ASC 842 GLOSSARY

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ACCOUNTING *(for lease and non-lease components practical expedient)*

As an accounting policy election, companies may choose not to separate non-lease components from lease components and instead account for each separate lease component and the non-lease components associated with that lease component as a single lease component. This election is made based on the class of the underlying asset.

Application: The practical expedient is available to lessees regardless of the extent or significance of the non-lease components in the contract.

Reference: *ASC 842-10-15-37*

ACCOUNTING *(for leases at a portfolio level)*

ASC 842 permits a lessee to account for its leases at a portfolio level provided that:

- The leases commenced at or around the same time and
- The resulting accounting at this level would not differ materially from the accounting at the individual lease level

Application: This approach would be permitted when the portfolio includes leases that are (1) similar in nature (e.g., similar underlying assets) and (2) have identical or nearly identical contract provisions.

Reference: *Deloitte A Roadmap to Applying the New Leasing Standard (2020) 8.2.2*

BARGAIN PURCHASE OPTION

A provision allowing the lessee, at his option, to purchase the leased property for a price that is sufficiently lower than expected fair value of the property at the date the option becomes exercisable that exercise of the option appears, at lease inception, to be reasonably assured.

Reference: *ASC 842-10 — Glossary*

BARGAIN RENEWAL OPTION

A provision allowing the lessee, at his option, to renew the lease for a rental sufficiently lower than the fair rental of the property at the date the option becomes exercisable that the exercise of the option appears, at least inception, to be reasonably assured. Fair rental of a property in this context shall mean the expected rental for equivalent property under similar terms and conditions.

Reference: *ASC 842-10 — Glossary*

CHANGING IN TIMING OR AMOUNT OF LEASE INCENTIVES

The amount and timing of the incentive may depend on the pace at which the lessee furnishes or improves the leased asset. Although the amount and timing of the incentive paid to the lessee could vary after lease commencement, it is generally very unlikely that a lessee would forgo any incentive it negotiated to receive from the lessor. Accordingly, we believe the lessee should treat the incentive in this scenario as an “in substance fixed payment” from the lessor to the lessee. We believe a lessee should estimate the timing of the maximum contractual incentive not yet received and record it as a negative lease payment. This would impact lease classification and the amount recognized for the lease liability and right-of-use asset at lease commencement.

Subsequent to lease commencement, if the actual receipt of the cash from the lessor differs in either timing or amount from the original estimate used to record the lease incentive, we believe the lessee should analogize to the remeasurement guidance for a lessee and remeasure the lease liability (and hence the right-of use asset) using the same discount rate used at the lease commencement date.

Reference: *PwC Leases October 2020 5.3.2*

CLASS OF UNDERLYING ASSET

While ASC 842 does not address what is meant by the phrase “class of underlying assets”, two views have emerged:

- **View 1 —** The class of underlying asset is determined on the basis of the physical nature and characteristics of the asset. For example, real estate, manufacturing equipment, and vehicles would all be reasonable classes of underlying assets given their differences in physical nature. Therefore, irrespective of whether there are different types of similar assets (e.g., within the real estate class, there may be retail stores, warehouses, and distribution centers), the class of underlying asset would be limited to the physical nature as described above.
- **View 2 —** The class of underlying asset is determined on the basis of the risks associated with the asset. While an asset’s physical nature may be similar to that of other assets (e.g., retail stores, warehouses, and distribution centers are all real estate, as discussed above), each has a different purpose and use to the lessee and would therefore have a separate risk profile. Therefore, for example, it could be appropriate for the lessee to disaggregate real estate assets into separate asset classes by “type” of real estate — to the extent that the different types are subject to different risks — when applying the practical expedients in ASC 842-10-15-37 and ASC 842-20-25-2.

Reference: *Deloitte A Roadmap to Applying the New Leasing Standard (2020) 4.3.3.1*

CONTRACT

An agreement between two or more parties that creates enforceable rights and obligations.

Reference: *ASC 842-10 — Glossary*

CONTRACT INCEPTION

The date a contract is executed for all parties. An entity is required at contract inception to identify whether a contract contains a lease. This date is typically prior to lease commencement.

Reference: *ASC 842-10-5-2*

DISCOUNT RATE FOR LEASES

The discount rate for a lease initially used to determine the present value of the lease payments for a lessee is calculated on the basis of information available at the lease commencement date.

