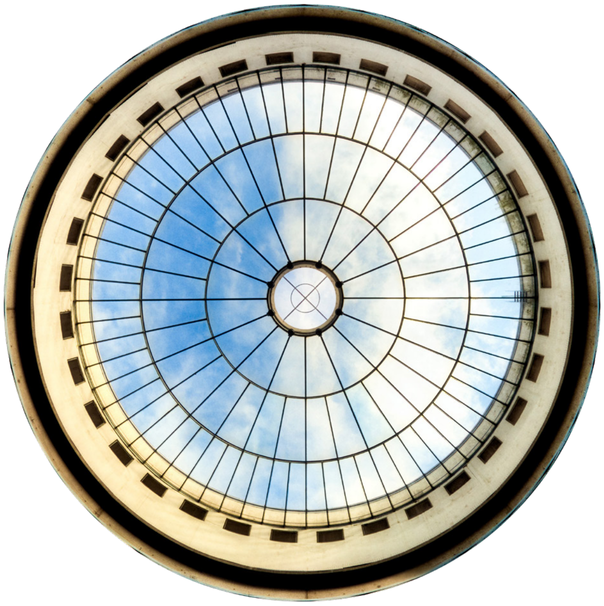
Heads Up | Volume 26, Issue 14
July 1, 2019



In This Issue

Reasonably Certain of Your Lease Disclosures? Observations on First-Quarter Filings

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Introduction

Calendar-year-end public business entities adopted the FASB's new leasing standard (ASC 842[1]) in the first quarter of 2019.[2] Most companies with lessee activity have disclosed that the new requirements are resulting in a material impact on their balance sheets but not on their other financial statements. Further, many companies with lessor activity have disclosed that the new requirements do not materially affect their accounting for lessor contracts. That said, all entities were affected by the standard's new and modified quantitative and qualitative disclosure guidance, which significantly increases the amount of information disclosed about leasing activities and related transactions when those requirements are material to the company's financial statements. However, we observed that the amount and level of detail disclosed by entities varied and that entities used different formats to present the information.

This *Heads Up* summarizes the presentation and disclosure trends we have observed in our review of lessee and lessor financial statements, and select lessee and lessor disclosures, provided in the public filings of a sample of companies that adopted the standard as of the first quarter of 2019. For a comprehensive discussion of the new leasing standard, including all presentation and disclosure requirements, see Deloitte's *A Roadmap to Applying the New Leasing Standard*.

[1] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

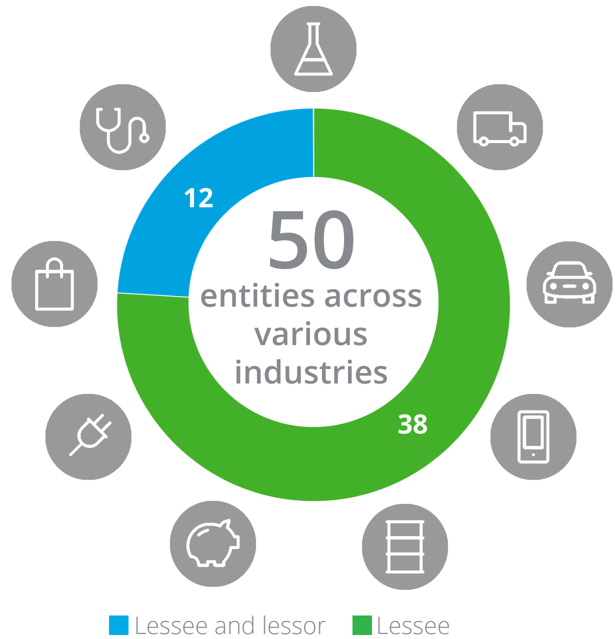
[2] Public business entities reporting under U.S. GAAP are required to adopt the new leasing standard for annual reporting periods (including interim reporting periods within those annual periods) beginning after December 15, 2018. For nonpublic entities, the new leasing standard is effective for annual periods beginning after December 15, 2019. Early adoption is permitted.

