FAQ: Lessee accounting for right-of-use assets in operating leases

At a glance

Under the new leases standard, lessees will need to recognize virtually all of their leases on the balance sheet by recording a right-of-use asset and a lease liability.

This In depth includes our responses to frequently asked questions on the subsequent measurement of right-of-use assets in operating leases. Topics include: impairment testing, abandonment, subleases, lease components, and the treatment of right-of-use assets in acquisitions.

Note: This In depth was updated on June 14, 2019 and April 14, 2020 to add additional questions or expand on existing responses. All content that was added or updated since the original issuance date has been marked accordingly.

Under the new leases standard (ASC 842), lessees will initially record an ROU asset and a corresponding lease liability. The ROU asset represents the lessee’s right to use an asset legally owned by another party for a period of time. The ROU asset receives accounting recognition as an asset because a lessee has control over an economic resource and is benefiting from its use. The lease liability represents the obligation to make payments for that right of use.

Although subsequent measurement of the ROU asset is subject to the long-lived assets impairment guidance (ASC 360), there are a number of considerations that are not specifically addressed for operating leases in either the new leases standard or the long-lived assets impairment guidance.

This In depth addresses common questions related to various aspects of the ROU asset impairment test, as well as other questions related to transactions that may impact the accounting for ROU assets.
Lease components

Lease accounting should be applied at the lowest component level. At inception, a lessee should consider whether the lease contains more than one component. The separate lease components are determined by considering the nature and interdependency of the individual assets covered by the arrangement. If the leased assets are functionally independent of one another, the arrangement includes multiple lease components. Refer to section 2.5 in our Leases guide for more information.

Question 1.1: Are there accounting considerations as a result of the determination that a lease has more than one lease component?

Answer 1.1: Yes. If the lessee determines that the lease has more than one lease component, the lessee will need to determine if the lease components should be included in different asset groups for purposes of testing for impairment; see Q&A 2.1. For further considerations on lease components, see Q&As 7.1 and 7.4. For considerations regarding nonlease components, see Q&A 9.1.

Asset grouping

Long-lived assets are tested for impairment at the asset group level. The asset group to be tested for impairment should represent the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The determination of a reporting entity's asset groups involves a significant amount of judgment, and all relevant facts and circumstances should be considered. In making this determination, company-specific operating characteristics should be assessed, including the interdependency of revenues between asset groups and shared cost structures.

ROU assets should be assigned to an asset group for purposes of applying the impairment guidance in ASC 360, Property, Plant and Equipment. There may be limited circumstances when an ROU asset is its own asset group.

Question 2.1: When should a lessee reassess its asset groupings?

Answer 2.1: A lessee should reassess its asset groupings when there is a change in facts and circumstances in the interdependency of cash flows. For an ROU asset, a reassessment of the asset group to which the ROU asset is assigned might be necessary if the lessee subleases all or a part of the underlying asset. For example, assume a lessee has two manufacturing facilities that it leases to make widgets. The manufacturing facilities are in the same asset group. The company decides it no longer needs one facility for production and subleases it. Because the cash inflows from the sublease are not dependent on the widget manufacturing, the lessee might determine that the facility should no longer be included in the widget asset group.

A decision to sublease, or a plan to abandon, may not, in isolation, cause a reassessment of an asset grouping, particularly if the lessee is continuing to use the underlying asset in substantially the same manner for a period of time after the decision (i.e., the level of identifiable cash flows have not yet materially changed).
Impairment of ROU assets - recoverability test (Step 1)

A long-lived asset (asset group) that is held and used should be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount of the asset (asset group) may not be recoverable. These events or changes in circumstances are often referred to as impairment indicators or triggers. The first step of the test is to determine whether the long-lived asset is recoverable, determined by comparing the net carrying amount of the asset (asset group) to the undiscounted net cash flows to be generated from the use and eventual disposition of the asset (asset group), commonly referred to as the recoverability test.

**Question 3.1:** How should a lessee consider operating lease liabilities and operating lease payments when performing the recoverability test?

