

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2018-01
January 2018

Leases (Topic 842)

Land Easement Practical Expedient for
Transition to Topic 842

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. The FASB has been assisting stakeholders with implementation questions and issues as organizations prepare to adopt Topic 842.

In connection with the FASB's transition support efforts, a number of stakeholders inquired about the application of the new lease requirements in Topic 842 to land easements. Land easements (also commonly referred to as rights of way) represent the right to use, access, or cross another entity's land for a specified purpose. There currently is diversity in practice in accounting for land easements. For example, while some entities apply current leases guidance in Topic 840, *Leases*, for the accounting of their land easements, other entities apply other Topics within the *FASB Accounting Standards Codification*[®], such as Topic 350, *Intangibles—Goodwill and Other*, or Topic 360, *Property, Plant, and Equipment*.

Entities that do not apply current leases guidance to land easements indicated that evaluating all existing or expired land easements in connection with the adoption of the new lease requirements to assess whether they meet the definition of a lease would be costly and complex (for example, because of the volume and age of those easements). Those entities also indicated that the benefits of applying the new lease requirements to those existing land easements would likely be limited because many of their land easements would not meet the definition of a lease or, even if they met that definition, many of their easements are prepaid and, therefore, already are recognized on the balance sheet.

To address stakeholder concerns about the costs and complexity of complying with the transition provisions of the new lease requirements, the amendments in this Update provide an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current leases guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date that the entity adopts Topic 842. An entity that does not elect this practical expedient should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities with land easements that exist or expired before an entity's adoption of Topic 842, provided that the entity does not account for those land easements as leases under Topic 840.

What Are the Main Provisions?

The amendments in this Update permit an entity to elect an optional transition practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under Topic 840. An entity that elects this practical expedient should apply the practical expedient consistently to all of its existing or expired land easements that were not previously accounted for as leases under Topic 840. Once an entity adopts Topic 842, it should apply that Topic prospectively to all new (or modified) land easements to determine whether the arrangement should be accounted for as a lease. An entity that does not elect this practical expedient should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. An entity should continue to apply its current accounting policy for accounting for land easements that existed before the entity's adoption of Topic 842. For example, if an entity currently accounts for certain land easements as leases under Topic 840, it should continue to account for those land easements as leases before its adoption of Topic 842.

This Update also amends Example 10 (paragraphs 350-30-55-29 through 55-32) of Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill. The amendment in this Update clarifies that an entity should determine whether land easements are leases in accordance with Topic 842 before applying the guidance in that example.

When Will the Amendments Be Effective?

The amendments in this Update affect the amendments in Update 2016-02, which are not yet effective but may be early adopted, and Example 10 of Subtopic 350-30. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in Update 2016-02. An entity that early adopted Topic 842 should apply the amendments in this Update upon issuance.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–5. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 350-30

2. Amend paragraph 350-30-55-30, with a link to transition paragraph 842-10-65-1, as follows:

Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill

Implementation Guidance and Illustrations

> Example 10: Easements

350-30-55-30 Entity A is a distributor of natural gas. Entity A has two self-constructed pipelines, the Northern pipeline and the Southern pipeline. Each pipeline was constructed on land for which Entity A owns perpetual easements that Entity A evaluated under Topic 842 and determined do not meet the definition of a **lease** under that Topic (because those easements are perpetual and, therefore, do not convey the right to use the underlying land for a period of time). The Northern pipeline was constructed on 50 easements acquired in 50 separate transactions. The Southern pipeline was constructed on 100 separate easements that were acquired in a business combination and were recorded as a single asset. Although each pipeline functions independently of the other, they are contained in the same **reporting unit**. Operation of each pipeline is directed by a different manager. There are discrete, identifiable cash flows for each pipeline; thus, each pipeline and its related easements represent a separate asset group under the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10. While Entity A has no current plans to sell or otherwise dispose of any of its easements, Entity A believes that if either pipeline was sold, it would most likely convey all rights under the easements with the related pipeline.

