January 2019

Accounting & Auditing Update

FASB Provides Additional Clarification on the New Lease Standard

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The Financial Accounting Standards Board (FASB) recently issued an amendment to Accounting Standards Update (ASU) No. 2016-2, *Leases (Topic 842)* released on February 25, 2016. The new guidance — ASU No. 2018-20, *Narrow Scope Improvements for Lessors* — released in December 2018 addresses the implementation issues expressed by stakeholders as organizations prepare to adopt the new lease requirements.

The new ASU deals with:

- Sales taxes and other similar taxes collected from lessees
- Accounting for certain lessor costs
- Recognition of variable payments for contracts with lease and non-lease components

Key Changes

The most significant changes in the new ASU include the following:

- Allows lessors to make an accounting policy election not to evaluate whether sales or other similar taxes imposed by a jurisdiction on a specific lease revenue-producing activity are the primary obligation of the lessor. A lessor that makes this election will exclude these taxes from the measurement of lease revenue and related expense.
- Requires lessors to exclude lessor costs paid directly by lessees to third parties on the lessor's behalf from variable payments and, therefore, lease revenue. This is common in triple net-leasing arrangements. Lessors are required to include lessor costs that are paid by the lessor and reimbursed by the lessee in the measurement of variable lease revenue and the associated expense.
- Clarifies that lessors are to allocate (rather than recognize) certain variable payments to the lease and non-lease components when changes in the facts and circumstances on which the variable payment is based occur. Allocations of variable payments to the lease component should be recognized in accordance with the new lease standard and non-lease components should be under the revenue recognition standard.

As We See It

ASU 2018-20 makes simplifications to the lease accounting requirements for lessors. Net basis reporting is now permitted for sales and other similar taxes arising from a leasing transaction (if an entity makes such an accounting policy election) and for lessor costs paid directly by a lessee to a third party. However, for lessor costs paid by a lessee to the lessor, the lessor costs must be reported on a gross basis.

Additionally, ASU 2018-20 clarifies that when variable payments are allocated to lease and non-lease components, the lease standard must be followed for the lease component and the revenue standard must be followed for the non-lease component.

The provisions in this ASU provide application relief similar to the new revenue recognition guidance in Topic 606 and provide conformity and consistency in anticipation of the upcoming adoption of Topic 606.

Effective Date

The amendments in ASU 2018-20 affect the amendments in ASU 2016-02, which are not yet effective but can be early adopted.

The effective date and transition requirements for the amendments in Update 2018-20 for entities that have not adopted Topic 842 before the issuance of this ASU are the same as the effective date and transition requirements in ASU 2016-02 (for example, January 1, 2019, for calendar-year-end public business entities).

For entities that have adopted Topic 842 before the issuance of this Update, the transition and effective date of the amendments in this Update are as follows:

1. An entity should apply the amendments at the original effective date of Topic 842 for the entity. Alternatively, the entity has the option to apply the amendments in either the first reporting period ending after the issuance of ASU 2018-20 (for example, December 31, 2018) or in the first reporting period beginning after the issuance of ASU 2018-20 (for example, January 1, 2019).
2. An entity may apply the amendments either retrospectively or prospectively.

All entities, including early adopters, must apply the amendments in ASU 2018-20 to all new and existing leases.

Contact Us

For questions related to accounting for leases, please contact the partner in charge of your account or any of those listed below:

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