

FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2023-01
March 2023

Leases (Topic 842)

Common Control Arrangements

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

For additional copies of this Accounting Standards Update and information on applicable prices and discount rates contact:

Order Department
Financial Accounting Standards Board
801 Main Avenue
PO Box 5116
Norwalk, CT 06851

Please ask for our Product Code No. ASU2023-01.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of March, May, July, August, October, and November by the Financial Accounting Foundation, 801 Main Avenue, Norwalk, CT 06851. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$380 per year. POSTMASTER: Send address changes to Financial Accounting Series, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116. | **No. 519**

Copyright © 2023 by Financial Accounting Foundation. All rights reserved. Content copyrighted by Financial Accounting Foundation may not be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Financial Accounting Foundation. Financial Accounting Foundation claims no copyright in any portion hereof that constitutes a work of the United States Government.



Accounting Standards Update

No. 2023-01
March 2023

Leases (Topic 842)

Common Control Arrangements

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

Accounting Standards Update 2023-01

Leases (Topic 842)

Common Control Arrangements

March 2023

CONTENTS

	Page Numbers
Summary.....	1–4
Amendments to the <i>FASB Accounting Standards Codification</i> ®	5–17
Background Information and Basis for Conclusions	18–30
Amendments to the GAAP Taxonomy.....	31

Summary

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

Since the issuance of Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, the Board has prioritized monitoring and assisting stakeholders with the implementation of Topic 842 through its Post-Implementation Review (PIR) process. PIR activities include, but are not limited to, responding to technical accounting inquiries and proactively seeking feedback on issues arising from applying Topic 842. The amendments in this Update respond to private company stakeholders' concerns about applying Topic 842 to related party arrangements between entities under common control.

What Are the Main Provisions, How Do They Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Are They an Improvement?

Issue 1: Terms and Conditions to Be Considered

Topic 842 requires that entities determine whether a related party arrangement between entities under common control (hereinafter referred to as a common control arrangement) is a lease. If the arrangement is determined to be a lease, an entity must classify and account for the lease on the same basis as an arrangement with an unrelated party (on the basis of legally enforceable terms and conditions). That represents a change from the requirements of Topic 840, *Leases*, which required that an entity classify and account for an arrangement on the basis of economic substance when those terms and conditions were affected by the related party nature of the arrangement. Private company stakeholders observed that determining the enforceable terms and conditions of a common control arrangement to apply Topic 842 often is difficult and costly. Specifically, private company stakeholders stated that determining the enforceable terms and conditions of those arrangements could necessitate obtaining a formal legal opinion in certain cases, which could be challenging because of the common control nature of the arrangement (even for written arrangements).

The amendments in this Update provide a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement to determine:

1. Whether a lease exists and, if so,
2. The classification of and accounting for that lease.

The practical expedient may be applied on an arrangement-by-arrangement basis. If no written terms and conditions exist (including in situations in which an entity does not document existing unwritten terms and conditions in writing upon transition to the practical expedient), an entity is prohibited from applying the practical expedient and must evaluate the enforceable terms and conditions to apply Topic 842.

The practical expedient is expected to reduce (1) the costs associated with implementing and applying Topic 842 to those arrangements and (2) diversity in practice by entities within its scope when applying lease accounting requirements to common control arrangements.

Issue 2: Accounting for Leasehold Improvements

Topic 842 generally requires that leasehold improvements have an amortization period consistent with the shorter of the remaining lease term and the useful life of the improvements, which is an approach that is largely consistent with legacy guidance. Lessees recognize leasehold improvements when they are the accounting owner of those improvements. Private company stakeholders noted that amortizing leasehold improvements associated with arrangements between entities under common control determined to be leases (hereinafter referred to as common control leases) over a period shorter than the expected useful life of the leasehold improvements may result in financial reporting that does not faithfully represent the economics of those leasehold improvements, particularly in common control leases with short lease terms. Those stakeholders further noted that this accounting, depending on the salvage value assigned to the leasehold improvements, may fail to recognize the transfer of value between the entities under common control when the lessee no longer controls the use of the underlying asset. Additionally, the Board noted that multiple methods of accounting for those improvements exist, causing diversity in practice.

The amendments in this Update require that leasehold improvements associated with common control leases be:

1. Amortized by the lessee over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset (the leased asset) through a lease. However, if the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period may not exceed the amortization period of the common control group.
2. Accounted for as a transfer between entities under common control through an adjustment to equity (or net assets for not-for-profit entities) if, and when, the lessee no longer controls the use of the underlying asset.

Additionally, those leasehold improvements are subject to the impairment guidance in Topic 360, Property, Plant, and Equipment.

The amendments in this Update improve current GAAP by clarifying the accounting for leasehold improvements associated with common control leases, thereby reducing diversity in practice. Additionally, the amendments provide investors and other allocators of capital with financial information that better reflects the economics of those transactions.

Who Is Affected by the Amendments in This Update?

Issue 1: Terms and Conditions to Be Considered

The practical expedient is available to entities that are not:

1. Public business entities
2. Not-for-profit conduit bond obligors
3. Employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission (SEC).

Issue 2: Accounting for Leasehold Improvements

The amendments in this Update affect all lessees that are a party to a lease between entities under common control in which there are leasehold improvements. The amendments apply to all entities (that is, public business entities, private companies, not-for-profit entities, and employee benefit plans).

When Will the Amendments Be Effective?

The amendments in this Update for both Issue 1 and Issue 2 are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been made available for issuance. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

What Are the Transition Requirements?

Issue 1: Terms and Conditions to Be Considered

Entities adopting the practical expedient in this Update concurrently with adopting Topic 842 are required to follow the same transition requirements used to apply Topic 842.

All other entities are required to apply the practical expedient in this Update either:

1. Prospectively to arrangements that commence or are modified on or after the date that the entity first applies the practical expedient
2. Retrospectively to the beginning of the period in which the entity first applied Topic 842 for arrangements that exist at the date of adoption of the practical expedient. The practical expedient does not apply to common control arrangements no longer in place at the date of adoption of the amendments in this Update.