Amendments to Subtopic 842-10

3. Amend paragraph 842-10-65-1 and its related heading as follows:

Leases—Overall

Transition and Open Effective Date Information

> **Transition Related to Accounting Standards Update No. 2016-02, *Leases (Topic 842)* and Accounting Standards Update No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842***

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-02, *Leases (Topic 842)* and Accounting Standards Update No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*: **[Note:** See paragraph 842-10-S65-1 for an SEC Staff Announcement on transition related to Update 2016-02.]

Practical expedients

- f. An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a **lessor**), when applying the pending content that links to this paragraph to leases that commenced before the effective date:
1. An entity need not reassess whether any expired or existing **contracts** are or contain leases.
 2. An entity need not reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as **operating leases** in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as **finance leases**).
 3. An entity need not reassess **initial direct costs** for any existing leases.
- g. An entity also may elect a practical expedient, which must be applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor) to use hindsight in determining the **lease term** (that is, when considering lessee options to extend or terminate the lease and to purchase the **underlying asset**) and in assessing impairment of the entity's **right-of-use assets**. This practical expedient may be elected separately or in conjunction with ~~the~~either one or both of the practical expedients in (f) and (gg).

gg. An entity also may elect a practical expedient to not assess whether existing or expired land easements that were not previously accounted for as leases under Topic 840 are or contain a lease under this Topic. For purposes of (gg), a land easement (also commonly referred to as a right of way) refers to a right to use, access, or cross another entity's land for a specified purpose. This practical expedient shall be applied consistently by an entity to all its existing and expired land easements that were not previously accounted for as leases under Topic 840. This practical expedient may be elected separately or in conjunction with either one or both of the practical expedients in (f) and (g). An entity that elects this practical expedient for existing or expired land easements shall apply the pending content that links to this paragraph to land easements entered into (or modified) on or after the date that the entity first applies the pending content that links to this paragraph as described in (a) and (b). An entity that previously accounted for existing or expired land easements as leases under Topic 840 shall not be eligible for this practical expedient for those land easements.

Disclosure

- i. An entity shall provide the transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraph 250-10-50-1(b)(2).
 - Note:** See paragraph 250-10-S99-6 on disclosure of the impact that recently issued accounting standards will have on the financial statements of a registrant.
- j. If an entity uses one or ~~both~~ more of the practical expedients in ~~(f) and (f)~~, (g), and (gg), it shall disclose that fact.

Amendments to Status Sections

4. Amend paragraph 350-30-00-1, by adding the following items to the table, as follows:

350-30-00-1 The following table identifies changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Lease	Added	2018-01	01/25/2018
350-30-55-30	Amended	2018-01	01/25/2018

5. Amend paragraph 842-10-00-1, by adding the following item to the table, as follows:

842-10-00-1 The following table identifies changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-10-65-1	Amended	2018-01	01/25/2018

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting the approach. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The amendments in Update 2016-02 were issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions. Since the issuance of the amendments in February 2016, the FASB has been assisting stakeholders with implementation questions and issues as organizations prepare to adopt Topic 842.

BC3. Stakeholders inquired about the application of Topic 842 to land easements. Their concerns primarily involved the cost and complexity of potentially having to evaluate all existing land easements at transition. Some entities reported having thousands of land easements going back many decades. A land easement, which represents the right to use, access, or cross another entity's land for a specified purpose, may take different forms. For example, a land easement might be acquired for the right to pass a pipeline or other assets over, under, or through an existing area of land or body of water while allowing the landowner (or others) continued use of the land for other purposes (farming, hunting, and so forth) as long as the landowner (or others) does not interfere with the rights of the easement holder.

BC4. A land easement may be perpetual or term based, provide for exclusive use or nonexclusive use (shared use) of the land, and may be prepaid or paid over a defined term. A perpetual land easement provides the easement holder with the right to use specified property in perpetuity, generally subject to the condition that the easement holder must continue to use the land for the purpose specified in the arrangement.