A lessee should use the rate implicit in the lease whenever that rate is readily determinable. If the rate implicit in the lease is not readily determinable, a lessee uses its incremental borrowing rate. A lessee that is not a public business entity is permitted to use a risk-free discount rate for the lease, determined using a period comparable with that of the lease term, as an accounting policy election for all leases.

While a lessee's use of a risk-free discount rate may reduce some of the complexities related to measuring its lease liabilities and ROU assets, there may be some unintended consequences. For example, using a risk-free discount rate would result in a lease liability and ROU asset that are larger than those that would have been calculated by using the lessee's incremental borrowing rate. In addition, using the risk-free rate could result in a present value calculation that may equal or exceed substantially all of the fair value of the underlying leased asset, causing the lease to be classified as a finance lease rather than an operating lease.

A lessee must update the discount rate when the lease liability is remeasured, unless the remeasurement results from changes in one of the following:

- The lease term or the assessment of whether a purchase option will be exercised, and the discount rate already reflects the lessee's option to extend or terminate the lease or purchase the asset.
- Amounts that it is probable the lessee will owe under a residual value guarantee.
- Lease payments resulting from the resolution of a contingency upon which some or all of the variable lease payments are based

Application: In determining the incremental borrowing rate, a lessee should evaluate the collateral considered for the borrowing as follows:

- The lessee should start with a rate that is obtained for a general, unsecured, recourse borrowing and should adjust that rate for the effects of collateral. This should have the effect of reducing the rate.
- The lessee should assume full collateralization and should not assume under- or over-collateralization.
- The collateral considered does not have to be the leased asset. It can be the leased asset, but it may also be any form of collateral that a creditor would be expected to accept to secure a borrowing for a similar term (i.e., collateral that is at least as liquid as the leased asset).

References: *ASC 842-20-30-2, ASC 842-20-30-3, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 7.1.2, 7.2.2., 7.2.3, ASC 842-20-55-20*

DISCOUNT RATE FOR THE LEASE

For a lessee, the discount rate for the lease is the rate implicit in the lease unless that rate cannot be readily determined. In that case, the lessee is required to use its incremental borrowing rate.

For a lessor, the discount rate for the lease is the rate implicit in the lease.

Reference: *ASC 842-10 — Glossary*

ECONOMIC LIFE

Either the period over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more users.

Reference: *ASC 842-10 — Glossary*

EFFECTIVE DATE OF THE MODIFICATION

The date that a lease modification is approved by both the lessee and the lessor.

Reference: *ASC 842-10 — Glossary*

ESTIMATED RESIDUAL VALUE

The estimated fair value of the leased property at the end of the lease term.

Reference: *ASC 842-10 — Glossary*

EVALUATION OF PERIODS COVERED BY OPTIONS

At the lease commencement date, an entity assesses whether the lessee is reasonably certain to exercise or not to exercise an option by considering all economic factors relevant to that assessment — contract- based, asset-based, market-based, and entity-based factors. An entity's assessment often will require the consideration of a combination of those factors because they are interrelated. Examples of economic factors to consider include, but are not limited to, any of the following:

- Contractual terms and conditions for the optional periods compared with current market rates, such as:
  - The amount of lease payments in any optional period
  - The amount of any variable lease payments or other contingent payments, such as payments under termination penalties and residual value guarantees
  - The terms and conditions of any options that are exercisable after initial optional periods (for example, the terms and conditions of a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
- Significant leasehold improvements that are expected to have significant economic value for the lessee when the option to extend or terminate the lease or to purchase the underlying asset becomes exercisable.
- Costs relating to the termination of the lease and the signing of a new lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's operations,or costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.
- The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset and the location of the underlying asset.

Reference: *ASC 842-10 — Glossary*

EVALUATION OF TERMINATION RIGHTS

If termination rights are symmetrical (both parties have the unilateral right to terminate the arrangement), the lessee and lessor should determine if terminating the lease would result in either party incurring more than an insignificant penalty, as defined in ASC 842-10-20. If the termination rights are symmetrical with no more than an insignificant penalty, the lease term is limited to the period up to the time those symmetrical rights are exercisable.

When evaluating whether the lessee or lessor would incur more than an insignificant economic penalty, they should consider not only cash payments required to be made upon exercise of the termination options, but also other penalties, such as the cost of abandoning leasehold improvements or the disruption caused by relocating employees.