Regardless of an entity's transition approach, the entity is permitted to document any *existing* unwritten terms and conditions of a common control arrangement before the date on which the entity's first interim (if applicable) or annual financial statements are available to be issued in accordance with the practical expedient in this Update.

Issue 2: Accounting for Leasehold Improvements

Entities adopting the amendments in this Update concurrently with adopting Topic 842 may follow the same transition requirements used to apply Topic 842 or may use either of the prospective approaches described below to avoid retrospectively accounting for leasehold improvements.

All other entities are required to apply the amendments in this Update using one of the following methods:

1. Prospectively to all new leasehold improvements recognized on or after the date that the entity first applies the amendments in this Update
2. Prospectively to all new and existing leasehold improvements recognized on or after the date that the entity first applies the amendments in this Update, with any remaining unamortized balance of existing leasehold improvements amortized over their remaining useful life to the common control group determined at that date
3. Retrospectively to the beginning of the period in which the entity first applied Topic 842, with any leasehold improvements that otherwise would not have been amortized or impaired recognized through a cumulative-effect adjustment to the opening balance of retained earnings (or net assets of a not-for-profit entity) at the beginning of the earliest period presented in accordance with Topic 842.

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

Introduction

1. The following table provides a summary of the amendments to the Accounting Standards Codification for applying Topic 842 to common control arrangements. The amendments are organized by issue.

Issue	Paragraphs
Issue 1: Terms and Conditions to Be Considered	3–6
Issue 2: Accounting for Leasehold Improvements	7–11

2. The Accounting Standards Codification is amended as described in paragraphs 3–13. 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~~.

Issue 1: Terms and Conditions to Be Considered

3. The following amendments provide entities that are not public business entities, not-for-profit bond obligors, or employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission with a practical expedient to use the written terms and conditions of a related party arrangement between entities under common control to determine:

- a. Whether a lease exists and, if so,
- b. The classification of and accounting for that lease.

An entity electing that practical expedient is allowed to elect the practical expedient on an arrangement-by-arrangement basis.

Amendments to Subtopic 842-10

4. Add paragraphs 842-10-15-3A through 15-3C, with a link to transition paragraph 842-10-65-7, as follows:

Leases—Overall

Scope and Scope Exceptions

> Identifying a Lease

842-10-15-2 At inception of a **contract**, an entity shall determine whether that contract is or contains a **lease**.

842-10-15-3 A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).

842-10-15-3A As a practical expedient, an entity that is not a **public business entity**; a **not-for-profit entity** that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market; or an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission may use the written terms and conditions of a related party arrangement between entities under common control to determine whether that arrangement is or contains a lease. For purposes of determining whether a lease exists under this practical expedient, an entity shall determine whether written terms and conditions convey the practical (as opposed to enforceable) right to control the use of an identified asset for a period of time in exchange for consideration. If an entity determines that a lease exists, the entity shall classify and account for that lease on the basis of those written terms and conditions. An entity may elect the practical expedient on an arrangement-by-arrangement basis.

842-10-15-3B If no written terms or conditions exist, an entity shall not apply the practical expedient in paragraph 842-10-15-3A. Rather, the entity shall determine whether the related party arrangement between entities under common control is or contains a lease in accordance with paragraph 842-10-15-3 and, if so, classify and account for that lease on the basis of its legally enforceable terms and conditions in accordance with paragraph 842-10-55-12.

842-10-15-3C If after an entity has applied the practical expedient in paragraph 842-10-15-3A an arrangement is no longer between entities under common control, the entity shall determine whether a lease exists in accordance with paragraph 842-10-15-3.

- a. If the arrangement was previously determined to be a lease and continues to be a lease, the entity shall classify and account for the lease on the basis of the enforceable terms and conditions. If the enforceable

terms and conditions differ from the written terms and conditions previously used to apply paragraph 842-10-15-3A, the entity shall apply the modification requirements in paragraphs 842-10-25-9 through 25-17 using the enforceable terms and conditions. If the enforceable terms and conditions are the same as the written terms and conditions previously used to apply paragraph 842-10-15-3A, the modification requirements in those paragraphs are not applicable.

- b. If the arrangement was previously not determined to be a lease and is determined to be a lease, the entity shall account for the arrangement as a new lease.
- c. If the arrangement was previously determined to be a lease and the lease ceases to exist:
 - 1. A lessee shall apply the derecognition requirements for fully terminated leases in paragraph 842-20-40-1.
 - 2. A lessor with a lease previously classified as a sales-type lease or a direct financing lease shall apply the derecognition requirements for terminated leases in paragraph 842-30-40-2.
 - 3. A lessor with a lease previously classified as an operating lease shall derecognize any amounts that would not exist if the arrangement was not accounted for as a lease and account for the arrangement in accordance with other generally accepted accounting principles (GAAP).

5. Amend paragraph 842-10-55-12, with a link to transition paragraph 842-10-65-7, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

. > Lease Classification

.. > Lease of a Related Party

842-10-55-12 Except for leases between entities under common control accounted for in accordance with the practical expedient in paragraph 842-10-15-3A, leases ~~Leases~~ between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease. Additionally, except for leases between entities under common control accounted for in accordance with paragraph 842-10-15-3A ~~in the separate financial statements of the related parties,~~ the classification and accounting for the leases should be the same as for leases between unrelated parties in the separate financial statements of the related parties.

6. Amend paragraph 842-10-65-1 and its related heading and add paragraph 842-10-65-7 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842)*, No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*, No. 2018-10, *Codification Improvements to Topic 842*, Leases, No. 2018-11, *Leases (Topic 842): Targeted Improvements*, No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, No. 2019-01, *Leases (Topic 842): Codification Improvements*, No. 2019-10, *Financial Instruments—Credit Losses (Topic 326)*, *Derivatives and Hedging (Topic 815)*, *Leases (Topic 842): Effective Dates*, No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, No. 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments*, and No. 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*, and No. 2023-01, *Leases (Topic 842): Common Control Arrangements*

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842)*, No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*, No. 2018-10, *Codification Improvements to Topic 842*, Leases, No. 2018-11, *Leases (Topic 842): Targeted Improvements*, No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, No. 2019-01, *Leases (Topic 842): Codification Improvements*, No. 2019-10, *Financial Instruments—Credit Losses (Topic 326)*, *Derivatives and Hedging (Topic 815)*, and *Leases (Topic 842): Effective Dates*, No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, No. 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments*, and No. 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*, and No. 2023-01, *Leases (Topic 842): Common Control Arrangements*: [Note: See paragraph 842-10-S65-1 for an SEC Staff Announcement on transition related to Update 2016-02.]

