Bloomberg BNA Tax and Accounting Center™

Accounting Policy & Practice Report: News Archive
2017
October
10/03/2017
BNA Insights

Leasing

Disclosures Under ASC 842

By Jeffrey Ellis

Jeffrey Ellis is a Senior Managing Director at FTI Consulting and is based in Chicago. He has extensive experience advising clients on the accounting for complex transactions and identifying alternative structures to meet client business needs and accounting objectives. Mr. Ellis has assisted law firms on a wide range of matters involving accounting issues, including investigating financial statement restatements and examining structured transactions to determine if the accounting violated generally accepted accounting principles, assisted companies in implementing new accounting standards, and provided advice to companies on financial statement restatements and conversions to International Financial Reporting Standards. In addition, Mr. Ellis has testified as an accounting expert in disputes over leveraged lease transactions.

This article is the fourth in a series of articles exploring the new guidance on accounting for leases (Accounting Standards Codification 842) issued by the Financial Accounting Standards Board ("FASB") in February 2016. This article discusses the disclosure requirements under ASC Topic 842 and highlights significant differences from ASC 840.

ASC 842 significantly expands the disclosures required by both lessees and lessors in financial statements for annual periods. In addition, ASC 842 expands lessor disclosure obligations to include in financial statements for interim periods. Similar to ASC 840, ASC 842 requires the disclosure of both quantitative and qualitative information about leases.

The only disclosures that ASC 842 doesn't change are those disclosures relating to leveraged leases. FASB carried forward the guidance on accounting for, and disclosure of, leveraged leases from ASC 840 into ASC 842 without change.

Lessee Disclosures Under ASC 842

Under ASC 842, a lessee is required to make the following qualitative disclosures:

- A general description of the leases into which the lessee has entered;
- The basis and terms and conditions on which variable lease payments are determined;
- The existence and terms and conditions of options to extend or terminate the lease and narrative disclosure about options that are, and are not, recognized as part of the right-of-use assets and lease liabilities;
- The existence and terms of residual value guarantees (operating and finance leases);
- Restrictions or covenants imposed by leases;
- Information about leases that have not yet commenced but create significant rights and obligations (*i.e.*, the nature of any involvement with the construction or design of an asset to be leased);

- Information about the significant assumptions and judgments made, including:
  - determining whether a contract contains a lease,
  - allocating consideration between lease and non-lease components, and
  - determining the discount rate for the lease;
- Whether the lessee accounts for short-term leases by not recognizing a right-of-use asset and lease liability; and
- Whether the lessee elected the practical expedient of not allocating consideration between lease and non-lease components and, if so, to which class or classes of underlying assets it has applied the practical expedient.

ASC 842 also requires a lessee to disclose information consistent with the first five points above for subleases.

In contrast, the qualitative disclosures required under ASC 840 were relatively limited:

- A general description of the leases into which the lessee has entered;
- The basis on which contingent rental payments are determined;
- The existence and terms of renewal or purchase options and escalation clauses;
- For operating leases, the nature of the residual value guarantee, including the events or circumstances that would require the lessee to perform under the guarantee, the current status, the maximum potential amount of future payments, and the current carrying amount of any liability; and
- Restrictions imposed by lease agreements.

Other than the first, second, and the fifth disclosures, the remaining disclosures are either new or expanded from the disclosures that ASC 840 required.

In addition to the qualitative disclosures, ASC 842 requires a lessee to provide the following quantitative disclosures:

- Finance lease cost, separated between amortization of the right-of-use asset and interest expense on the lease liability;
- Operating lease cost;
- Short-term lease cost, excluding the cost on leases with a term of one month or less;
- Variable lease cost;
- Gross sublease income;
- Net gain or loss recognized on sale-leaseback transactions;
- Cash paid for amounts included in the measurement of lease liabilities, separately for finance and operating leases;
- Supplemental non-cash information on lease liabilities arising from obtaining right-of-use assets, separately for finance and operating leases;
- Weighted-average remaining lease term, separately for finance and operating leases;
- Weighted-average discount rate, separately for finance and operating leases; and
- The amount of short-term lease commitments, if short-term lease expense for the period is not reflective of those commitments.

The last six quantitative disclosures above are new disclosures.

ASC 842, similar to ASC 840, requires a lessee to disclose a maturity analysis of its finance lease liabilities, showing the undiscounted cash flows for at least the first five years following the date of the financial statements and a total of the amounts for the remaining years. Under both ASC 842 and ASC 840, a lessee is required to reconcile the undiscounted cash payments to the finance lease liability recognized in the statement of financial position. ASC 842 requires the same disclosure for operating lease liabilities. However, the only change from ASC 840 is that a lessee will reconcile the undiscounted cash payments to the operating lease liability recognized in the statement of financial position.

Finally, ASC 842 requires a lessee to disclose lease transactions with related parties in accordance with the requirements in ASC 850 *Related Party Disclosures*. ASC 840 required that a lessee to disclose the nature and extent of leasing transactions involving related parties.

ASC 842 doesn't prescribe specific disclosures for sale-leaseback transactions that don't qualify as a sale. For sale-leaseback transactions that qualify as sales, ASC 842 requires the seller-lessee to disclose the main terms and conditions of the transaction and any gains or losses from the sale-leaseback, separately from gains or losses from the sale or disposal of other assets.

Although ASC 842 added a number of new disclosures, FASB elected not to retain the following disclosures required by ASC 840:

- The total of minimum rentals to be received in the future on noncancelable subleases as of the date of the financial statements for both operating and capital leases;
- The gross amount of assets recorded under capital leases by major classes according to nature or function for each statement of financial position presented. ASC 840 permitted the lessee to combine that information with comparable information for owned assets; and
- For sale-leaseback transactions to which the seller-lessee applied the deposit or financing method, the future minimum lease payments and minimum sublease rentals in the aggregate at the date of the financial statements and for each of the five succeeding fiscal years.