Reference: *PwC Leases October 2020 3-7*

FAIR VALUE

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Reference: *ASC 842-10 — Glossary*

FISCAL FUNDING CLAUSE

A provision by which the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the lease agreement.

Reference: *ASC 842-10 — Glossary*

HINDSIGHT PRACTICAL EXPEDIENT

During ASC 842 implementation, companies may elect to use hindsight when considering:

- Lessee options to extend or terminate the lease
- To purchase the underlying asset
- Assessment of impairment of the entity’s right-of-use assets

Application: When performing its hindsight assessment, an entity must consider events and circumstances that occurred up to the effective date of ASC 842.

This practical expedient may be elected separately or in conjunction with other practical expedients. However, most believe the“package of three” practical expedients has priority over the use-of hindsight practical expedient with respect to lease classification.

References: *ASC 842-10-65-1, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 16.5.1*

IDENTIFIED ASSET

An asset is identified in a contract either:

- Explicitly by serial number, VIN, GPS coordinates, etc or,
- Implicitly based on whether a particular asset is required to fulfill a contract from commencement

For portions of an asset not physically distinct, it is not an identified asset unless it represents substantially all of the capacity of the asset. Although ASC 842 does not define “substantially all”, entities may utilize a 90% threshold test which aligns to the lease classification test.

Application: Customer JB enters into a contract with Supplier TK to use a railcar to transport hazardous liquids over a three- year period. The contract does not explicitly specify the railcar that will be used to transport JB’s products but does stipulate that the railcar used must be capable of transporting hazardous bulk commodities (e.g., hazardous liquids and gases). Supplier TK has a large fleet of railcars but only one railcar that is designed to transport hazardous bulk commodities. Therefore, although the railcar is not explicitly specified in the contract, it is implicitly specified because TK has only one railcar that can be used to fulfill the contract.

References: *ASC 842-10-15-9 through 15-16, ASC 842-10-15-16, ASU 2016-02 (paragraph BC73), Deloitte A Roadmap to Applying the New Leasing Standard (2020) Example 3-2*

IN SUBSTANCE FIXED PAYMENTS

In substance fixed payments are payments that may, in form, appear to contain variability but are, in effect, unavoidable. In substance fixed payments for a lessee or a lessor may include, for example, any of the following:

- Payments that do not create genuine variability (such as those that result from clauses that do not have economic substance)
- The lower of the payments to be made when a lessee has a choice about which set of payments it makes, although it must make at least one set of payments.

Application: Example- Monthly Service Fee

Reference: *ASC 842-10-55-31*

INCREMENTAL BORROWING RATE

The rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment.
When determining the Incremental Borrowing Rate, the entity must consider the following:

- Fully secured rate, regardless of the form of collateral
- Timing of cash payments (annually, monthly, etc)
- Lease Term (lessee may make an accounting policy election to either include or exclude options that are not reasonably certain of exercise when determining the term of the borrowing)

Application: Therefore, when an entity is establishing the incremental borrowing rate based on a borrowing, it should ensure that the borrowing has similar payment terms as in the lease. For example, if the lease requires monthly payments, the borrowing should also have monthly payment terms. If the borrowing does not have monthly payments, then the appropriate adjustments to the rate should be made to make sure it approximates the payment terms in the lease.

References: *ASC 842-10 — Glossary, PwC Leases October 2020 3.3.4.6*

INITIAL DIRECT COST

Incremental costs of a lease that would not have been incurred if the lease had not been obtained.

Application: Initial direct costs for a lessee or a lessor may include, either of the following:

- Commissions
- Payments made to an existing tenant to incentivize that tenant to terminate its lease

Costs to negotiate or arrange a lease that would have been incurred regardless of whether the lease was obtained, such as fixed employee salaries, are not initial direct costs. The following items are examples of costs that are not initial direct costs:

- General overheads, including, for example, depreciation, occupancy and equipment costs, unsuccessful origination efforts, and idle time
- Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities
- Costs related to activities that occur before the lease is obtained, such as costs of obtaining tax or legal advice, negotiating lease terms and conditions, or evaluating a prospective lessee's financial condition.