[The remainder of this paragraph is not shown here because it is unchanged.]

> Transition Related to Accounting Standards Update No. 2023-01, *Leases (Topic 842): Common Control Arrangements*

842-10-65-7 The following represents the transition and effective date information related to the practical expedient in Accounting Standards Update No. 2023-01, *Leases (Topic 842): Common Control Arrangements*:

- a. The pending content that links to this paragraph shall be effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2023. Early adoption is permitted in any annual or interim period for which financial statements have not yet been made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim period, it shall adopt that pending content as of the beginning of the fiscal year that includes that interim period.
- b. An entity that adopts the pending content that links to this paragraph concurrently with adopting the pending content that links to paragraph 842-10-65-1 shall apply the pending content that links to this paragraph using the same transition method elected for the pending content that links to paragraph 842-10-65-1.
- c. An entity that adopted the pending content that links to paragraph 842-10-65-1 before adopting the pending content that links to this paragraph shall apply the pending content that links to this paragraph using either of the following two methods:
 - 1. Prospectively to arrangements that commence or are modified on or after the date that the entity first applies the pending content that links to this paragraph.
 - 2. Retrospectively to the beginning of the period in which the pending content that links to paragraph 842-10-65-1 was first applied. The pending content that links to this paragraph shall not be applicable for arrangements no longer in place at the date of adoption. Under this transition method:
 - i. If an arrangement previously considered to be a lease continues to be a lease after applying the pending content that links to this paragraph, an entity shall apply the requirements in paragraphs 842-10-25-9 through 25-17 to any changes in the lease resulting from application of the practical expedient in the pending content that links to this paragraph. Any amounts that otherwise would have been recognized in earnings shall be recognized as a cumulative-effect adjustment to opening retained earnings (or net assets of a not-for-profit entity) at the beginning of the earliest period presented in accordance with the pending content that links to paragraph 842-10-65-1.
 - ii. If an arrangement previously not considered a lease becomes a lease after applying the pending content that links to this paragraph, an entity shall account for the arrangement as a new lease.

- d. An entity may document any existing unwritten terms and conditions of an arrangement between entities under common control before the date on which the entity's first interim (if applicable) or annual financial statements are available to be issued in accordance with the pending content that links to this paragraph.
- e. An entity within the scope of (c) shall provide the applicable transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraphs 250-10-50-1(b)(2) and 250-10-50-3. An entity that elects the transition method in (c)(2) shall provide the transition disclosures in paragraph 250-10-50-1(b)(3) as of the beginning of the earliest period presented but not before the date on which the pending content that links to paragraph 842-10-65-1 was adopted.
- f. An entity that elects the practical expedient(s) in paragraph 842-10-65-1(f) or (g) is not required to apply either of those practical expedients to common control arrangements for which the pending content that links to this paragraph is being applied.

Issue 2: Accounting for Leasehold Improvements

7. The following amendments require that all entities with leases between entities under common control account for the associated leasehold improvements by:

- a. Amortizing leasehold improvements over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the underlying asset through a lease with another entity not within the same common control group, the amortization period shall not exceed the amortization period of the common control group.
- b. Accounting for any remaining leasehold improvements as a transfer between entities under common control through an adjustment to equity (net assets for not-for-profit entities) if, and when, the lessee no longer controls the use of the underlying asset.

Additionally, an entity with leasehold improvements associated with common control leases is required to apply the impairment requirements in Topic 360, Property, Plant, and Equipment.

Amendments to Subtopic 842-10

8. Amend paragraph 842-10-30-6, with a link to transition paragraph 842-10-65-8, as follows:

Leases—Overall

Initial Measurement

> Initial Measurement of the Lease Payments

842-10-30-6 Lease payments do not include any of the following:

- a. Variable lease payments other than those in paragraph 842-10-30-5(b)
- b. Any guarantee by the lessee of the **lessor's** debt
- c. Amounts allocated to nonlease components in accordance with paragraphs 842-10-15-33 through ~~15-42~~ ~~15-42~~.
- d. Leasehold improvements recognized by a lessee and accounted for in accordance with paragraph 842-20-35-12A.

Amendments to Subtopic 842-20

9. Amend paragraph 842-20-35-12 and add paragraphs 842-20-35-12A through 35-12C, with a link to transition paragraph 842-10-65-8, as follows:

Leases—Lessee

Subsequent Measurement

> Amortization of Leasehold Improvements

842-20-35-12 Leasehold improvements, other than those accounted for in accordance with paragraph 842-20-35-12A, shall be amortized over the shorter of the **useful life** of those leasehold improvements and the remaining **lease term**, unless the **lease** transfers ownership of the **underlying asset** to the **lessee** or the lessee is reasonably certain to exercise an option to purchase the underlying asset, in which case the lessee shall amortize the leasehold improvements to the end of their useful life.

842-20-35-12A Leasehold improvements associated with a lease between entities under common control shall be:

- a. Amortized over the useful life of those improvements to the common control group as long as the lessee controls the use of the underlying asset through a lease. If the **lessor** obtained the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period shall not exceed the amortization period of the common control group determined in accordance with paragraph 842-20-35-12.

- b. Accounted for as a transfer between entities under common control through an adjustment to equity (net assets for a **not-for-profit entity**) when the lessee no longer controls the use of the underlying asset.

842-20-35-12B An entity with leasehold improvements accounted for in accordance with paragraph 842-20-35-12A shall apply the impairment requirements in paragraph 360-10-40-4, considering the useful life to the common control group.