Interim Versus Annual Reporting Considerations

As entities prepare disclosures for their quarterly filings for the second quarter of 2019, they should consider the interim reporting requirements in ASC 270. Further, in accordance with Section 1500 of the SEC Financial Reporting Manual, SEC registrants must provide both annual and interim disclosures in the first interim period after adopting any new accounting standard and **in each subsequent quarter in the year of adoption**[3] since registrants are required to disclose material matters that were not disclosed in their most recent annual financial statements.

Population Demographics

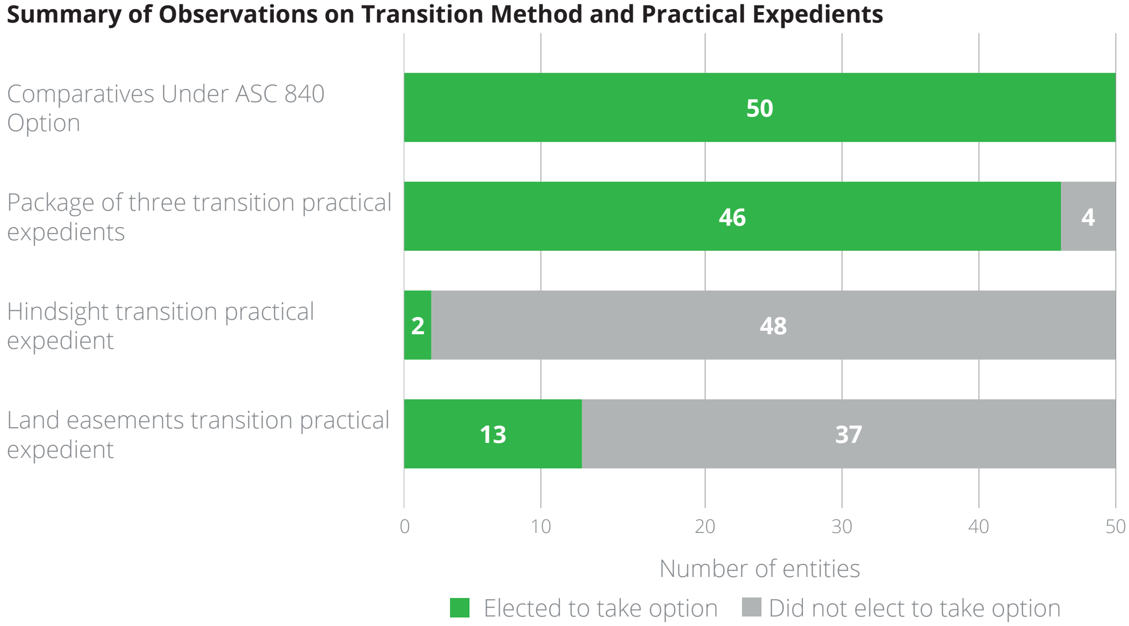
The discussion in this *Heads Up* is based on the quarterly Form 10-Q filings of 50 Fortune 125 companies that had adopted the new leasing standard as of January 2019 (referred to hereafter as the "entities" or the "Population"). Of the 50 entities in the Population, 38 are primarily a lessee and 12 are both a lessee and a lessor. The entities are from various industries, including automotive, consumer products, financial services, health care, life sciences, oil and gas, power and utilities, retail and distribution, and technology. The discussion below summarizes several key categories of disclosures required under the new leasing standard, highlights trends identified in the sample of filings, and gives examples of disclosures as applicable.



Transition and Practical Expedients

The following chart summarizes Population observations related to transition and practical expedients, which are discussed further below:

Summary of Observations on Transition Method and Practical Expedients



[3] In the second year after adoption, entities may exclude these annual disclosures from their interim financial statements.