Examples of Costs Included:

- Certain substantive incentive-based commissions (including payments to employees acting as selling agents)
- Lease documentation preparation costs incurred after the execution of the lease (e.g., regulatory and other filing fees)
- Legal fees that are contingent on successful execution of the lease
- Certain payments to existing tenants to move out
- Consideration paid for a guarantee of a residual asset by an unrelated third party

Examples of Costs Excluded:

- Employee salaries (including commissions that are in-substance salaries)
- Internal engineering costs
- Negotiating lease term and conditions (including the preparation of drafts)
- Legal fees for services rendered before the execution of the lease
- Advertising
- Other origination efforts
- Depreciation
- Costs related to an idle asset

Any costs that would have been incurred even if the lessee or the lessor failed to execute the lease are not incremental costs and should be excluded from initial direct costs

***References:** ASC 842-10-30-9, ASC 842-10-30-10, ASC 842-10 — Glossary, PwC Leases October 2020 4-1*

LAND EASEMENTS PRACTICAL EXPEDIENT

For existing or expired land easements that were not previously accounting for in accordance with ASC 840, this practical expedient allows entities to elect not to assess whether those land easements are, or contain, leases in accordance with ASC 842 when transitioning to ASC 842.

Land easements entered into (or existing land easements modified) on or after the effective date of ASC 842 must be assessed under ASC 842.

Application: The transition practical expedient for existing land easements may be elected alone or with any of the other transition practical expedients. In a manner consistent with the other transition practical expedients, entities must disclose whether they are electing the transition practical expedient for land easements.

References: *ASC 842-10-65-1, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 16.5.3*

LEASE

A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, equipment (identified asset) for a period of time in exchange for consideration.

Reference: *ASC 842-10-15-3*

LEASE COMMENCEMENT DATE

The date on which a lessor makes an underlying asset available for use by a lessee. The timing of when lease payments are under the contract does not affect the commencement date of the lease. Lease classification and initial measurement occurs on the lease commencement date.

Application:

- **(ASC 842-10-55-19)-** In some lease arrangements, the lessor may make the underlying asset available for use by the lessee (for example, the lessee may take possession of or be given control over the use of the underlying asset) before it begins operations or makes lease payments under the terms of the lease. During this period, the lessee has the right to use the underlying asset and does so for the purpose of constructing a lessee asset (for example, leasehold improvements).
- **(ASC 842-10- 55-20)-** The contract may require the lessee to make lease payments only after construction is completed and the lessee begins operations. Alternatively, some contracts require the lessee to make lease payments when it takes possession of or is given control over the use of the underlying asset. The timing of when lease payments begin under the contract does not affect the commencement date of the lease.

References: *ASC 842-10 — Glossary, ASC 842-10-55-20*

LEASE COMPONENT

The right to use an underlying asset is considered a separate lease component if (1) a lessee can benefit from the use of the underlying asset either on its own or with other resources that are readily available and (2) the underlying asset is not highly dependent on or highly interrelated with other assets in the arrangement.

An entity shall account for the right to use land as a separate lease component unless the accounting effect of doing so would be insignificant.

References: *ASC 842-10-15-28, ASC 842-10-15-29*

LEASE IMPAIRMENT INDICATORS

- A significant decrease in the market price of a long-lived asset (asset group)
- A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
- A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
- An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
- A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
- A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term more likely than not refers to a level of likelihood that is more than 50 percent.

Reference: *ASC 360-10-35-21*

LEASE INCENTIVES

Lease incentives include both of the following:

- Payments made to or on behalf of the lessee
- Losses incurred by the lessor as a result of assuming a lessee's pre-existing lease with a third party. In that circumstance, the lessor and the lessee should independently estimate any loss attributable to that assumption. For example, the lessee's estimate of the lease incentive could be based on a comparison of the new lease with the market rental rate available for similar underlying assets or the market rental rate from the same lessor without the lease assumption. The lessor should estimate any loss on the basis of the total remaining costs reduced by the expected benefits from the sublease for use of the assumed underlying asset.

Application: PwC Leases October 2020 3.3.4.2

- Up-front cash payment to a lessee
- Payment of lessee costs (such as moving expenses)
- The assumption by a lessor of a lessee's pre existing lease

Reference: *ASC 842-10-55-30*

LEASE LIABILITY

A lessee's obligation to make the lease payments arising from a lease, measured on a discounted basis.

***Reference:** ASC 842-10 — Glossary*

LEASE MODIFICATION

A change to the terms and conditions of a contract that results in a change in the scope of or the consideration for a lease (for example, a change to the terms and conditions of the contract that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term).