**Answer 3.1:** Lessees should elect to either: (1) include the carrying amount of operating lease liabilities in the asset group and include the associated operating lease payments in the undiscounted cash flows, or (2) exclude the carrying amount of the operating lease liabilities from the asset group and exclude the associated operating lease payments from the undiscounted cash flows.

Generally, debt payments are not included in the cash flows used in a recoverability test as they do not represent the lowest level of identifiable cash flows (i.e., debt payments are generally funded at the corporate level and are not attributable to an asset group). Refer to section 5.2.4.3 in our Property, plant, equipment and other assets guide for more information. The rationale for including an operating lease liability in a recoverability test is based on the ASC 842 requirement to separate operating lease liabilities from finance lease liabilities on the balance sheet as they are not “debt-like.” Conversely, because operating leases liabilities have characteristics that are similar to finance lease liabilities, a lessee could choose to exclude the operating lease payments from the undiscounted cash flows.

In principle, different results in the recoverability test for similar asset groups should not result from the use of different capital structures. Therefore, the inclusion or exclusion of the lease liability and the related cash flows generally should not result in a different conclusion in the recoverability test.

**Question 3.2:** If a lessee has elected to include the carrying amount of operating lease liabilities in the asset group, should it include the effective interest portion of the operating lease payments as a cash outflow in the recoverability test?

**Answer 3.2:** Lessees should make an accounting policy election to either include or exclude the interest portion of the operating lease payments as a cash outflow in the recoverability test. Including the interest payments as a cash outflow is consistent with the inclusion of rent expense for operating leases prior to the adoption of the new leases standard. In contrast, including only the principal lease payments is similar to the model for debt in the limited circumstances when debt is considered in the test. Refer to section 5.2.4.3 in our Property, plant, equipment and other assets guide for more information on whether to include debt in the recoverability test.
**Question 3.3:** Should variable lease payments be included in the undiscounted cash outflows in a recoverability test?

**Answer 3.3:** Generally, variable lease payments should be included in the undiscounted cash flows in the recoverability test when the variable lease payments are not already included in the measurement of the lease liability. For example, a lease of retail property may specify that lease payments are based on a percentage of the lessee’s retail sales at the property, which would be a variable lease payment not included in the lease liability. The estimate of these payments would be included in the undiscounted cash flows regardless of the election noted in Q&A 3.1.

**Question 3.4:** If including operating lease liabilities in an asset group results in the asset group having a zero or negative carrying amount, should the recoverability test still be performed?

**Answer 3.4:** Assuming an impairment indicator exists for an asset group that includes long-lived assets that are not fully impaired, a recoverability test should still be performed when the asset group has a zero or negative carrying amount. If the undiscounted cash flows of the asset group are less than the carrying amount of the asset group, including when the undiscounted cash flows are more negative than the carrying amount of the asset group, the asset group fails the recoverability test and the lessee should measure the impairment loss.

**Question 3.5:** The remaining useful life of a group of assets tested for recoverability should be based on the remaining useful life of the “primary” asset of the group. This would be the period over which the asset will be depreciated or amortized. Can an ROU asset be the primary asset of an asset group?

**Answer 3.5:** Yes. ASC 360-10-35-31 states that the primary asset is the principal long-lived tangible asset being depreciated or intangible asset being amortized that is the most significant component asset from which the asset group derives its cash flow-generating capacity. If an ROU asset meets this definition, it can be the primary asset of an asset group. Refer to section 5.2.4.1 in our *Property, Plant, equipment and other assets* guide for further considerations on identifying the primary asset.

**Impairment of ROU assets - measuring an impairment loss (Step 2)**

**Question 4.1:** How should a lessee consider operating lease liabilities when measuring the fair value of the asset group?

**Answer 4.1:** The lessee can elect to either include or exclude the operating lease liabilities in the asset group when measuring the asset group’s fair value. We generally do not expect significant differences in the measurement of an impairment loss because a lessee’s estimate of the fair value of the asset group would reflect whether the asset group includes or excludes operating lease liabilities. Refer to chapter 8 in our *Fair value* guide for a detailed discussion of the incorporation of credit risk in the fair value measurement of assets and liabilities.
Question 4.2: Should variable lease payments be included when determining the fair value of the asset group using the discounted cash flow approach?