Transition Method

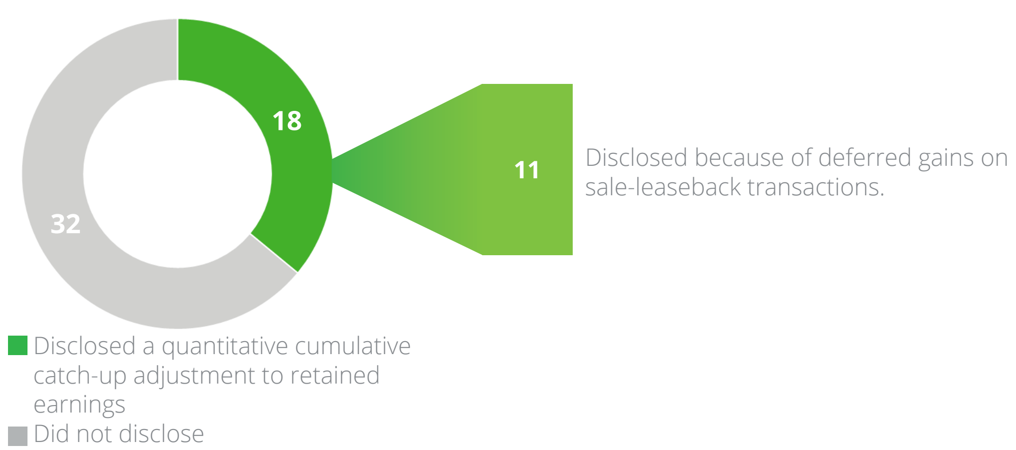
An entity adopts ASC 842 by using a modified retrospective transition approach. Under this approach, the standard is implemented either (1) as of the earliest period presented and through the comparative periods in the entity's financial statements or (2) as of the effective date of ASC 842 (the "Comparatives Under 840 Option"), with a cumulative-effect adjustment to equity in the first period in which ASC 842 is adopted. The following table summarizes the disclosure requirements in ASC 842 associated with certain aspects of transition along with related insights gathered from the Population:

Category	Disclosure Requirement	Observations Based on the Population
Transition method	In accordance with ASC 842-10-65-1(jj), an entity electing the Comparatives Under 840 Option must provide the disclosures required by ASC 840 for all periods that continue to be presented in accordance with ASC 840.	All entities in the Population adopted the new leasing standard by using the Comparatives Under 840 Option.
Transition impact	An entity must provide the ASC 250 disclosures (except those in ASC 250-10-50-1(b)(2)), including the cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position.	Of the 50 entities in the Population, 18 disclosed a quantitative cumulative catch-up adjustment to retained earnings. Approximately 61 percent of these 18 entities explain that the increase in retained earnings resulted from the cumulative effect of recognizing previously deferred gains on sale-leaseback transactions. The remaining entities were silent on the impact on retained earnings.

Comparatives Under 840 Option

One of the FASB's amendments in ASU 2018-11[4] (issued in July 2018) established the Comparatives Under 840 Option as an alternative method of transitioning to the new leasing standard. The Board's objective in creating this option was to provide entities with transition relief, since stakeholders indicated that implementation costs have been significant. All entities in the Population have elected the Comparatives Under 840 Option, demonstrating that the option is providing entities with relief as the Board had intended. Note that under ASC 842-10-65-1(jj), an entity electing the Comparatives Under 840 Option is required to provide the disclosures in ASC 840 for all periods that continue to be presented in accordance with ASC 840.

Cumulative-Effect Adjustment at Transition



[4] FASB Accounting Standards Update No. 2018-11, *Leases (Topic 842): Targeted Improvements*.

Transition Practical Expedients

In addition to the relief afforded by the Comparatives Under 840 Option, ASC 842 offers entities certain practical expedients in transition. Depending on the expedients elected, certain aspects of ASC 842 will not be implemented until the standard's effective date, regardless of whether an entity elects to recast comparative periods under ASC 842. The transition expedients are as follows (source literature provided in parentheses):

- *"Package of three" practical expedients* — An entity need not reassess (1) whether any expired or existing leases are or contain leases, (2) the lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases (ASC 842-10-65-1(f)).
- *Hindsight practical expedient* — An entity uses hindsight in determining the lease term and in assessing impairment of the entity's right-of-use (ROU) assets (ASC 842-10-65-1(g)).
- *Land easements practical expedient* — An entity need not assess whether existing or expired land easements that were not previously accounted for as leases under ASC 840 are or contain a lease under ASC 842 (ASC 842-10-65-1(gg)).