BC5. In response to stakeholder questions about land easements, the FASB conducted outreach meetings and held a workshop on land easements with representatives from various industries and accounting firms that are most involved in land easement arrangements to better understand how land easements are currently accounted for under generally accepted accounting principles (GAAP). Stakeholders said that diversity in practice currently exists in accounting for land easements. While some entities currently apply Topic 840 to account for their land easements, other entities apply other guidance. For example, some

entities account for prepaid land easements as costs incurred to bring the related asset (for example, a pipeline) to the condition and location necessary for its intended use (paragraph 360-10-30-1), while others account for prepaid land easements as intangible assets on the basis of the guidance in Example 10 in Subtopic 350-30 (paragraphs 350-30-55-29 through 55-32). Furthermore, some entities account for land easements paid over time as either executory contracts or finite life intangible assets, while others account for such easements as leases.

BC6. Stakeholders that do not currently apply Topic 840 for the accounting of their land easements said that it is unclear whether they should evaluate existing and future land easements under Topic 842 upon adoption of that Topic. They also said that evaluating all existing land easements under Topic 842 would be costly and complex and have limited benefits.

BC7. At its August 2, 2017 meeting, the Board discussed land easements and decided to address stakeholder concerns about the costs and complexity of complying with the transition requirements in Topic 842 by providing an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current leases guidance in Topic 840.

BC8. On September 25, 2017, the Board issued proposed Accounting Standards Update, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*, for public comment, with a comment period that ended on October 25, 2017. The Board received 17 comment letters on the proposed Update, all of which generally supported the objective of providing transition relief for land easements to which Topic 840 had not previously been applied. In addition, all comment letters supported aligning the transition provisions of the proposed amendments with those in Update 2016-02.

BC9. At its November 29, 2017 meeting, the Board considered feedback received on the proposed Update and decided to proceed with the issuance of this final Update. In addition, some respondents to the proposed Update asked that the Board clarify how to apply the lease identification guidance in Topic 842 to land easements (specifically, the unit of account for lease identification purposes) once Topic 842 is effective. However, the Board did not consider this issue to be within the scope of the proposed amendments and it did not view the unit of account issue as being limited to land easements and, therefore, decided not to address it.

Basis for Conclusions

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should

justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements. The Board concluded that the expected benefits of the amendments in this Update justify the expected costs, as explained in paragraphs BC13 and BC14.

Scope

BC11. The Board noted that a land easement conveys (in various forms) a right to use land and that a right to use land needs to be evaluated to determine whether it is within the scope of Topic 842. Accordingly, the amendments in this Update provide clarity that an entity should apply Topic 842 to a land easement to determine whether that easement is or contains a lease. Although land easements need to be evaluated under the provisions of Topic 842, not all land easements will meet the definition of a lease in Topic 842. Topic 842 has a framework (that is, the guidance on identifying a lease and related implementation and illustrative guidance) to determine whether a land easement is or contains a lease. If an entity determines that a land easement is not, or does not contain, a lease, then the entity would look to other Topics (for example, Topic 350 or Topic 360) for the accounting guidance on that land easement. While there may be diversity about which guidance an entity should apply when a land easement is not a lease, that diversity is outside the scope of the amendments in this Update, and, accordingly, the amendments do not modify an entity's accounting for land easements that are not leases.

BC12. The Board acknowledged that the diversity in practice about whether an entity applies Topic 840 to land easements might be due, in part, to Example 10 in Subtopic 350-30. That example describes perpetual land easements in that fact pattern as intangible assets. Some stakeholders interpreted that example to indicate that all land easements should be accounted for as intangible assets. Accordingly, the Board is amending Example 10 in Subtopic 350-30 in this Update to clarify that the entity determined that the easements in that fact pattern do not meet the definition of a lease before they are accounted for as intangible assets.

Land Easement Practical Expedient for Transition to Topic 842

BC13. Stakeholders that do not apply Topic 840 when accounting for some or all of their existing land easements observed that evaluating existing land easements under Topic 842 likely would result in substantial implementation costs for some entities (for example, because of the volume and age of those arrangements) and could result in significant challenges to the ability to adopt

Topic 842 in a timely manner. Those stakeholders also noted that there would be limited benefits from this required evaluation because:

- a. Many of their land easements would not meet the definition of a lease in Topic 842 because of the characteristics of their land easements (for example, many land easements are perpetual in nature)
- b. A large majority of land easements are prepaid and, therefore, already are recognized on the balance sheet.