Answer 4.2: Yes. Consistent with ASC 820, a market participant would take into account expected lease cash outflows in determining the fair value of the asset group.

Question 4.3: The inclusion of operating lease liabilities in a lessee’s asset group may result in the carrying amount of the asset group being zero or negative. Is it possible for the fair value of an asset group to be negative?

Answer 4.3: Yes. While the fair value of a legal entity is generally not negative as the equity holders can choose not to fund future losses, asset groups are often not legal entities, thus an asset group can have a negative fair value. This is in contrast to calculating the fair value of a reporting unit for purposes of a goodwill impairment test. The fair value for a reporting unit typically would not be negative because a reporting unit often consists of one or more legal entities and is typically a business.

A negative asset group fair value (i.e., the need to pay a market participant to step in the current owner’s shoes) may result when there are costs to exit an activity that is within a larger entity. Although the fair value of the asset group can be negative, the fair value of an individual asset cannot be less than zero.

Question 4.4: What is the appropriate discount rate to use when calculating the fair value of an ROU asset using the income approach?

Answer 4.4: When determining the fair value of an ROU asset for impairment, market participant assumptions should be used. For example, the discount rate applied should be based on a market participant’s assessment of the risk in the cash flow forecast related to the asset (asset group). This would not necessarily be the same as the lessee’s incremental borrowing rate. To determine an appropriate rate, a lessee should consider the highest and best use of the ROU asset (e.g., is the space more profitable as retail versus office space, which would likely result in different market discount rates). This use may be different than how the lessee is currently using the ROU asset.

For discussion on the considerations of the highest and best use of nonfinancial assets, refer to section 4.2.5 in our Fair value guide. For discussion of the considerations when determining the fair value of the lease liability, refer to section 4.2.6 in our Fair value guide.

Other impairment-related considerations

In addition to these Q&As, refer to section 5.2.6 in our Property, plant, equipment and other assets guide for further lease impairment considerations.

Question 5.1: Does an ROU asset impairment trigger the need to reassess the lease term?

Answer 5.1: It depends. An impairment trigger under ASC 360 does not necessarily cause a trigger to reassess the lease term under ASC 842. The criteria that trigger an ASC 360 impairment test are different than the triggers...
for a lease term reassessment under ASC 842. For further discussion on when to test for impairment, refer to section 5.2.3 in our *Property, plant, equipment and other assets* guide, and for lease term reassessment, refer to section 5.3.1 in our *Leases* guide.

**Question 5.2:** If there has been a trigger for impairment testing of the asset group, but no triggering event for lease term reassessment, should a lessee still reassess the useful life of the ROU asset?

**Answer 5.2:** It depends. We believe the useful lives of long-lived assets should be reassessed whenever events or circumstances indicate that a revision to the useful life (presumably shorter) is warranted. Refer to section 4.2.4 in our *Property, plant, equipment and other assets* guide for further discussion. This assessment is separate from the lease term reassessment contemplated in ASC 842.

**Question 5.3:** Does the accounting for an ROU asset change after it has been impaired?

**Answer 5.3:** Yes. If an ROU asset is impaired, it would be written down to fair value and its amortization is delinked from the lease liability. Prior to impairment, the amortization of the ROU asset is the difference between the straight-line lease expense and the effective interest calculated on the lease liability. This results in straight-line lease expense. However, in accordance with ASC 842-20-25-7, once the ROU asset is impaired, the lessee will continue to amortize the lease liability using the same effective interest method but the ROU asset will be amortized on a straight-line basis. The resulting accounting is similar to the accounting a lessee would apply to a finance lease.

**Question 5.4 (updated April 2020):** If the useful life of an ROU asset has changed, does the pattern of expense recognition change?

**Answer 5.4:** A lessee loses straight-line expense recognition in the case of an impairment based on ASC 842-20-25-7. If an ROU asset has not been impaired but its useful life has been shortened, acceptable approaches to subsequently account for the lease include a delinked approach and a linked approach. Refer to Q&A 6.3 for more information.