842-20-35-12C If after the **commencement date** the lessee and lessor become within the same common control group or are no longer within the same common control group, any change in the required amortization period for leasehold improvements shall be accounted for prospectively as a **change in accounting estimate** in accordance with paragraph 250-10-45-17.

10. Add paragraph 842-20-50-7A, with a link to transition paragraph 842-10-65-8, as follows:

Disclosure

842-20-50-7 A lessee shall disclose lease transactions between related parties in accordance with paragraphs 850-10-50-1 through 50-6.

842-20-50-7A When the **useful life** of leasehold improvements to the common control group determined in accordance with paragraph 842-20-35-12A exceeds the related lease term, a lessee shall disclose the following information:

- a. The unamortized balance of the leasehold improvements at the balance sheet date
- b. The remaining useful life of the leasehold improvements to the common control group
- c. The remaining lease term.

11. Add paragraph 842-10-65-8 and its related heading as follows:

Leases—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2023-01, *Leases (Topic 842): Common Control Arrangements*

842-10-65-8 The following represents the transition and effective date information related to the accounting for leasehold improvements associated with leases between entities under common control in Accounting Standards Update No. 2023-01, *Leases (Topic 842): Common Control Arrangements*:

- a. The pending content that links to this paragraph shall be effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2023. Early adoption is permitted in any annual or interim period for which financial statements have not yet been made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim period, it shall adopt that pending content as of the beginning of the fiscal year that includes that interim period.
- b. An entity that adopts the pending content that links to this paragraph concurrently with adopting the pending content that links to paragraph 842-10-65-1 may apply the pending content that links to this paragraph using the same transition method elected for the pending content that links to paragraph 842-10-65-1 or may apply the pending content that links to this paragraph using either of the prospective methods specified in (c)(1) and (c)(2) below.
- c. An entity that adopted the pending content that links to paragraph 842-10-65-1 before adopting the pending content that links to this paragraph shall apply the pending content that links to this paragraph using one of the following methods:
 1. Prospectively to all new leasehold improvements recognized on or after the date that the entity first applies the pending content that links to this paragraph.
 2. Prospectively to all new and existing leasehold improvements recognized on or after the date that the entity first applies the pending content that links to this paragraph. An entity that elects this transition approach shall amortize the remaining balance of leasehold improvements existing at the date of adoption of the pending content that links to this paragraph over the remaining useful life of those improvements to the common control group determined at that date.
 3. Retrospectively to the beginning of the period in which the pending content that links to paragraph 842-10-65-1 was first applied. Any leasehold improvements previously amortized or impaired that otherwise would not have been amortized or impaired had the pending content that links to this paragraph been applicable shall be recognized through a cumulative-effect adjustment to the opening balance of retained earnings (or net assets of a not-for-profit entity) at the beginning of the earliest period presented in accordance with the pending content that links to paragraph 842-10-65-1.
- d. An entity within the scope of (c) shall provide the applicable transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraphs 250-10-50-1(b)(2) and 250-10-50-3. An entity that elects the transition method in (c)(3) shall

provide the transition disclosures in paragraph 250-10-50-1(b)(3) as of the beginning of the earliest period presented but not before the date on which the pending content that links to paragraph 842-10-65-1 was adopted.

Amendments to Status Sections

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

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

Paragraph	Action	Accounting Standards Update	Date
842-10-15-3A through 15-3C	Added	2023-01	3/27/2023
842-10-30-6	Amended	2023-01	3/27/2023
842-10-55-12	Amended	2023-01	3/27/2023
842-10-65-1	Amended	2023-01	3/27/2023
842-10-65-7	Added	2023-01	3/27/2023
842-10-65-8	Added	2023-01	3/27/2023

13. Amend paragraph 842-20-00-1, by adding the following items to the table, as follows:

842-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-20-35-12	Amended	2023-01	3/27/2023
842-20-35-12A through 35-12C	Added	2023-01	3/27/2023
842-20-50-7A	Added	2023-01	3/27/2023

The amendments in this Update were adopted by affirmative vote of four members of the Financial Accounting Standards Board. Ms. Botosan and Messrs. Buesser and Cannon dissented.

Ms. Botosan and Mr. Cannon's dissent is as follows:

Ms. Botosan and Mr. Cannon support the relief afforded to private companies and certain not-for-profit entities by the practical expedient to rely on the written terms and conditions of a common control arrangement without having to determine whether those terms and conditions are enforceable (Issue 1). They believe that this simple clarification will mitigate the cost of having to obtain an unnecessary legal opinion and will serve to align practice more closely with the Board's original intent.

However, Ms. Botosan and Mr. Cannon do not support exempting all entities' common control lease arrangements from Topic 842's requirement to amortize leasehold improvements over the shorter of the remaining lease term and the useful life of the improvements (Issue 2). The amendments will require a related party lessee under a common control arrangement to measure its right-of-use asset and lease liability over the lease term but amortize any related leasehold improvements over the useful life of those improvements to the common control group, even in the likely event that this period exceeds the lease term used to measure the underlying lease asset and lease liability. They object to this outcome on both conceptual and pragmatic grounds.

Ms. Botosan and Mr. Cannon believe that beyond the recognized lease term, a leasehold improvement does not meet the definition of an asset. FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, Chapter 4, *Elements of Financial Statements*, defines an asset as "a present right of an entity to an economic benefit." Beyond the recognized lease term, no present right to the economic benefit from use of the underlying leased asset exists, and, correspondingly, no present right to the economic benefit from use of any associated leasehold improvements exists.

Ms. Botosan and Mr. Cannon believe that this amendment will yield misleading financial reporting information because it will inflate the balance sheet and misstate solvency ratios by recognizing a leasehold improvement asset but not recognizing the underlying lease asset or liability. They believe that this reporting does not provide a faithful representation of the underlying economic activity, since generally it is uneconomic for an entity to fund leasehold improvements with a longer duration than the lease term. Therefore, they do not agree that the amendments for Issue 2 result in financial information that better reflects the economics of leasehold improvements. In addition, they are concerned that the favorable accounting treatment afforded to leasehold improvements by this exemption will incentivize short-term common control lease arrangements, thereby compounding the harm.

