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Defining Issues®

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FASB Sets 2019 Effective Date for New Leases Standard

At its November 11 meeting, the FASB set the effective dates of the new leases standard and decided to permit early adoption. The FASB also discussed cost-benefit considerations and a follow-up issue related to lease classification to complete its due process. The FASB plans to issue a final leases standard in January 2016.

Key Facts

- Public business entities, certain not-for-profit entities, and certain employee benefit plans will be required to apply the new leases standard for interim and annual periods in fiscal years beginning after December 15, 2018.
- All other entities will be required to apply the new leases standard for fiscal years beginning after December 15, 2019, and interim periods in fiscal years beginning one year later.
- Early adoption will be permitted for all entities.
- Entities will not apply the lease-term criterion when evaluating classification of a lease that begins near the end of an asset's economic life.[1]

Key Impacts

- Issuance of the new leases standard is just around the corner. Entities should start assessing how it will affect them if they haven't already done so.
- Entities can elect to early adopt the leases standard beginning in 2016.
- Determining whether an asset is *near the end* of its economic life will involve judgment. Using the 25 percent threshold currently in U.S. GAAP to make that judgment will be considered a *reasonable approach*.[2]
- When the lease term begins near the end of an asset's economic life, entities will apply the other lease-classification criteria to determine whether the lessee obtains control of the underlying asset.

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[1] The lease-term criterion: Is the lease term for the major part of the underlying asset's remaining economic life?

[2] ASC Topic 840, Leases, available at www.fasb.org.

The FASB decided not to align the effective date of the new leases standard with the revenue standard. Early adoption will allow entities to adopt the leases standard *before* the revenue standard.

Adoption Date Considerations

Except for early adoption, the FASB's decision on effective date for public business entities aligns with the IASB's recent decision for its leases standard.[3]

Because the leases standard can be early adopted on issuance, entities could decide to adopt it before they adopt the new revenue standard.[4]

KPMG Observations

The alignment of the effective dates for the FASB's and IASB's leases standards will make it easier for global entities to prepare their financial statements.

Given the interplay between the new leases and revenue standards, entities should consider their facts and circumstances and potential benefits of adopting the leases and revenue standards concurrently. Implementation challenges may arise when entities adopt the leases standard at the effective date. For example, current U.S. GAAP lease accounting guidance contains specific real estate sale-leaseback accounting guidance that was not carried forward to the new leases and revenue standards.

Lease Classification Issue

Current U.S. GAAP and the forthcoming leases standard include similar lease classification tests, including a lease-term criterion. However, current U.S. GAAP is more prescriptive than the leases standard will be.

The FASB received feedback that current operating leases with lease terms beginning near the end of an asset's economic life may be classified as finance leases under the proposed guidance solely based on the asset's age. Under current U.S. GAAP, when the lease term falls within the last 25 percent of an asset's total estimated economic life, the lease-term criterion is not applied.

The FASB decided to include a similar exception in the new standard without requiring the use of the bright line. While determining whether an asset is near the end of its economic life will require judgment, entities may apply the 25 percent threshold in current U.S. GAAP as a *reasonable approach* to make that judgment.

KPMG Observations

Interestingly, no concerns were raised about the fair value lease-classification criterion, although a similar exception exists for end-of-life leases when applying that criterion under current U.S. GAAP.

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[3] IFRS 16, Leases, available at www.ifrs.org.

[4] ASC Topic 606, Revenue from Contracts with Customers, available at www.fasb.org.

Under the forthcoming standard, lease classification will be based on whether the lease gives the lessee control of the underlying asset. One criterion indicating control transfer is when the asset is so specialized that it is expected to have no alternative use to the lessor at lease expiration. With the FASB's decision, lease classification will now potentially be different from current guidance based solely on an asset's uniqueness.

Because this issue is specific to U.S. GAAP, it will create an additional difference with IFRS 16.

Cost-Benefit Considerations

The FASB concluded that the benefits of the new leases standard will outweigh implementation costs, and that financial statement users will receive better information under the new standard.

- For lessees, all leases (except short-term leases) will be recognized on balance sheet, which will improve comparability between entities and reduce differences related to how financial statement users adjust the financial reporting for leases.
- More information will be disclosed in the financial statement notes for both lessees and lessors to provide a more complete picture of their leasing activities and exposure (e.g., asset risk and, for lessors, credit risk).

The FASB believes implementation and ongoing compliance costs with the new standard will not be as significant as they would have been under the 2010 and 2013 exposure drafts. Through redeliberations, the FASB made decisions it believes will reduce the necessary changes to systems and processes for both lessees and lessors.

Staying Informed

The FASB expects to issue an Accounting Standards Update in January 2016. KPMG will issue a *Defining Issues®* about the new standard when it is issued followed by an *Issues In-Depth* with a more comprehensive analysis of the new standard.

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