**Question 5.5 (added April 2020):** When an ROU asset is included in a disposal group that meets the held-for-sale criteria in ASC 360-10-45-9, should the ROU asset continue to be amortized?

**Answer 5.5:** No. In accordance with ASC 360-10-35-43, a long-lived asset is not depreciated (amortized) when held for sale. Additionally, interest and other expenses attributable to the liabilities of a disposal group should continue to accrue. Once the disposal group meets the held-for-sale criteria, amortization of the ROU asset should cease while interest on the lease liability will continue to be accredited.

**Abandonment**

Prior to abandonment, a long-lived asset is considered held and used. A long-lived asset to be abandoned is considered disposed when it ceases to be used. For example, equipment that a reporting entity plans to dispose of after it is used to fulfill current orders is not considered abandoned because the reporting entity receives an ongoing benefit from the equipment while it is...
still in use. Further, a temporarily idled ROU asset is not considered abandoned as the asset will be used in the future.

**Question 6.1:** Would a decision by a lessee to stop using an ROU asset as it was originally anticipated and instead sublease the underlying asset be considered an abandonment under ASC 360?

**Answer 6.1:** A decision by a lessee to sublease an ROU asset does not constitute an abandonment of the ROU asset under ASC 360. ASC 842-10-15-17 states that a lessee can obtain economic benefits from the use of an asset directly or indirectly by using, holding, or subleasing the asset. In a sublease, the lessee still intends to obtain economic benefits from the asset, just in a different capacity.

**Question 6.2:** Should a lessee’s decision to abandon an ROU asset in the future cause the asset group to be tested for impairment?

**Answer 6.2:** A long-lived asset (asset group) that is held and used should be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount of the asset (asset group) may not be recoverable. ASC 360-10-35-21 provides indicators of impairment, including a significant adverse change in the extent or manner in which an asset (asset group) is being used. As such, the decision to abandon an ROU asset may be an indicator that an impairment test is required for the asset group.

However, ASC 360-10-35-48 states that only in unusual situations is the fair value of a long-lived asset to be abandoned zero while it is still being used. When the long-lived asset is actually abandoned, its carrying amount should equal its fair value. Fair value should consider market participant assumptions and therefore may not be zero (e.g., if the lessee has the ability to sublease or transfer the asset group to a third party).

**Question 6.3 (updated April 2020):** Should a lessee’s commitment to abandon an ROU asset cause the useful life of the ROU asset to be reconsidered?

**Answer 6.3:** Yes. While the asset group may not fail the recoverability test, adjustment of the useful life of the to-be-abandoned asset may still be necessary in accordance with ASC 360-10-35-47. The useful life assessment of a long-lived asset is based on the lessee’s assumption of the length over which it intends to use the asset. Refer to section 4.2.1 in our *Property, plant, equipment and other assets* guide for more information.

If an ROU asset has not been impaired but its useful life has been shortened, one acceptable approach to subsequently account for the lease is to follow the accounting for an ROU asset that has been impaired (“delinked approach”). Under this approach, amortization of the ROU asset and lease liability would be delinked in the subsequent accounting. Refer to Example PPE 6-12 in our *Property, plant, equipment and other assets* guide, which illustrates this delinked approach.

Another acceptable approach to subsequently account for the lease is to retain the linkage between the ROU asset amortization and the lease liability (“linked approach”). In this case, the straight-line lease expense should be remeasured over the shortened useful life, which is consistent with the guidance in ASC 842-20-25-6(a). Refer to Example PPE 6-13 in our *Property, plant, equipment and other assets* guide, which illustrates this linked approach.
Decision to sublease

**Question 7.1:** Would a sublease of a portion of an ROU asset result in a change in the unit of account for the lease?

**Answer 7.1:** If the lessee originally accounted for the building as one unit of account, the lessee should consider whether it needs to reassess the unit of account. Lease accounting should be applied at the lowest component (i.e., unit of account). For example, assume that a lessee originally accounts for a ten-year lease of a five-story building as a single ROU asset. In year five, the lessee decides to sublease two of the floors. The lessee may have accounted for the building as a single leased asset at lease inception because all floors were intended to have the same use (e.g., as a single administrative office). The lessee should consider whether its subsequent decision to sublease two floors indicates that the lease contains more than one lease component. The lessee should consider the nature and interdependency of the floors covered by the arrangement using the lease component guidance to determine its units of account. Refer to section 2.5 and 3.3.3.3 in our Leases guide.