Ms. Botosan and Mr. Cannon also are concerned that the exemption applies to public entities. Those entities adopted Topic 842 for fiscal years beginning after December 15, 2018. It is their understanding that the FASB has received no concerns about the application of Topic 842 to common control lease arrangements from public entity preparers, practitioners, or financial statement

users. Accordingly, they question the existence of a pervasive problem for those entities.

Furthermore, neither the comment letters nor the staff's research on Issue 2 included input from public entities that will be affected by the amendments or the users of those entities' financial statements. Accordingly, Ms. Botosan and Mr. Cannon concluded that they do not have sufficient stakeholder input to make an informed decision on the issue or to make an informed assessment about whether the expected benefits of the amendments would justify the perceived costs for those entities.

Topic 842 is in the final stage of implementation by entities required to adopt the standard for fiscal years beginning after December 15, 2021. Ms. Botosan and Mr. Cannon believe that addressing Issue 1 alone would have delivered a timely response to the primary concern raised by those entities. In their opinion, incorporating Issue 2 in the amendments is unnecessary and detrimental to the decision usefulness of the resulting financial information.

Mr. Buesser's dissent is as follows:

Broadly, Mr. Buesser does not believe that Topic 842 provides investors with information that is decision useful, primarily because he believes that the lease liability recognized is noncomparable across companies.

To illustrate this concern, Mr. Buesser analyzed the balance sheets and lease disclosures for 25 of the largest U.S. public retail companies for fiscal years beginning in 2021. First, Mr. Buesser found that the range of lease terms for those retailers was 5 years to 22 years, with a median of 9 years. Second, Mr. Buesser found that the range of operating lease liability multiples was 2.7x to 8.8x, with a median of 4.6x. An operating lease liability multiple equals an entity's operating lease liability divided by its total operating lease cost (including variable and short-term lease costs). Mr. Buesser further found that the correlation coefficient between the lease term and the lease liability multiple is 0.82. Mr. Buesser believes that the wide disparity in operating lease liability multiples across entities diminishes the decision usefulness of the lease liability information provided in financial statements.

Notwithstanding his opposition to Topic 842, Mr. Buesser believes that those supporting Topic 842 agree that the lease liability and right-of-use asset should be measured using the accounting lease term.

Mr. Buesser believes that the amendments for Issue 2 undercut the importance of the accounting lease term used for applying Topic 842 by allowing a commonly controlled lessee to amortize leasehold improvements associated with the right-of-use asset over the useful life to the common control group, which will probably be longer than the accounting lease term used for measuring the lease liability.

Mr. Buesser notes that private company stakeholders provided feedback indicating that amortizing leasehold improvements associated with common control leases over a period shorter than the life of the improvements may result in financial reporting that does not faithfully represent the economics of those arrangements, particularly for leases with short lease terms. Mr. Buesser believes that if the Topic 842 model for amortizing leasehold improvements associated with common control leases does not faithfully represent the economics of those transactions, then measuring the related right-of-use asset and lease liability for those leases using the accounting lease term also does not represent the economics of the transactions.

Additionally, Mr. Buesser is concerned that the amendments for Issue 2 could incentivize certain preparer stakeholders to request that the Board extend the accounting for leasehold improvements associated with common control leases to all leases (that is, other related party leases and leases between unrelated parties). Mr. Buesser believes that the accounting for leasehold improvements should be consistent, regardless of whether the lease is between entities under common control or is not.

Finally, Mr. Buesser believes that the amendments for Issue 2 weaken Topic 842, which Mr. Buesser views as an already problematic standard.

Members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Frederick L. Cannon
Susan M. Cospers
Marsha L. Hunt

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 certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. 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.

BC3. As part of the Board's post-implementation review of Topic 842, the Board and staff continue to assist stakeholders by responding to technical accounting inquiries and proactively seeking feedback on potential implementation issues that have arisen as entities began implementing Topic 842. Since the issuance of Update 2016-02, the Board has issued seven Updates to assist stakeholders with implementation issues and two Updates deferring the effective date for private companies and certain not-for-profit organizations. The staff continues to perform outreach with stakeholders to determine whether the standard is accomplishing its stated objective and evaluate the benefits being provided to investors and other allocators of capital and continuing costs related to Topic 842.

BC4. The amendments in this Update respond to the following issues related to applying Topic 842 to related party arrangements between entities under common control (hereinafter referred to as common control arrangements) brought to the Board's attention primarily through interactions with private company stakeholders:

- a. The terms and conditions to be considered for:
 - i. Determining whether a lease exists and, if so,
 - ii. The classification of and accounting for that lease (Issue 1).
- b. Accounting for leasehold improvements (Issue 2).

BC5. The Board issued proposed Accounting Standards Update, *Leases (Topic 842): Common Control Arrangements*, on November 30, 2022, and received 29 comment letters in response to the amendments in that proposed Update. The Board considered respondents' comments in reaching the conclusions in this Update, as discussed further below.

Benefits and Costs

BC6. 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.

BC7. For Issue 1, the Board concluded that providing the practical expedient in this Update to entities that are not (a) public business entities, (b) not-for-profit bond obligors, or (c) employee benefit plans that file or furnish financial statements with or to the SEC will reduce the cost of implementation and ongoing application of Topic 842 for those entities while reducing diversity in practice when applying lease accounting requirements to common control arrangements. Additionally, the Board expects that using the written terms and conditions of a common control arrangement will often result in financial reporting for those arrangements that is consistent with financial reporting that uses enforceable terms and conditions, thereby not compromising the decision usefulness of information provided to investors and other allocators of capital.

BC8. For Issue 2, the Board concluded that the amendments in this Update improve current GAAP by clarifying the accounting for leasehold improvements associated with common control leases, thereby reducing diversity in practice. Additionally, the Board decided that the amendments result in financial information for investors and other allocators of capital that better reflects the economics of those transactions. The Board does not anticipate that entities will incur significant costs as a result of applying the amendments in this Update.