<table>
<tr><th>Transition Practical Expedients</th><th>Disclosure Requirement</th><th>Observations Based on the Population</th></tr>
<tr><td>Package of three</td><td rowspan="3">An entity that elects one of these practical expedients must disclose that election.</td><td>Of the 50 entities in the Population, 46 disclosed that they elected the package of three practical expedients.</td></tr>
<tr><td>Hindsight</td><td>Of the 50 entities in the Population, 2 disclosed that they elected the hindsight practical expedient.</td></tr>
<tr><td>Land easements</td><td>Of the 50 entities in the Population, 13 disclosed that they elected the land easements practical expedient.</td></tr>
</table>

Hindsight Practical Expedient

While the measurement of lease ROU assets and lease liabilities in transition may be more accurately reflected if an entity elects the hindsight practical expedient, this election may also result in some cost and complexity for both lessors and lessees. For example, including additional periods in the lease term may affect straight-line rent calculations for lessors and lessees as well as the measurement of lease liabilities. In addition, for entities with a large number of lease contracts, the election of the hindsight practical expedient could significantly increase implementation costs, since the standard requires the use of hindsight for all lease contracts. Accordingly, we expected that a limited number of entities would choose to apply the hindsight practical expedient in transition; our observations of the Population were consistent with that expectation.

Land Easements Practical Expedient

On the basis of our experience with preparers during the implementation phase, we believe that most, if not all, companies with a significant number of preexisting land easements did elect the land easements practical expedient. The number of entities that elected this expedient (see table above) most likely reflects the fact that only a subset of the Population enters into land easements as part of their ongoing business activities and that therefore only that subset would be expected to use the expedient.

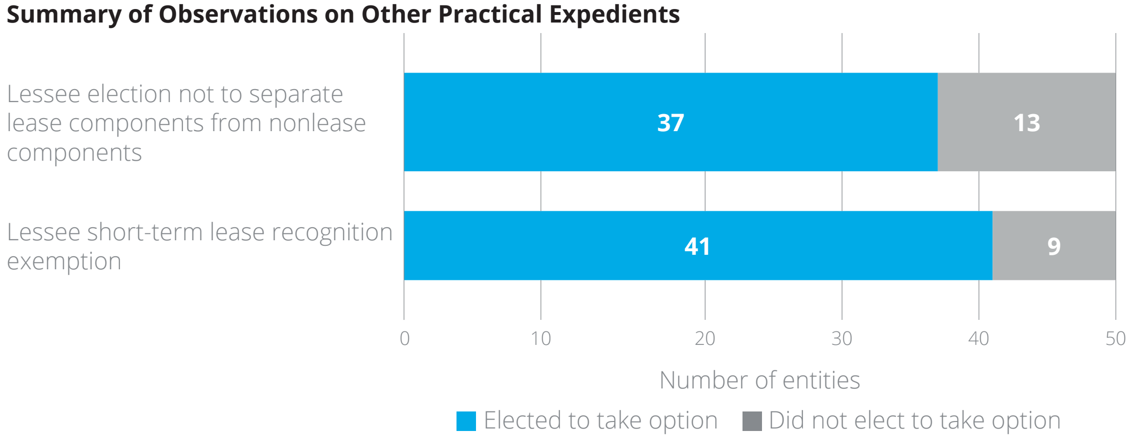
Other Practical Expedients for Lessees

In addition to the overall transition practical expedients afforded to both lessees and lessors, the new leasing standard offers just lessees certain practical expedients that they can apply to leases in transition as well as new leases entered into after initial adoption of the new standard. Lessees that elect to use any of these practical expedients must disclose that fact. Further, the practical expedients must be elected by class of underlying asset and lessees are required to disclose the class(es) to which they have elected to apply the expedients. The lessee practical expedients are as follows (source literature provided in parentheses):