**Question 7.2:** If a lessee decides to sublease an ROU asset that is a portion of a larger asset group, should the asset group be tested for impairment?

**Answer 7.2:** ASC 360-10-35-21 provides indicators of impairment, including a significant adverse change in the extent or manner in which an asset group is being used. As such, the decision to sublease a portion of a larger ROU asset may be an indicator of impairment depending on the nature and magnitude of the lease component relative to the overall asset group.

**Question 7.3:** Would a lessee’s decision to sublease an ROU asset cause the life of the ROU asset to be changed?

**Answer 7.3:** It depends. While a decision to sublease the ROU asset changes how the lessee is using the asset, it may not change the period over which an asset is expected to contribute directly or indirectly to future cash flows.

**Question 7.4:** Assume the following scenario from Q&A 7.1: a lessee originally accounts for a ten-year lease of a five-story building as a single ROU asset (i.e., a single unit of account). In year five, the lessee decides to sublease two of the floors. The lessee has determined that it now has two lease components (three floors used in operations and two floors subleased to a tenant). How should the lessee allocate the carrying amount of the ROU asset and lease liability to the lease components?

**Answer 7.4:** Generally, we believe the allocation should be based on the relative fair value of the lease components at the lease commencement date, as defined in the ASC Master Glossary. If the lessee does not know the fair value of the lease components at lease commencement, the lessee could base its allocation on the relative fair value on the date that the lessee decides to sublease.
Acquisition accounting considerations

**Question 8.1:** How should a lessee determine lease classification when a lease is acquired in a business combination?

**Answer 8.1:** When an acquiree in a business combination is a lessee, ASC 842-10-55-11 requires the acquiring entity to retain the acquiree's previous lease classification unless the lease is modified. Refer to section 8.6.1 in our Leases guide for further discussion.

**Question 8.2:** Should a lessee reassess lease classification when a lease is acquired in an asset acquisition?

**Answer 8.2:** Yes. We generally believe that a lessee should reassess lease classification when a lease is acquired in an asset acquisition.

**Question 8.3:** When a lease is acquired in a business combination, how should the ROU asset be valued?

**Answer 8.3:** When recording an ROU asset in a business combination, ASC 805-20-30-24 requires that the lease liability be measured as if it were a new lease (e.g., reassessment of the lease term, discount rate, lease payments) and that the ROU asset be measured at the same amount as the lease liability, adjusted to reflect favorable or unfavorable terms of the lease as compared to market terms. Refer to section 4.3.3.7 in our Business combinations and noncontrolling interests guide for more information on acquisition accounting for leases acquired in a business combination.

**Question 8.4 (added June 2019):**

When a lease is acquired in an asset acquisition, how should the ROU asset be valued?

**Answer 8.4:** The lease liability and the ROU asset should be measured as if there were a new lease. However, the ROU asset should be adjusted to allocate the cost of the acquisition to the buyer. Refer to section 4.2 in our Leases guide for the initial recognition and measurement for a lessee.

Asset acquisitions are measured based on their cost to the buyer. An asset’s acquisition cost or the consideration transferred by the acquiring entity is assumed to be equal to the fair value of the net assets acquired, unless contrary evidence exists. In an asset acquisition, goodwill is not recognized; therefore, any excess consideration transferred over the fair value of the net assets acquired is reallocated to the identifiable assets based on their relative fair value, including the ROU asset and any intangible for favorable or unfavorable terms of the lease. The presence of excess consideration transferred may indicate that not all assets acquired have been recognized or that there are preexisting relationships being settled with the transaction that should be accounted for separately. See section 2.5 in our Property, plant, equipment and other assets guide for more information on allocating cost.