Basis for Conclusions

Common Control

BC9. The amendments in this Update address issues with applying Topic 842 to common control arrangements. The Board decided not to include other related party arrangements within the scope of the amendments primarily because stakeholders' feedback, including the feedback received in comment letters, indicated that issues with applying Topic 842 were most frequently associated with common control arrangements (see paragraphs BC13 and BC14). Additionally,

that feedback indicated that common control arrangements in particular pose unique challenges.

BC10. Some comment letter respondents requested that the Board define *common control* or provide additional guidance for determining whether entities are under common control. Consistent with deliberations in previous projects addressing common control arrangements, the Board decided not to define *common control* in this Update. The Board noted that *common control* exists in other areas of GAAP (for example, to determine the measurement basis for assets transferred between entities under common control under Topic 805, Business Combinations). For purposes of applying the amendments in this Update, the Board believes that it would be appropriate for entities to reference, among other things, the SEC staff's observations¹ documented in EITF Issue No. 02-5, "Definition of 'Common Control' in Relation to FASB Statement No. 141," to determine *common control*.

BC11. Consistent with its observations in paragraph BC19 of Accounting Standards Update No. 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*, the Board continues to believe that the term *common control* should be broader for private companies and most not-for-profit entities than what the SEC staff observed in Issue 02-5. For example, an entity owned by a grandparent and an entity owned by a grandchild could, on the basis of facts and circumstances, be considered entities under common control for the purposes of applying the amendments in this Update.

¹ . . . the SEC staff has indicated that common control exists between (or among) separate entities only in the following situations:

- a. An individual or enterprise holds more than 50 percent of the voting ownership interest of each entity.
- b. Immediate family members hold more than 50 percent of the voting ownership interest of each entity (with no evidence that those family members will vote their shares in any way other than in concert).
 - (1) Immediate family members include a married couple and their children, but not the married couple's grandchildren.
 - (2) Entities might be owned in varying combinations among living siblings and their children. Those situations would require careful consideration regarding the substance of the ownership and voting relationships.
- c. A group of shareholders holds more than 50 percent of the voting ownership interest of each entity, and contemporaneous written evidence of an agreement to vote a majority of the entities' shares in concert exists. [paragraph 3 of Issue 02-5]

Issue 1: Terms and Conditions to Be Considered

BC12. Topic 842 requires that entities determine whether a related party arrangement, including one between entities under common control, is a lease on the basis of the legally enforceable terms and conditions of the arrangement. That requirement is consistent with the requirements for an arrangement between unrelated parties. The classification and accounting under Topic 842 for all leases—both leases between related parties and leases between unrelated parties—also are based on the enforceable terms and conditions. Under Topic 840, if those terms and conditions were affected by the related party nature of the arrangement, an entity was required to classify and account for that arrangement on the basis of its *economic substance* as opposed to its *legal form*.

BC13. Many private company stakeholders stated that determining the enforceable terms and conditions in common control arrangements often presents unique challenges, even when the terms and conditions are written. Moreover, those stakeholders noted that a common owner or owners typically can amend the terms and conditions of an arrangement at any time. Similarly, a common owner or owners typically can choose not to enforce the terms and conditions of an arrangement. In other words, the arrangements are generally controlled entirely by one party or control group and, thus, pose unique issues when considering enforceability.

BC14. Private company stakeholders consistently indicated that common control arrangements often are unwritten or lack sufficient detail (for example, the agreements may not explicitly specify whether lessee-controlled renewal options exist). Additionally, those stakeholders stated that the terms and conditions of the arrangements often are not negotiated at arm's length and not aligned with other related transactions or agreements. In those cases, private company stakeholders were concerned that determining the enforceable terms and conditions could necessitate obtaining a formal legal opinion, which is challenging and costly because of the common control nature of the arrangement (even for written arrangements).

BC15. The Board acknowledged that the related party requirements in Topic 842 were intended to address stakeholders' concerns about the complexities and diversity in practice associated with applying the *economic substance* requirements in Topic 840. Notwithstanding, the Board concluded on the basis of feedback from stakeholders and additional analysis that determining whether terms and conditions of arrangements between entities under common control are enforceable may be overly challenging when applying Topic 842, particularly in situations in which those terms and conditions are unwritten. Furthermore, the Board learned through outreach that in situations in which an entity identifies oral or implicit terms and conditions for purposes of applying Topic 842, practitioners often require that those terms and conditions be written to satisfy audit requirements.

BC16. To respond to stakeholders' concerns, the Board provided a practical expedient to entities that are not (a) public business entities, (b) not-for-profit bond obligors, or (c) employee benefit plans that file or furnish financial statements with or to the SEC. An entity electing the practical expedient will use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, to classify and account for that lease. An entity is not required to determine whether written terms and conditions are enforceable when applying the practical expedient and may apply the practical expedient on an arrangement-by-arrangement basis. If no written terms and conditions exist, the Board decided that an entity cannot apply the practical expedient and must use enforceable rights and obligations to apply Topic 842, consistent with the requirements for arrangements between related parties *not* under common control. Additionally, the Board observed that, similar to legacy requirements and practice, if an entity determines that an arrangement is not a lease, the entity should apply other applicable GAAP to account for both the arrangement and any improvements made by a customer to a supplier's asset.

BC17. The Board noted that entities that have common control arrangements are subject to Topic 850, Related Party Disclosures. The disclosures required by Topic 850 are intended to provide investors and other allocators of capital with sufficient information to analyze those arrangements. Those disclosure requirements were developed to address the fact that arrangements between related parties often are not consummated at arm's length and, therefore, may not reflect the economic substance of those arrangements. The Board concluded that applying the practical expedient, coupled with the Topic 850 disclosure requirements, should provide investors and allocators of capital with sufficient information to analyze an entity's common control arrangements.