Application: The following are examples of lease terms which may be amended after the lease commencement date:

- A lease extension
- Early termination of the lease
- A change in the timing of lease payments
- Leasing additional space in the same building

***References:** ASC 842-10 — Glossary, PwC Leases October 2020 5.2*

LEASE PAYMENTS / LEASE CONSIDERATION

To determine the appropriate lease classification and measure a lessee's ROU asset and lease liability and a lessor's net investment in the lease at lease commencement, lessees and lessors, respectively, must determine the lease payments related to the use of the underlying asset during the lease term.

Lease Payments Include:

- Fixed Payments, including in substance fixed payments
- Variable lease payments that depend on an index or a rate
- Exercise price of a purchase option reasonably certain to be exercised
- Penalties for terminating a lease
- Fees paid by the lessee to owners of special- purpose entities
- Amounts that it is probable that the lessee will owe under a residual value guarantee
- Less any Other Incentives Paid or Payable

Types of payments that are not included in the calculation of the lease payments at lease commencement:

- Variable lease payments that do not depend on an index or rate
- Lessee's guarantee of the lessor's debt
- Amounts allocated to non-lease components

***Reference:** ASC 842-10-15-35, ASC 842-10-30-5*

LEASE RECEIVABLE

A lessor's right to receive lease payments arising from a sales-type lease or a direct financing lease plus any amount that a lessor expects to derive from the underlying asset following the end of the lease term to the extent that it is guaranteed by the lessee or any other third party unrelated to the lessor, measured on a discounted basis.

Reference: *ASC 842-10 — Glossary*

LEASE TERM

The noncancellable period for which a lessee has the right to use an underlying asset, together with all of the following:

- Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
- Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.

References: *ASC 842-10 — Glossary, ASC 842-10-30-1, ASC 842-10-55-25*

LEASE TERMINATION

A termination of a lease before the expiration of the lease term shall be accounted for by the lessee by removing the right-of-use asset and the lease liability, with profit or loss recognized for the difference.

Reference: *ASC 842-20-40-1*

LEASE ENTITY

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

Reference: *ASC 842-10 — Glossary*

LESSEE

An entity that enters into a contract to obtain the right to use an underlying asset for a period of time in exchange for consideration.

Reference: *ASC 842-10 — Glossary*

LESSOR

An entity that enters into a contract to provide the right to use an underlying asset for a period of time in exchange for consideration.

Reference: *ASC 842-10 — Glossary*

LESSOR REASSESSMENT OF LEASE TERM

A lessor shall not reassess the lease term or a lessee option to purchase the underlying asset unless the lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8. When a lessee exercises an option to extend the lease or purchase the underlying asset that the lessor previously determined the lessee was not reasonably certain to exercise or exercises an option to terminate the lease that the lessor previously determined the lessee was reasonably certain not to exercise, the lessor shall account for the exercise of that option in the same manner as a lease modification.

Reference: *ASC 360-10-35-3*

LEVERAGED LEASE

From the perspective of a lessor, a lease that was classified as a leveraged lease in accordance with the lease's guidance in effect before the effective date and for which the commencement date is before the effective date.

Reference: *ASC 842-10 — Glossary*

MARKET PARTICIPANTS

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- They are independent of each other, that is, they are not related parties, although the price in a related- party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms.
- They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- They are able to enter into a transaction for the asset or liability.
- They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so

Reference: *ASC 842-10 — Glossary*

MODIFICATION *(in which classification changes from finance lease to operating lease)*

If a finance lease is modified and the modified lease is classified as an operating lease, any difference between the carrying amount of the right-of-use asset after recording the adjustment required by paragraph 842-10-25 12 or 842-10-25-13 and the carrying amount of the right-of-use asset that would result from applying the initial operating right-of-use asset measurement guidance in paragraph 842-20-30-5 to the modified lease shall be accounted for in the same manner as a rent prepayment or a lease incentive.

Reference: *ASC 842-10-25-14*

NONCOMPONENT

Any activity in a contract that does not transfer a separate good or service to the lessee is neither a lease component nor a non-lease component; therefore, consideration in the contract would not be allocated to such an activity.

Application
Lessee:

- Payments made by the customer for property taxes or insurance that covers the supplier's interests would not represent a component in the contract
- Administrative tasks to set up a contract or initiate the lease that do not transfer a good or service to the lessee
- Reimbursement or payment of the lessor's costs.

