not answering any specific inquiry, the staff believed it was important to highlight the Board’s objectives in its transition decisions in the hope that it would resolve future questions that may arise from stakeholders. Two core objectives of transition were specifically discussed:

1. *Leverage existing systems and processes for in-place leases* — The first objective was “to enable entities to leverage their existing systems and processes . . . for leases entered into before the effective date of [ASC] 842.” The Board focused on reducing costs of implementation and did not believe that the benefit of a full retrospective approach justified the cost to preparers. The Board therefore required the modified retrospective approach that limits the application of ASC 842 during the transition period by “grandfathering” leases and eliminating the need to maintain two sets of accounting records for comparative periods.⁴ The transition guidance also allows entities to carry the existing leases “as is” for the remainder of the lease term unless (a) the “lease is modified and that modification is not accounted for as a separate contract” under ASC 842-10-25-8 or (b) “the lease liability [for the lessee] is remeasured in accordance with the subsequent measurement guidance” in ASC 842. In those situations, the lease should be accounted for under ASC 842.
2. *Limit optionality* — The second objective was to limit the number of “various combinations of transition approaches that entities may elect during transition.” This resulted in the Board’s decision to require practical expedients to be elected as a package and to prohibit a full retrospective approach.

⁴ This approach would not apply to instances in which (1) an entity does not elect the package of practical expedients in ASC 842-10-65-1(f) and (2) a lease’s classification changes. When classification changes upon the reevaluation, the lease will be accounted for during the comparative periods using the new guidance in ASC 842 (i.e., the lease would not be grandfathered).

In addition, the discussion highlighted the following key outcomes of the Board's transition provisions:

- "Leases entered into *on or after* the effective date of [ASC] 842 should *always* be accounted for by applying the guidance in [ASC] 842."
- "Leases that have ended before the date of initial application (that is, the beginning of the earliest comparative period presented in the first annual financial statements issued after the effective date) require no transition accounting."

The Board agreed with the staff's analysis and did not suggest any additional standard setting was required at this time.

Editor's Note: While the staff outlined the core objectives of the Board's transition provisions, it did not specifically address some of the open questions regarding transition and in particular, questions raised primarily by lessors regarding the transition provisions of ASC 842 and ASC 606. Specifically, stakeholders have raised questions regarding whether ASC 606 or ASC 842 should govern the transition for certain service components (e.g., maintenance) embedded in leases that are currently accounted for as executory costs under ASC 840. We expect that future Board discussions may address those specific questions and updates will be provided as circumstances warrant.

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