Lessor Disclosures Under ASC 842

ASC 842 requires the following qualitative disclosures of lessors:

- A general description of the leases into which the lessor has entered;
- The basis and terms and conditions on which variable lease payments are determined;
- The existence and terms and conditions of options to extend or terminate the lease;
- The existence and terms and conditions of options for the lessee to purchase the leased asset;
- Information about the significant assumptions and judgments made, including (a) determining whether a contract contains a lease, (b) allocating consideration between lease and non-lease components, and (c) determining the amount of the unguaranteed residual asset; and
- How the lessor manages residual risk associated with leases, including (a) the lessor's risk management strategy for residual assets, (b) the carrying amount of residual assets covered by residual value guarantees (excluding guarantees that are qualify as lease payments), and (c) any other means by which the lessor mitigates is residual risk.

ASC 840, by comparison, only required the first and elements of the second disclosures. The last four disclosures noted above are new.

ASC 842 also expands lessor quantitative disclosures, requiring the following:

- Profit or loss recognized at the commencement date;
- Interest income either in the aggregate or separated by components of the net investment in the lease;
- Income relating to lease payments on operating leases; and
- Income from variable lease payments not included in the measurement of the lease receivable.

The first three items above are new disclosures. ASC 840 only required the lessor to disclose the total of contingent rentals included in income in each period presented.

ASC 842 requires a lessor to provide the quantitative disclosures in each annual and interim reporting period, and to present the information in a tabular format. ASC 840, in contrast, didn't specify disclosures in interim periods, nor did it require a particular format.

A lessor is required to disclose the components (*i.e.*, lease receivable, unguaranteed residual asset, deferred selling profit on direct financing leases) of its aggregate net investment in sales-type and direct financing leases. In addition, a lessor is required to explain significant changes in the balance of the unguaranteed residual asset and deferred selling profit on direct financing leases. ASC 840 also required a lessor to disclose the components *(i.e.*, minimum lease payments, unguaranteed residual value, initial direct costs, unearned income) of the net investment in sales-type and direct financing leases, with additional lines showing deductions for executory costs and any allowance for uncollectible lease payments. ASC 840 didn't require a lessor to explain significant changes in the components of the net investment.

ASC 842, similiar to ASC 840, requires a lessor to disclose a maturity analysis of its lease receivables, showing the undiscounted cash flows to be received for at least the first five years following the date of the financial statements and a total of the amounts for the remaining years. ASC 842 retains ASC 840's requirement that a lessor reconcile the undiscounted cash flows to the lease receivable recognized in the statement of financial position. A lessor is also required to disclose a maturity analysis of lease payments to be received on operating leases, showing the undiscounted cash flows to be received for at least the first five years following the date of the financial statements and a total of the amounts for the remaining years. ASC 840 required the same disclosure for operating leases. ASC 842 also requires the lessor to provide disclosures required by ASC Topic 360 *Property, Plant, and Equipment* for assets leased under operating leases, which will result in similar disclosures to the disclosures required by ASC 840.

Finally, similar to the requirement for lessees, ASC 842 requires a lessor to disclose lease transactions with related parties in accordance with the requirements in ASC 850.

Internal Control Implications

Reporting entities will need to determine the source (or sources) of information for the new disclosures required by ASC 842, along with processes and controls over those disclosures, and will need to revisit processes and controls over existing disclosures to determine whether any changes are necessary to comply with the disclosure objectives of ASC 842. In addition to the new disclosures identified above, reporting entities will want to consider the following:

- Disclosure of the cost incurred on short-term leases by lessees. Under ASC 840, lessees were not required to include the cost incurred on leases with terms of one month or less that were not renewed in the disclosure of rent expense on operating leases, but were not prohibited from doing so. ASC 842 prohibits lessees from including the cost incurred on leases with a term of one month or less in the disclosure of short-term lease cost. If reporting entities have not segregated the recognition of expense on such leases from the recognition of expense on short-term leases with terms of greater than one month, they will need to consider whether additional processes and controls are needed to ensure proper segregation of the cost on the two types of short-term leases.

- Aggregation of leases when a lessee or lessor has a large volume of leases. ASC 842 permits lessees and lessors with a large volume of leases to aggregate leases for purposes of complying with the disclosure requirements, but does not provide guidance on how a reporting entity should determine the level of aggregation. ASC 842 notes that a reporting entity should not aggregate leases that have "different characteristics," but also cautions against providing large amounts of insignificant data, thereby obscuring "useful information." While ASC 840 did not include similar guidance, reporting entities (particularly public companies) with a large volume of leases may have already implemented processes and controls over the aggregation of leases for purposes of meeting the disclosure requirements under ASC 840. If they have not, however, because of the increased disclosures required by ASC 842, reporting entities with large volumes of leases will at least need to consider whether new processes and controls over the aggregation of leases for disclosure purposes should be implemented.

Reporting entities that decide to implement a software solution for ASC 842 need to ensure that the software selected is capable of providing all of the required quantitative information. The processes and controls that reporting entities will need to establish for a software solution that is capable of providing the required quantitative information will, in all likelihood, differ from the processes and controls that reporting entities who decide not to implement a software solution for ASC 842 will need, as will the controls over entering data from leases into whatever solution the reporting entity elects to use.

Conclusion

ASC 842 expands the qualitative and quantitative disclosures for both lessees and lessors, and requires lessors to provide information about leases in financial statements for both interim and annual reporting periods. The additional disclosures will require lessees and lessors to identify sources of information for the new disclosures and implement new processes and controls over those disclosures.

The views expressed herein are those of the author and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals.

ISSN 1947-3923