In an asset acquisition, the new leases standard does not have a specific provision related to the recognition of favorable or unfavorable terms of the lease. An intangible asset or liability should be recorded for favorable or unfavorable terms and generally classified separate from the ROU asset balance, and would be amortized over the term of the lease and included in lease expense.
Refer to section 2.6 in our *Property, plant, equipment and other assets* guide for more information on acquisition accounting for leases acquired in an asset acquisition.

**Question 8.5 (added June 2019):**

What are some considerations when measuring the favorable and unfavorable terms of a lease in a business combination or an asset acquisition?

**Answer 8.5:** All the terms of the lease (e.g., contractual rent payments, renewal or termination options, purchase options, lease incentives) should be considered when determining whether there are any favorable or unfavorable terms of a lease that require recognition. For example, if there is an option to purchase the asset at the end of the lease for $10, and the fair value of the asset on the option date is estimated to be $15, then the measurement of the favorable terms of the lease would be $5, less the impact of discounting the fair value back to the acquisition date. If the purchase option is reasonably certain of being exercised, the purchase option payment of $10 would be included in the lease payments used to measure the lease liability and ROU asset. Refer to section 3.4 and 4.2 in our *Leases* guide for more information on the application of the reasonably certain threshold and the measurement of the lease liability and ROU asset, respectively.

As another example, if there is a renewal option that allows the lessee to renew with favorable lease terms (i.e., contractual rent payments are less than market rent), the renewal option should be considered in measuring the favorable terms of the lease. Renewal options should be considered when determining the lease term. When renewal options are reasonably certain of being exercised, the lease term should include the additional term provided by the renewal option. The contractual rent payments made during the lease term will be considered when measuring the lease liability and ROU asset. The measurement of the favorable terms of the lease should only include the value represented by the favorable difference between the contractual rent and the market rent. If the renewal option is not reasonably certain of being exercised, the additional lease term from the option would not be included within the lease term used to determine the lease liability and ROU asset. When the renewal option is not reasonably certain of being exercised, there would still be value associated with the favorable renewal option; this value would be included within the favorable terms of the lease.

In a business combination, the favorable or unfavorable terms of the lease should be recorded as an adjustment to the ROU asset, as discussed in Q&A 8.3. In an asset acquisition, the favorable or unfavorable terms of the lease should generally be recorded as an intangible asset or liability, as discussed in Q&A 8.4.

**Question 8.6 (added June 2019):**

Are there any accounting policy elections available that exempt the measurement and recognition of short-term leases acquired in a business combination or asset acquisition?

**Answer 8.6:** Yes.

As discussed in ASC 805-20-25-28B, an acquirer in a business combination can make an accounting policy election to not measure or recognize leases that have a remaining lease term of 12 months or less at the acquisition date.
In addition to not recording the lease on the balance sheet, under this exception, the acquirer would not recognize an intangible asset if the terms of an operating lease are favorable relative to market terms or a liability if the terms are unfavorable relative to market terms. The election is made by class of underlying asset and is applicable to all of the company’s acquisitions. Refer to section 8.6.1 in our Leases guide for additional information.

An acquirer that has elected the lease measurement and recognition exemption for short-term leases in ASC 842-20-25-2 should apply this policy to leases acquired in an asset acquisition. Refer to section 2.2.1 in our Leases guide for more information. Unlike the accounting policy election in a business combination, in an asset acquisition, the acquirer would recognize an intangible asset or liability for any terms of an operating lease that are favorable or unfavorable relative to market terms, respectively.

**Question 8.7 (added June 2019):**
Are there any private company alternatives under ASC 842 that impact acquisition accounting?

**Answer 8.7:** Yes. ASC 842-20-30-3 provides a practical expedient for nonpublic business entities that allows a lessee to use a risk-free rate for a period comparable to the lease term. Use of a risk-free rate is an accounting policy election, and once elected must be utilized consistently for all leases. Since a risk-free rate is lower than an entity’s incremental borrowing rate, it will result in a higher lease liability and ROU asset. The risk-free rate would also be lower than the discount rate used in calculating the fair value of the lease liability and the ROU asset. This could have implications on impairment testing and acquisition accounting, which should be taken into consideration when making this accounting policy election.