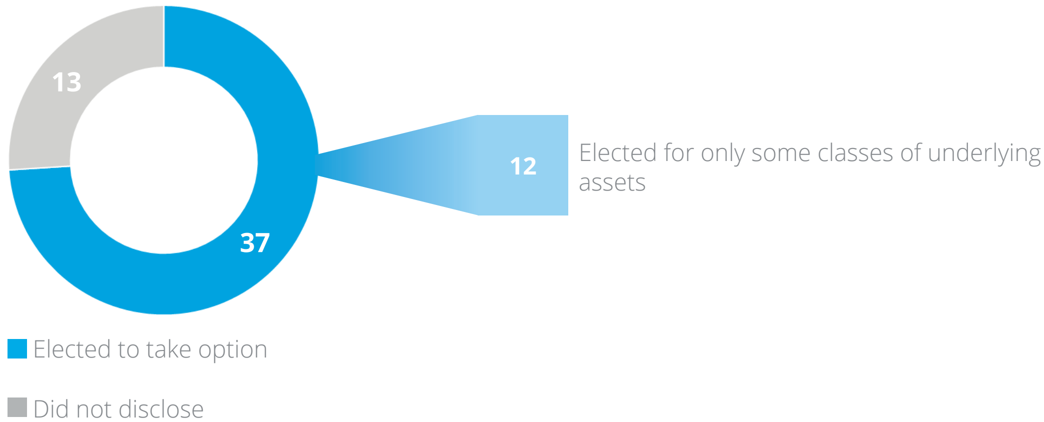
- *Not separating lease components from nonlease components* — Lessees that elect this expedient are not required to separate lease and nonlease components; rather, each lease component and the associated nonlease component(s) would be accounted for together as a single lease component (see ASC 842-10-15-37).
- *Short-term lease recognition exemption* — Lessees that elect this expedient are not required to recognize — on their balance sheets — leases whose lease term, at commencement, is 12 months or less and that do not include a purchase option that is reasonably certain to be exercised (see ASC 842-20-25-2).

Practical Expedients	Disclosure Requirement	Observations Based on the Population
Not separating lease components from nonlease components	Lessees that elect this practical expedient must disclose that election and the class(es) of underlying assets for which the election was made.	Of the 50 entities in the Population, 37 disclosed that they elected not to separate lease components from nonlease components. Approximately 32 percent of those 37 entities explain that they only made the election for certain classes of underlying assets. The remaining entities in the Population either (1) explicitly stated that they did not apply the election to all asset classes or (2) did not explicitly specify to which classes of assets the expedient was applied.
Short-term lease recognition exemption	An entity electing this practical expedient is required to disclose its election as well as the short-term lease costs.	Of the 50 entities in the Population, 41 disclosed that they elected the short-term lease recognition exemption.

Summary of Observations on Other Practical Expedients



Lessees That Elected Not to Separate Lease Components From Nonlease Components



Short-Term Lease Recognition Exemption

Although the short-term lease recognition exemption relieves an entity from recognizing short-term leases on its balance sheet, short-term lease costs associated with those leases must be disclosed in accordance with ASC 842-20-50-4. As discussed above, 41 of the 50 entities in the Population disclosed that they had elected the short-term lease recognition exemption. However, only 21 of the 50 entities in the Population disclosed short-term lease costs. That is, even though the entities stated that they had elected the short-term lease recognition exemption, 20 did not separately disclose the short-term lease costs recognized in the financial statements. There are various reasons why an entity would not disclose its short-term lease costs in a filing, but we believe that the most common of those reasons is that the costs are not significant to the financial statements.

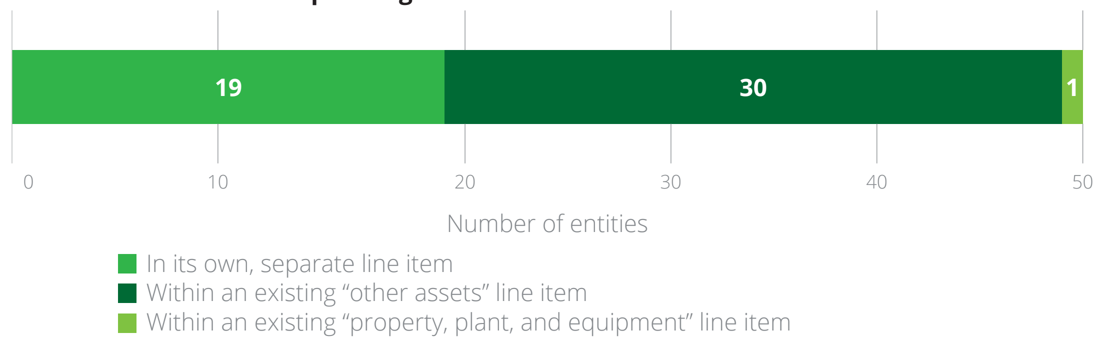
Lessee's Presentation Requirements Related to Statement of Financial Position

Lessees must present in the statement of financial position (or disclose in the notes thereto) (1) finance lease ROU assets separately from operating lease ROU assets and (2) finance lease liabilities separately from operating lease liabilities. While the leasing standard does not require distinct presentation on the face of the statement of financial position, the assets and liabilities related to each lease classification must be presented separately (i.e., in either distinct or separate financial statement line items) in accordance with ASC 842-20-45-1 through 45-3.