BC18. The Board concluded that the option to use written terms and conditions for common control arrangements instead of the enforceable terms and conditions is a practical expedient. The *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, describes a practical expedient as "a more cost-effective way of achieving the same or a similar accounting or reporting objective." If the information provided by existing GAAP is deemed relevant to the users of private company financial statements, then a practical expedient should be used to lower the cost and complexity of applying the guidance. Because the Board expects that applying Topic 842 to common control arrangements on the basis of written terms and conditions is generally consistent with public business entity practice, it concluded that a practical expedient was warranted.

BC19. More than a majority of comment letter respondents supported the practical expedient. Many of those respondents stated that the practical expedient (a) is operable and (b) will not compromise the decision usefulness of financial information provided to investors.

BC20. The Board considered whether the practical expedient should be available for all entities but decided to limit the practical expedient to entities that are not (a) public business entities, (b) not-for-profit bond obligors, or (c) employee benefit plans that file or furnish financial statements with or to the SEC. The Board reasoned that the entities in (a) through (c) have fully adopted Topic 842 and have raised no significant concerns since the issuance of Update 2016-02 in February 2016 about applying related party requirements in Topic 842 to common control arrangements. Moreover, the Board noted that feedback indicated that public business entities are generally concluding that the written terms and conditions of a common control arrangement are the legally enforceable terms and conditions in accordance with paragraph 842-10-55-12. Therefore, the Board expects that using written terms and conditions in accordance with the practical expedient will generally be consistent with the accounting for similar arrangements by public business entities.

BC21. Some respondents broadly supporting the practical expedient recommended that the Board describe the specific terms and conditions that must be included in the written arrangement to apply the practical expedient. The Board considered that feedback but determined that providing additional guidance was unnecessary given the specificity of the existing requirements in Topic 842 for (a) determining whether a lease exists and, if so, (b) classifying and accounting for that lease. The Board further observed that applying the practical expedient does not eliminate the need for an entity to apply relevant guidance in Topic 842 to account for the lease. For example, an entity is still required to determine whether an arrangement contains lease and nonlease components.

BC22. Other respondents requested clarification on the form required for documenting the written terms of an agreement to apply the practical expedient. The Board observed that entities have latitude to use reasonable judgment when deciding how the terms and conditions of an arrangement are conveyed in writing and, therefore, did not prescribe a specific form or approach.

BC23. The Board decided that the practical expedient may be applied on an arrangement-by-arrangement basis, primarily because it expects that entities will apply Topic 842 to common control arrangements on the basis of written terms and conditions. Notwithstanding, the Board reasoned that if entities wish to identify and account for enforceable unwritten terms and conditions for certain arrangements and not elect the practical expedient, they should be allowed to do so. Almost all comment letter respondents supported allowing entities to apply the practical expedient on an arrangement-by-arrangement basis.

Issue 2: Accounting for Leasehold Improvements

BC24. Leasehold improvements, although not defined in the Master Glossary, generally constitute improvements made by a lessee to the underlying asset (the leased asset) for which the lessee is determined to be the accounting owner. In

addition, those improvements are recognized as leasehold improvements on a lessee's balance sheet only when an arrangement is determined to be a lease (under either Topic 842 or Topic 840). Topic 842 generally requires that leasehold improvements have an amortization period consistent with the shorter of the remaining lease term and the useful life of the improvements. That requirement is largely consistent with legacy guidance. Private company stakeholders stated that it is not uncommon for private company common control leases to have short lease terms (for example, one year), even in situations in which the commonly controlled lessee makes significant leasehold improvements with an estimated useful life that far exceeds the lease term. Those stakeholders were concerned that amortizing leasehold improvements over a period shorter than that estimated useful life of the improvements may result in financial reporting that does not faithfully represent the economics or the common control nature of those improvements because:

- a. The lessee will continue to control the use of the leased asset after the initial lease term either by extending the existing lease or entering into a new lease. Unlike transactions involving entities that are not under common control, the decision for that continued use often is controlled by a single party in the control group.
- b. The leasehold improvements will benefit another party within the common control group after the lessee ceases using the leased asset.

BC25. The Board observed that multiple methods of accounting for leasehold improvements in leases with entities under common control are acceptable under current GAAP. Those methods include, but are not limited to:

- a. Recognizing the improvements as leasehold improvements on the balance sheet and fully amortizing those improvements over the shorter of the lease term and useful life of the leasehold improvements
- b. Recognizing the improvements as leasehold improvements on the balance sheet and amortizing those improvements over the lease term to an estimated salvage value, with the unamortized balance accounted for as a dividend to the common owner or owners at the end of the lease term
- c. Recognizing the improvements as leasehold improvements on the balance sheet and amortizing those improvements over the lease term with a portion of the leasehold improvements recognized as a lease payment.

BC26. Comment letter respondents had differing views about the extent of diversity in practice for leasehold improvements in common control leases. Many respondents to the proposed Update stated that the amendments would clarify the accounting for those improvements and reduce diversity or the potential for diversity in practice. Other comment letter respondents stated that they have not observed diversity in practice among principally public entities that have adopted Topic 842.

BC27. The Board noted that leasehold improvements associated with common control leases are economically different from those associated with third-party and other related-party leases. The Board observed that leasehold improvements associated with common control leases generally are made at the direction of a common owner or owners. The Board further observed that in common control leases, those improvements are expected to benefit all common control parties through (a) the lessee's use of those improvements or (b) a transfer to the common control lessor or another entity within the common control group with the leased asset. The Board noted that this is not the case for leasehold improvements associated with leases between entities not under common control. Outreach and feedback from respondents to the proposed Update supported the Board's observations about the economics of leasehold improvements associated with common control leases.

BC28. To clarify the accounting for leasehold improvements associated with common control leases, better reflect the economics of those transactions, and reduce diversity in practice, the Board decided to require that those leasehold improvements be:

- a. Amortized by the lessee over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the underlying asset through a lease with another entity not within the same common control group, the amortization period may not exceed the amortization period of the common control group.
- b. Accounted as a transfer between entities under common control through an adjustment to equity (or net assets for not-for-profit entities) if, and when, the lessee no longer controls the right to use the underlying asset.