**Question 8.8 (added June 2019):**
Does an ROU asset need to be considered in the screen test used to determine whether the transaction is a business combination or an asset acquisition?

**Answer 8.8:** Yes, the ROU asset should be included in the screen test.

In the screen test, an entity determines whether substantially all of the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets. If so, the set is not considered a business. While the standard does not define what constitutes “substantially all,” this term is used in other areas of GAAP (e.g., revenue, leases). There is no bright line, but it is typically interpreted to mean at least 90%.

A single asset for purposes of the screen test includes any individual asset or group of assets that could be recognized and measured as a single asset under the business combination guidance (ASC 805). With the adoption of ASC 842, an ROU asset is recognized as a single asset under the business combinations guidance.

The guidance specifies certain assets that must be grouped for purposes of applying the screen test. This grouping is only applicable for the screen test, and all assets acquired should be recorded separately in acquisition accounting.

Two scenarios in which separately recorded assets must be grouped into a single asset for the purpose of the screen test include:
• A tangible asset that is attached to another tangible asset (e.g., a building with an associated ground lease, leasehold improvements with an associated office lease)
• In-place lease intangibles, including favorable and unfavorable intangible assets or liabilities, and the related leased assets

The screen can also be met if the fair value of the set is concentrated in a group of similar assets. Entities should consider the nature of the assets and the risks associated with managing and creating outputs when determining if assets should be grouped as similar. For example, a company that leases multiple office buildings that each represent separate lease components should assess whether the lease components are considered similar assets that should be grouped for the purposes of the screen test. Refer to section 1.2.1 in our Business combinations and noncontrolling interests guide for more information on applying the screen test.

**Question 8.9 (added June 2019):**

How should the acquirer record a lease when the acquiree had previously applied sale and leaseback accounting as the seller-lessee?

**Answer 8.9:** When the acquiree’s original leaseback transaction qualified as a sale, the acquisition accounting will depend on whether the acquiree had previously recognized any additional financing under ASC 842-40-30-2. Refer to chapter 6 in our Leases guide for more information on sale and leaseback transactions.

In the original sale and leaseback transaction, if the sales proceeds exceeded the fair value of the asset, the seller-lessee would have recorded a financing payable to the buyer-lessor (i.e., debt) for the excess, and would have allocated the contractual lease payments between the lease and financing liabilities. In the subsequent acquisition accounting, the financing will continue to be recorded as a separate liability from the lease liability and remains under the scope of ASC 470 (i.e., not within the scope of 842).

The portion of the contractual payments that relates to the lease will be used in recording the lease in acquisition accounting and the lease will be recorded as discussed in Q&A 8.3 for a business combination and Q&A 8.4 for an asset acquisition.

In the original sale and leaseback transaction, if the sales proceeds were less than the fair value of the asset, the seller-lessee would have treated the shortfall as prepaid rent and included it within the initial measurement of the right-of-use asset. This would not impact how the associated lease is recorded by the acquirer in the subsequent acquisition accounting. The lease will be recorded as discussed in Q&A 8.3 for a business combination and Q&A 8.4 for an asset acquisition.

**Question 8.10 (added June 2019):**

In an acquisition, how should the acquirer record a lease when the acquiree previously had a failed sale and leaseback transaction as the seller-lessee?

**Answer 8.10:** When the acquiree’s original leaseback transaction was a failed sale and leaseback, the acquiree would have recorded the transaction as a financing arrangement and would not have derecognized the underlying asset. The acquirer would retain the acquiree’s accounting as a failed sale and leaseback transaction and continue to follow the guidance under ASC 842-40 to determine if and when a sale occurs. Refer to section 6.5 in our
Leases guide for more information on leaseback transactions which are not accounted for as a sale.