Presentation in the Statement of Financial Position

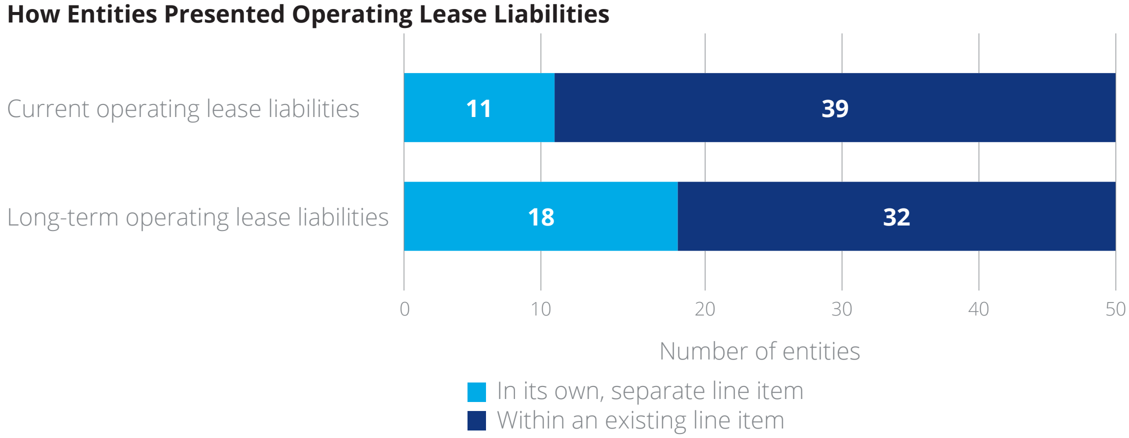
Of the 50 entities in the Population, 19 presented operating lease ROU assets in their own, separate line item. That is, the operating lease ROU asset was presented on the face of the statement of financial position. In addition, 30 of the 50 entities in the Population presented operating lease ROU assets within an existing "other assets" line item. Only one entity presented operating lease ROU assets within an existing "property, plant, and equipment" line item.

How Entities Presented Operating Lease ROU Assets



Moreover, 39 and 32 of the 50 entities in the Population presented current operating lease liabilities and long-term operating lease liabilities, respectively, within an existing line item. Of the 19 entities that separately presented operating lease ROU assets in their own, separate line item, only 11 presented *current* operating lease liabilities in this way. That is, 8 of the 19 entities opted to separately present the operating lease ROU asset but not the *current* operating lease liability. However, 18 of the 19 entities that separately presented operating lease ROU assets in their own, separate line item presented *long-term* operating lease liabilities in this same manner.

How Entities Presented Operating Lease Liabilities



No entities in the Population presented finance lease ROU assets in their own, separate line item. Of the 50 entities, 27 presented finance lease ROU assets within an existing "property, plant, and equipment" line item. The remaining entities did not disclose finance leases.

Although no entities presented the finance lease ROU asset separately, two entities presented finance lease liabilities in their own, separate line item for both the current and long-term finance lease liabilities. The remaining entities disclosed finance leases within an existing "debt" or "other liabilities" line item.

Significant Judgments and Estimates

The new leasing standard requires additional significant judgments and estimates related to lease accounting; entities must therefore also provide new and expanded disclosures about these judgments and estimates. Specifically, ASC 842-20-50-3(c) states that a lessee should disclose "[i]nformation about significant assumptions and judgments made in applying the requirements" of ASC 842; ASC 842-30-50-3(b) has a similar requirement for lessors.