Lessor:

- If the lessor's commitment is more extensive than a typical product warranty, it might indicate that the commitment is providing a service to the lessee that should be accounted for as a non-lease component of the contract.

References: *ASC 842-10-15-30, ASC 842-10-55-33, ASC 842-10-55-141*

NONENFORCEABLE PERIOD

A lease is no longer enforceable when both the lessee and the lessor each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term, as described in paragraph 842-10-30-1(b). If only a lessor has the right to terminate a lease, the lease term includes the period covered by the option to terminate the lease, as described in paragraph 842-10-30-1(c).

References: *ASC 842-10-55-23, ASC 842-10-55-24*

NON-LEASE COMPONENT

An activity that transfers a separate good or service to the customer is a non-lease component. Non-lease components do not need to be distinct from lease components to be accounted for separately.

An entity shall account for each separate lease component separately from the non-lease components of the contract (that is, unless a lessee makes the accounting policy election described in paragraph 842-10- 15-37 or unless a lessor makes the accounting policy election in accordance with paragraph 842-10-15-42A). If the practical expedient election is not elected, non-lease components are not within the scope of this Topic and shall be accounted for in accordance with other topics.

Application:

- Maintenance services consumed by the customer (CAM, equipment maintenance, facilities cleaning services, parking snow plow service)
- Water, gas, electricity services included within the lease contract
- Providing operating personnel to operate the leased asset
- Major maintenance services

References: *ASC 842-10-15-30, ASC 842-10-15-31, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 4.3.1*

ORDERLY TRANSACTION

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Reference: *ASC 842-10 — Glossary*

PACKAGE OF THREE PRACTICAL EXPEDIENT

During ASC 842 implementation, 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), to leases that commenced before the effective date:

- An entity need not reassess whether any expired or existing contracts are or contain leases.
- An entity need not reassess the lease classification for any expired or existing leases. For example, 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.
- An entity need not reassess initial direct costs for any existing leases

Application: If this is not elected, the lease should be classified in accordance with the ASC 842 lease classification criteria and facts and circumstances as of the later of the (1) lease commencement date or (2) date the lease was last modified in accordance with ASC 840. If a lease was renewed or extended before the date of initial application, the renewal or extension date would be considered the lease commencement date for this purpose unless the renewal was assumed to be reasonably certain as of the initial lease commencement date. While this practical expedient alleviates some of the burden of transitioning to ASC 842, it does not allow for errors in assessing if a lease exists under 840 to be carried forward.

References: *ASC 842-10-65-1, Deloitte A Roadmap to Applying the New Leasing Standard (2020)*

PURCHASE OF UNDERLYING ASSET

The termination of a lease that results from the purchase of an underlying asset by the lessee is not the type of termination of a lease contemplated by paragraph 842-20-40-1 but, rather, is an integral part of the purchase of the underlying asset. If the lessee purchases the underlying asset, any difference between the purchase price and the carrying amount of the lease liability immediately before the purchase shall be recorded by the lessee as an adjustment of the carrying amount of the asset. However, this paragraph does not apply to underlying assets acquired in a business combination, which are initially measured at fair value in accordance with paragraph 805-20-30-1.

The lessee's purchase of the underlying asset is not a lease termination under ASC 842-20-40-1. Rather, when a lessee purchases the underlying asset, it would reclassify the ROU asset balance and adjust the carrying value of the purchased asset by the difference between the purchase price of the asset and the lease liability immediately before the purchase.

References: *ASC 842-20-40-2, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 8.7.3*

PURCHASE OPTIONS

An option to purchase the underlying asset. At the commencement date, an entity shall assess an option to purchase the underlying asset on the same basis as an option to extend or not to terminate a lease, as described in paragraph 842-10-30-2.

Reference: *ASC 842-10-30-3*

RATE IMPLICIT IN THE LEASE

The rate of interest that, at a given date, causes the aggregate present value of:

- the lease payments and
- the amount that a lessor expects to derive from the underlying asset following the end of the lease term to equal the sum of:
  - the fair value of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and
  - any deferred initial direct costs of the lessor. However, if the rate determined in accordance with the preceding sentence is less than zero, a rate implicit in the lease of zero shall be used.