**Treatment of nonlease components under ASC 420**

Prior to adopting the new leases standard, lease termination costs were accounted for under the Exit or disposal cost obligations guidance (ASC 420). ASC 842 modified the guidance in ASC 420 to remove operating leases from its scope but “costs to terminate a contract that is not a lease” are still addressed in ASC 420. Refer to section 6.5.3 in our Property, plant, equipment and other assets guide for more information on contract termination costs after the adoption of ASC 842.

**Question 9.1:** Should costs to terminate nonlease components within a contract (e.g., common area maintenance or services, such as security) continue to be evaluated under ASC 420 after the adoption of ASC 842?

**Answer 9.1:** Under ASC 842, a lessee may elect an accounting policy, by asset class, to include both the lease and nonlease components as a single component and account for it as a lease. When a lessee has not elected this practical expedient, the nonlease components should continue to be evaluated under ASC 420.

**Leases related to an asset retirement obligation (added June 2019)**

An asset retirement obligation (ARO) is an obligation associated with the retirement of a tangible long-lived asset. Capital intensive companies can have significant AROs due to their ownership of major plant assets that ultimately will be removed from service and oftentimes lease assets to satisfy their AROs. Refer to chapter 3 in our Property, plant, equipment and other assets guide for more information on AROs.

**Question 10.1:** If a reporting entity enters into an operating lease for equipment needed to perform asset retirement activities for an existing ARO, should the reporting entity adjust the existing ARO liability as part of the initial recognition of the operating lease?

**Answer 10.1:** No. The reporting entity has two separate obligations:

1. the legal obligation associated with the retirement of the long-lived asset under ASC 410-20, and
2. the lease liability representing its obligation to make future payments for the right to use the leased equipment.

The obligation associated with the retirement of the long-lived asset is not settled until the asset retirement activities occur. Leasing the equipment that will be used to satisfy the ARO does not reduce the ARO since it is not an asset retirement activity.
This treatment is consistent with the accounting when equipment is purchased for the purpose of performing asset retirement activities. When equipment is purchased, a reporting entity records an asset for the equipment. The ARO liability would be reduced as the purchased equipment is used as part of asset retirement activities (i.e., depreciation of the equipment), not simply through the ownership of the equipment.

**Question 10.2:** If a reporting entity uses equipment under an operating lease to perform asset retirement activities for an existing ARO, can the reporting entity reduce the ARO liability for the period lease costs (i.e., operating lease expense) on an ongoing basis?

**Answer 10.2:** Yes. If a leased asset is used as part of the reporting entity’s asset retirement activities, the periodic lease costs (i.e., operating lease expense) may be recorded as a reduction to the ARO liability.

This accounting is consistent with the illustrative example in ASC 410-20-55-37 through ASC 410-20-55-38. In that example, the payroll costs incurred for employees conducting asset retirement activities are recorded as a reduction of the ARO.

**Other questions (added June 2019)**

**Question 11.1:** Should ROU assets be included in the entity-wide disclosure of long-lived assets by geography required by ASC 280-10-50-41?

**Answer 11.1:** In many circumstances, an ROU asset would be included within the long-lived assets disclosure. An ROU asset is within the scope of ASC 360 and is similar to a tangible asset. While ASC 280-10-55-23 does not define what is required to be included in long-lived assets and allows an entity to apply judgment, the phrase “long-lived” implies tangible assets that are not readily removed. The reasons for requiring disclosure of long-lived assets (rather than total assets) in geographic areas is that long-lived assets are potentially at greater risk than current assets because they are difficult to move and relatively illiquid.

**Question 11.2:** Should a currency translation adjustment be recorded on an ROU asset and lease liability?

**Answer 11.2:** Yes, currency translation adjustments apply to ROU assets and lease liabilities and would be translated like any other asset and liability attributable to a foreign entity. Some preparers may record all of their ROU assets and lease liabilities at the parent level. When an ROU asset and lease liability is attributable to a foreign entity, but recorded by the parent as a top-side entry, the ROU asset and lease liability need to be considered in the currency translation process as if they were recorded at the foreign entity level.
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