Disclosures about the significant judgments and estimates used to apply the leasing guidance are expected to increase as entities adopt ASC 842. For example, among entities in the Population, we observed an increase in disclosures related to the significant judgments and estimates entities applied in determining the discount rate used for measurement of lease liabilities. The following are excerpts in the footnotes to these entities' financial statements that describe those judgments and estimates:

- The present value of the lease payments is calculated using the incremental borrowing rate for operating and finance leases, which was determined using a portfolio approach based on the rate of interest that we would have to pay to borrow an amount equal to the lease payments on a collateralized basis over a similar term. We use the unsecured borrowing rate and risk-adjust that rate to approximate a collateralized rate in the currency of the lease, which will be updated on a quarterly basis for measurement of new lease liabilities.
- As for most leases the implicit rate is not readily determinable, [the Company] uses a discount rate in determining the present value of future payments based on the yield-to-maturity of [the Company's] secured publicly traded USD denominated debt instruments interpolating the duration of the debt to the term of the executed lease.
- The lease liabilities are measured at the lease commencement date and determined using the present value of the minimum lease payments not yet paid and the company's incremental borrowing rate, which approximates the rate at which the company would borrow, on a secured basis, in the country where the lease was executed. The interest rate implicit in the lease is generally not determinable in transactions where the company is the lessee.
- The future lease payments are discounted at a rate that represents [the Company's] collateralized borrowing rate for financing instruments of a similar term and are included in accounts payable and other liabilities.
- [The Company] will typically use its fully collateralized incremental borrowing rate as of the commencement date to calculate and record the lease. The incremental borrowing rate is influenced by the lessee's credit rating and lease term and as such may differ for individual leases, embedded leases or portfolios of leased assets.

Disclosure Requirements for Lessors

In addition to being required to provide general disclosures regarding their lease portfolios, lessors must provide certain disclosures related to lease income. For example, ASC 842-30-50-5 requires lessors to include the following information, in a tabular format, in their disclosures about lease income recognized in each annual and interim reporting period:

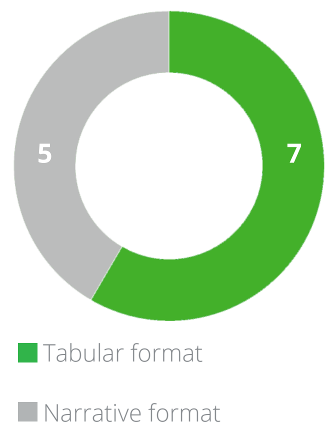
a. For sales-type leases and direct financing leases:
    1. Profit or loss recognized at the commencement date (disclosed on a gross basis or a net basis consistent with paragraph 842-30-45-4)
    2. Interest income either in aggregate or separated by components of the net investment in the lease.
b. For operating leases, lease income relating to lease payments.
c. Lease income relating to variable lease payments not included in the measurement of the lease receivable.

Category	Disclosure Requirement	Observations Based on the Population
Tabular format	ASC 842-30-50-5 requires that the lease income disclosures be provided in a tabular format.	Of the 12 entities in the Population with lessor activity, 7 disclosed the lease income information in a tabular format.
Lease income related to variable lease payments	An entity must disclose lease income related to variable lease payments not included in the measurement of the lease receivable.	Of the 12 entities in the Population with lessor activity, 5 disclosed lease income related to variable lease payments.

Format of Lease Income Disclosures

Although the standard explicitly requires that certain lease income disclosures be provided in a tabular format, some entities in the Population chose to provide those disclosures in a narrative form. We suspect that such entities believed that a tabular format would not be meaningful when certain of the required lease income disclosures were not applicable or the amounts were not significant.

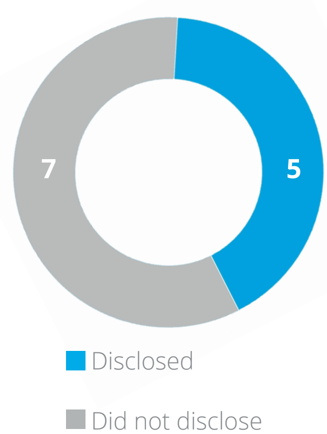
Disclosure of Lease Income in Tabular Format



Lease Income Related to Variable Lease Payments

The leasing standard requires entities to disclose lease income related to variable lease payments. The amount disclosed should include variable lease income associated with *all lease classifications* but should exclude any lease income already furnished within the disclosures about sales-type, direct financing, or operating leases (i.e., this amount should exclude lease income related to payments included in the measurement of the lease receivable or in the calculation of straight-line operating lease income). There are various reasons why an entity would not disclose its variable lease income in a filing, but we believe that the most common of those reasons is that the cost is not significant to the financial statements or applicable to the leases accounted for by the entities in the Population.