The Rate that yields these to be equal:

PV of Lease Payments + PV of Expected Future Value of Residual Asset

=

Fair Value of Underlying Asset Less Investment Tax Credits Retained by Lessor + Deferred Initial Direct Costs of Lessor

Reference: *ASC 842-10 — Glossary*

REASONABLY CERTAIN

"Reasonably Certain" is considered a high threshold of probability under ASC 842. An entity must assess economic factors relevant to that assessment — contract- based, asset-based, market-based, and entity-based factors. An entity's assessment often will require the consideration of a combination of those factors because they are interrelated.

Reference: *ASC 842-10-55-26*

REASSESSMENT OF LEASE TERM AND PURCHASE OPTIONS

A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs:

- There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the lease or to purchase the underlying asset.
- There is an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.
- The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.
- The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

When there is a change in lease term or in the conclusion about whether it is reasonably certain that an option to purchase the underlying asset will be exercised, a lessee must:

- Reassess lease classification,
- Remeasure the lease liability by using revised inputs as of the reassessment date,
- And adjust the associated ROU asset.

A lessee is not required to continually reassess the lease term absent a significant event or change in circumstances.

Application: Examples of significant events or significant changes in circumstances that a lessee should consider in accordance with paragraph 842-10-35-1 include, but are not limited to, the following:

- Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable
- Making significant modifications or customizations to the underlying asset
- Making a business decision that is directly relevant to the lessee's ability to exercise or not to exercise an option (for example, extending the lease of a complementary asset or disposing of an alternative asset)
- Subleasing the underlying asset for a period beyond the exercise date of the option

A change in market-based factors (such as market rates to lease or purchase a comparable asset) should not, in isolation, trigger reassessment of the lease term or a lessee option to purchase the underlying asset.

References: *ASC 842-10-35-1, ASC 842-10-55-28, ASC 842-10-55-29, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 5.4.1, PwC Leases October 2020 5.3.1*

REMOTE

The chance of the future event or events occurring is slight.

***Reference:** ASC 842-10 — Glossary*

RESIDUAL VALUE GUARANTEE

A guarantee made to a lessor that the value of an underlying asset returned to the lessor at the end of a lease will be at least a specified amount.

If a lease contract contains a provision under which the lessee guarantees to the lessor the residual value of the leased asset at the end of the lease term, the lessee should include in its lease payments the amount that it is probable that the lessee will owe at the end of the lease term.

Application: If the lessor has the right to require the lessee to purchase the underlying asset by the end of the lease term, the stated purchase price is included in lease payments. That amount is, in effect, a guaranteed residual value that the lessee is obligated to pay on the basis of circumstances outside its control.

A lease provision requiring the lessee to make up a residual value deficiency that is attributable to damage, extraordinary wear and tear, or excessive usage is similar to variable lease payments in that the amount is not determinable at the commencement date. Such a provision does not constitute a lessee guarantee of the residual value.

***References:** ASC 842-10 — Glossary, ASC 842-10-55-34, ASC 842-10-55-35, Paragraph BC214 of ASU 2016-02*

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

To convey the right to control the use of an identified asset for a period of time (or amount), the customer must have BOTH of the following:

- Right to obtain substantially all of the economic benefits from the use of the identified asset
- The right to direct the use of the identified asset

If the right to control the use of an identified asset is only for a portion of the contract term, the contract contains a lease for that portion of the contract.

***References:** ASC 842-10-15-4, ASC 842-10-15-17 through 15-19, ASC 842-10-15-20 through 15-26, ASC 842-15-5*

RIGHT TO DIRECT USE OF IDENTIFIED ASSET

A customer has the right to direct the use of an identified asset throughout the period of use if either of the following situations:

- The customer has the right to direct how and for what purpose the asset is used throughout the period of use
- The relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph 842-10-15-21) and at least one of the following conditions exists:
  - The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the supplier having the right to change those operating instructions.
  - The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

Only decisions made during the period of use (and not before) should be considered unless the customer designed the asset in a way that predetermines how and for what purpose the asset will be used.

Application:
Examples of decision-making rights that, depending on the circumstances, grant the right to direct how and for what purpose an asset is used, within the defined scope of the customer's right of use, include the following:

- The right to change the type of output that is produced by the asset (for example, deciding whether to use a shipping container to transport goods or for storage, or deciding on the mix of products sold from a retail unit)
- The right to change when the output is produced (for example, deciding when an item of machinery or a power plant will be used)
- The right to change where the output is produced (for example, deciding on the destination of a truck or a ship or deciding where a piece of equipment is used or deployed)
- The right to change whether the output is produced and the quantity of that output (for example, deciding whether to produce energy from a power plant and how much energy to produce from that power plant).