Some stakeholders noted that transition to Topic 842 would be eased significantly if an entity was required to evaluate only land easements entered into on or after the effective date of Topic 842.

BC14. The Board acknowledged that the accounting result from an entity applying its current accounting policies might not be the same as the result from applying Topic 842 to all existing land easements. However, the Board also noted that the accounting result of requiring an entity to evaluate all existing land easements under Topic 842 likely would not be significantly different for many entities and, therefore, the benefits of that evaluation would not justify the costs. Accordingly, the Board decided to provide transition relief in the form of an optional practical expedient. The practical expedient should substantially reduce the cost and complexity of transitioning to Topic 842 without significantly reducing the quality of information provided to investors as well as enable those entities to adopt Topic 842 in a timely manner. The practical expedient does not create a precedent for future standard setting but, rather, provides transition relief for Topic 842 that is specific to land easements on the basis of the costs and benefits considerations just described.

BC15. The Board, therefore, is providing a practical expedient as part of the transition guidance in Topic 842. If an entity elects that practical expedient in paragraph 842-10-65-1(gg), it will not evaluate under Topic 842 its land easements that exist or expired before the entity's adoption of Topic 842, provided that the entity does not account for those land easements as leases under Topic 840. The effect of the practical expedient is that, if it is elected, an entity will "run off" those land easements that existed before Topic 842's adoption date using its historical accounting policy, unless the entity modifies those land easements on or after the date that the entity adopts Topic 842. In addition, the practical expedient does not apply to land easements entered into on or after an entity's adoption of Topic 842. A new or modified land easement should be assessed prospectively under Topic 842 to determine whether it is or contains a lease.

BC16. The Board also decided that an entity should apply the practical expedient in paragraph 842-10-65-1(gg) to all of the entity's land easements that were not previously accounted for as leases under Topic 840 (rather than, for example, on a contract-by-contract basis). An entity also may elect to apply the practical expedient regardless of whether it elects to apply other practical expedients included in Topic 842. If an entity uses the practical expedient, it should disclose that fact. An entity that does not account for its land easements as leases under

Topic 840 and that does not elect the land easement transition practical expedient should evaluate all those existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease.

BC17. An entity that accounts for its land easements as leases under Topic 840 is not eligible for the practical expedient in paragraph 842-10-65-1(gg) for those land easements. Instead, that entity should maintain its current accounting policies for those land easements up to the entity's adoption of Topic 842, at which point it should apply Topic 842 (see paragraph BC19 for additional considerations). Similar to its applying Topic 840, an entity may account for some land easements as leases under Topic 842 and not account for others as leases. If existing or expired land easements were accounted for as operating leases under Topic 840 (and, therefore, were off balance sheet), those land easements generally will go on the balance sheet when an entity adopts Topic 842. Although the entity cannot elect the practical expedient in paragraph 842-10-65-1(gg) for those land easements, it may elect other practical expedients included in the transition guidance of Topic 842. An entity that elects one or more of the practical expedients in Topic 842's transition guidance must disclose that fact.

Effective Date and Transition

BC18. The amendments in this Update affect the amendments in Update 2016-02, which are not yet effective but may be early adopted, and in Example 10 of Subtopic 350-30. The Board decided that the effective date and transition requirements for the amendments in this Update should be the same as the effective date and transition requirements in Update 2016-02. An entity that early adopted Topic 842 should apply the amendments in this Update upon issuance.

BC19. A Board member expressed concerns that if the effective date of the amendments in this Update is aligned with Topic 842's effective date, some entities might take advantage of the current lack of clarity in GAAP on how to account for land easements between the date that the amendments in this Update are issued and the date that an entity adopts Topic 842. To address those concerns, the Board observed that it would be inappropriate for an entity to change its current accounting policy (or adopt a new accounting policy) on land easements (or economically similar arrangements) before the entity's adoption of Topic 842 simply to obtain a specific accounting outcome. For example, an entity that currently accounts for some or all of its land easements as leases under Topic 840 would not be able to change its current accounting policy for those land easements before its adoption of Topic 842 without applying Topic 250, Accounting Changes and Error Corrections, including the requirement that the change should be preferable.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2019 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.