

Accounting & Auditing Update

Proposed Amendments to Impending Implementation of Changes to Accounting for Leases (Topic 842)

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The Financial Accounting Standards Board (FASB or Board) recently proposed two amendments to improve Accounting Standards Update No. 2016-02, **Leases** (Topic 842). To keep our clients updated, we are summarizing the two amendments proposed by the Board.

Lease Presentation in Comparative Financial Statements

Feedback from entities planning to implement the new lease requirements cited the unanticipated costs and complexities associated with the requirement to present comparative financial statements using the modified retrospective transition method. This method requires presenting the prior year financial statements as if they had always accounted for leases following ASU 2016-02.

In response to this feedback, the FASB has proposed allowing another transition method whereby a cumulative effect adjustment for a change in accounting principle would be allowed for a one-time adjustment to the opening balance of retained earnings (or net assets) in the period of adoption. This change would allow an entity to present its financial statements in a comparative format with prior years following the pre-implementation guidance and the current year following the post-implementation guidance.

All other guidance from ASU 2016-02 with respect to accounting for leases would remain unchanged.

Lease and Non-Lease Components of Contracts

The FASB also proposed to simplify reporting and disclosures for lessors who have a contract that has both lease components and non-lease components (for example, maintenance services).

Currently, each component of the contract has to be accounted for separately based on the relative standalone price of the component. Under the proposed amendment, the lessor would have the option not to separate the lease components from the non-lease components for revenue recognition purposes so as to account for the contract as a single lease component. This accounting option would be limited:

- contracts where the timing and pattern of revenue recognition is the same for both components of the contract (for example, the lease and maintenance services portion); and
- when the combined single lease would be classified as an operating lease.

Example: A simple example of the application of the proposed guidance follows: Entity A as lessor leases equipment to Lessee for a three-year period and during such period also provides monthly maintenance of the equipment, the cost of which is included in each monthly lease payment. Under the FASB proposal, the Lessor would not be required to separately allocate and account for the lease and maintenance components of the lease in its financial statements because the timing and recognition of the lease and maintenance components are the same.

Effective Dates

These changes would be effective as of the effective date of ASU 2016-02, namely:

- Public entities: for annual reporting periods beginning after December 15, 2018.
- Other entities: for annual reporting periods beginning after December 15, 2019.

The FASB is accepting comments on the proposed Accounting Standards Update through February 5, 2018.

Contact Us

Should you have any questions regarding this matter, please feel free to reach out to your PKF O'Connor Davies partner or Robert Rollmann, CPA, CGMA, Partner at rollmann@pkfod.com or 914.421.5605.

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