Examples of decision-making rights that do not grant the right to direct how and for what purpose an asset is used include rights that are limited to operating or maintaining the asset.

References: *ASC 842-10-15-20 through 15-26, ASC 842-10-15-24 through 15-26, ASC 842-10-15-21, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 3.4.2.1.1*

RIGHT TO OBTAIN SUBSTANTIALLY ALL OF THE ECONOMIC BENEFITS OF IDENTIFIED ASSET

To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use. A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. Examples include:

- Primary outputs (e.g., physical receipt of the widgets produced by or at a widget factory).
- By-products (e.g., physical receipt of the steam produced as a by-product of the manufacturing process in the widget factory).
- Cash flows derived from primary outputs and by-products (e.g., cash flows derived from the supplier's selling, on the customer's behalf, of widgets produced by or at the widget factory).

Although ASC 842 does not define "substantially all", entities may utilize a 90% threshold test which aligns to the lease classification test. Parties should first identify all economic benefits resulting from the use of an asset then determine which of those benefits are within the scope of the customer's right to use the asset in the contract.

References: *ASC 842-10-15-17 through 15-19, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 3.4.1.1, Deloitte A Roadmap to Applying the New Leasing Standard (2020) 3.4.1.3*

RIGHT-OF-USE ASSET (ROU ASSET)

An asset that represents a lessee's right to use an underlying asset for the lease term.

Reference: *ASC 842-10 — Glossary*

SHORT-TERM LEASES

A lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise.

The determination of short-term, as defined in ASC 842-10-20, should be evaluated on the basis of aggregate nonconsecutive periods.

References: *ASC 842-10 — Glossary, PwC Leases October 2020 3-8*

SHORT-TERM LEASE: RECOGNITION EXEMPTION

As an accounting policy election, a lessee may elect not to apply the recognition requirements of ASC 842 to short-term leases. Instead, a lessee may recognize the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred (consistent with paragraphs 842-20-55-1 through 55-2).

The accounting policy election for short-term leases shall be made by the class of underlying asset to which the right of use relates.

Reference: *ASC 842-20-25-2*

SUBLEASE

A transaction in which an underlying asset is re-leased by the lessee (or intermediate lessor) to a third party (the sublessee) and the original (or head) lease between the lessor and the lessee remains in effect n asset that represents a lessee's right to use an underlying asset for the lease term.

Reference: *ASC 842-10 — Glossary*

SUBSTANTIVE SUBSTITUTION RIGHTS

A customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- The supplier has the practical ability to substitute alternative assets throughout the period of use
- The supplier would benefit economically from the exercise of its right to substitute the asset

An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at contract inception and should exclude consideration of events that, at inception, are not considered likely to occur (development of new technology or a future customer paying above- market rate for use of the asset).

The supplier's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the customer from having the right to use an identified asset.

If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

Application:

- **Practical Ability:** The customer cannot prevent the supplier from substituting an asset, and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time.
- **Benefit Economically:** The economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset. The costs associated with substitution are generally higher when located at the suppliers premises and are more likely to exceed the benefits of substitution.

References: *ASC 842-10-15-10, ASC 842-10-15-11, ASC 842-10-15-12, ASC 842-10-15-14, ASC 842 10-15*

USEFUL LIFE

The period over which an asset is expected to contribute directly or indirectly to future cash flows.

Reference: *ASC 842-10 — Glossary*

VARIABLE LEASE PAYMENTS

Payments made by a lessee to a lessor for the right to use an underlying asset that vary because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Lease payments include variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate). An entity should measure the variable lease payments on the basis of the spot index or rate at lease commencement.

Changes in an index or rate alone would not give rise to a remeasurement of a lease. However, as highlighted in ASC 842-10-35-5, if a lessee remeasures the lease payments for any of the other reasons detailed in ASC 842-10-35-4, the lessee is required to remeasure variable lease payments that depend on an index or rate by using the index or rate in effect on the remeasurement date.

Payments based on a change in an index or a rate should not be considered in the determination of lease payments vs payments adjusted each year for LIBOR would be included

References: *ASC 842-10 — Glossary, ASC 842-10-30-5, Deloitte A Roadmap to Applying the New Leasing Standard (2020) Q&A 6-6*