Disclosure of Lease Income Related to Variable Lease Payments



ASC 842 Amends Disclosure Requirements Related to the Components of Net Investments in Leases

Both ASC 840 and ASC 842 require lessors to provide disclosures about the components of net investments in leases. The following table summarizes those requirements:

ASC 840 Requirement (ASC 840-30-50-4)	ASC 842 Requirement (ASC 842-30-50-6)
Components of the net investment in sales-type and direct financing leases: • Future minimum lease payments to be received (with certain separate deductions). • Unguaranteed residual values accruing to the benefit of the lessor. • For direct financing leases only, initial direct costs. • Unearned income.	Components of aggregate net investment in sales-type and direct financing leases — that is, the carrying amount of: • Lease receivables. • Unguaranteed residual assets. • Any deferred selling profit on direct financing leases.

Under ASC 840, unearned income in a direct financing lease was initially measured as the difference between the gross investment in the lease and the cost or carrying amount of the underlying asset (if applicable). Accordingly, under ASC 840, the disclosure of the components of the net investment in a sales-type or a direct financing lease consisted of the **gross amount** of the components, with an unearned income adjustment to arrive at a total that corresponded to the balance sheet amount. On the other hand, ASC 842 requires that the **carrying amount** of the components of the net investment be disclosed. That is, each individual component should be presented at a discounted value.

Interim Disclosure Requirement for Lease Income

Generally, ASC 270 requires that entities report significant changes in financial position (see ASC 270-10-50-4) and changes in accounting principles and estimates (see ASC 270-10-45-12 through 45-16), along with other information that helps users understand the interim financial reporting results compared with those for its most recent annual period. To comply with these interim reporting requirements, an entity may elect to provide interim lease disclosures in a manner consistent with its annual financial statements if its leasing activities are significant or if there are significant changes in the entity's leasing activities on an interim basis. However, as a reminder to lessors, the lease income tabular disclosure is the only disclosure under ASC 842 that is explicitly required on an interim basis for either lessees or lessors. Therefore, lessors that believe that interim lease disclosures do not need to be provided in a manner consistent with how their disclosures are provided in their annual financial statements must still furnish the lease income tabular disclosure.

Lessor Practical Expedient

As with the lessee practical expedient related to not separating lease components from nonlease components, the new leasing standard provides a similar nonseparation practical expedient for lessors when the following criteria are met:

- *Criterion A* — The timing and pattern of transfer for the lease component are the same as those for the nonlease components associated with that lease component.
- *Criterion B* — The lease component, if accounted for separately, would be classified as an operating lease (see ASC 842-10-15-42A).

A lessor would account for the combined component as either a single lease component or a single revenue component, depending on which component is more predominant. If electing this practical expedient, a lessor must disclose its election and provide additional disclosures in accordance with ASC 842-30-50-3A.

Lessor Practical Expedient

Of the 12 lessor entities in the Population, 2 elected the lessor practical expedient related to not separating lease components from nonlease components. Although this practical expedient was aimed at providing late-stage relief to entities, we believe that lessors that did not disclose making such an election either (1) did not have lease contracts with both lease and nonlease components that were significant to the financial statements or (2) believed that separately accounting for the lease and nonlease components results in better information regarding these leases.

Thinking Ahead

The adoption of the new leasing standard has led to a noticeable increase in the amount and type of information entities have disclosed about leasing activities and related transactions. Although we observed some consistency in the disclosures provided, entities differed in their interpretations of the requirements and the amount of information they disclosed. We expect entities to continue refining their lease disclosures as accounting standard setters clarify guidance, regulators review disclosures and issue comments, and entities evaluate their peers' filings.

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