BC29. The Board noted that common control leases are not prevalent for public companies and, therefore, it did not expect to receive formal feedback on Issue 2 from that stakeholder group. Furthermore, for the more limited set of public companies that engage in common control leases, the Board expects that leasehold improvements associated with those leases will not be a significant issue. Notwithstanding the limited expected effect for the vast majority of public companies, the Board received feedback from (a) auditors (including those that audit the majority of public companies), (b) professional societies that include public company members, and (c) regulators of public companies and obtained sufficient information to conclude that additional outreach was unnecessary. While the effect of the amendments in this Update is not expected to be significant for public companies, the Board concluded that the amendments better reflect the economics of leasehold improvements associated with common control leases and will reduce diversity in practice; therefore, the amendments are applicable for all entities (that is, including public business entities).

BC30. In the proposed Update, the Board decided that leasehold improvements associated with common control leases should be amortized over the economic life of those improvements. The Board observed that using economic life as opposed to useful life would be appropriate for leasehold improvements associated with common control leases because economic life is not limited to entity-specific (that is, lessee-specific) assumptions about how an entity intends to use an asset.

BC31. Many comment letter respondents recommended that the Board replace amortizing leasehold improvements over their *economic life* with amortizing those improvements over the *useful life to the common control group*. Those respondents noted that using *economic life* could be challenging because impairment guidance in Topic 360, Property, Plant, and Equipment, specifically requires that an entity consider the useful life. Additionally, amortizing leasehold improvements over the economic life would have required commonly controlled lessees to consider factors that are outside the control of the common control group. The Board agreed with those respondents and concluded that leasehold improvements associated with common control leases should be amortized by the lessee over the useful life of those improvements to the common control group (regardless of lease term) as long as the lessee controls the right to use the underlying asset through a lease.

BC32. The Board also concluded that the amortization period for leasehold improvements associated with common control leases is limited to the period in which the common control group can direct the use of the underlying asset. Therefore, if the lessor under common control obtains the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period is limited to the lease term associated with that other lease, unless that other lease transfers ownership of the underlying asset to the lessor or the lessor is reasonably certain to exercise an option to purchase the underlying asset, in which case the lessee should amortize the leasehold improvements over the useful life to the common control group.

BC33. The Board observed that entities may need to obtain information from the lessor or common owner or owners to determine the useful life of leasehold improvements to the common control group. The Board observed that commonly controlled lessees will be able to readily obtain the necessary information from the commonly controlled lessor and the common owner or owners to comply with the requirements.

BC34. The Board expects that leasehold improvements associated with common control leases often may benefit another party within the common control group if, and when, the lessee no longer controls the use of the underlying asset. Therefore, the Board decided that the unamortized cost of the leasehold improvements on that date should be accounted for as a transfer between entities under common control through equity (net assets for a not-for-profit entity). The Board concluded that this accounting faithfully represents the economics of leasehold improvements associated with common control leases and is consistent with how entities

currently account for transfers of other similar assets to entities within the same common control group. The Board also concluded that this accounting appropriately reflects the derecognition of those improvements at the date of transfer.

BC35. The Board decided against providing specific requirements for situations in which a lessee does not expect to transfer leasehold improvements associated with a common control lease to another entity within the common control group if, and when, the lessee no longer controls the use of the underlying asset. The Board noted that the useful life of leasehold improvements to the common control group would include that expectation.

BC36. The Board concluded that an entity with leasehold improvements associated with common control leases is required to apply the impairment requirements in Topic 360, particularly paragraph 360-10-40-4. That paragraph requires that a long-lived asset (asset group) be tested for recoverability while the asset is held and used and an entity should consider estimates of future undiscounted cash flows based on the asset's remaining useful life, assuming that a transfer will not occur. Paragraph 360-10-40-4 also requires that an entity recognize an impairment when the asset is transferred if the carrying amount of the asset exceeds its fair value at the transfer date. The Board concluded that this impairment guidance is appropriate for leasehold improvements associated with leases between entities under common control that may be transferred to another party within the common control group. Moreover, the Board observed that applying this impairment guidance effectively prohibits a lessee under common control from transferring leasehold improvements at an amount that would be immediately impaired by the receiving entity.

BC37. The Board decided that lessees that have leasehold improvements associated with common control leases in situations in which the useful life to the common control group is longer than the lease term must make specific disclosures to enhance the transparency of those arrangements. The purpose of those required disclosures is to assist users of financial statements in analyzing those circumstances. Most comment letter respondents stated that the additional disclosures should provide investors and other allocators of capital with decision-useful information.

BC38. Most respondents who did not support the proposed amendments expressed a concern that commonly controlled lessees could establish leases with short lease terms and avoid recognizing a lease liability while benefiting from recognizing leasehold improvements on the balance sheet and amortizing those improvements over a longer period. Some respondents suggested that the Board require that commonly controlled lessees impute a lease for a period equal to the useful life of the leasehold improvements and recognize a corresponding lease liability and right-of-use asset. Other respondents suggested that the Board require that commonly controlled lessees fully amortize leasehold improvements over the shorter of the lease term and the useful life of those improvements to incentivize

the common control parties to document a longer lease term. Many of those respondents questioned whether an inconsistency between the amortization period and the lease term used for recognizing lease liabilities would result in information that is decision useful.

BC39. The Board agreed that situations may exist for which the amortization period for leasehold improvements associated with common control leases is longer than the lease term. The Board concluded that the amendments in this Update (including the disclosure requirements) better reflect the economics of leasehold improvements associated with common control leases and clarify the accounting for those improvements. Furthermore, the Board rejected requiring that commonly controlled lessees impute a lease liability in situations in which no lease and corresponding obligation exist. The Board noted that the recognition of an imputed lease liability would similarly require that an entity recognize a right-of-use asset that also does not exist. The Board further noted that requiring accounting that fails to reflect the economics of transfers of value between entities under common control to incentivize those entities to alter business arrangements is inconsistent with the objective of general purpose financial reporting.

BC40. The Board acknowledged that for improvements made by a lessee to an underlying asset to be recognized as leasehold improvements, the lessee must be determined to be the accounting owner of the improvements. The Board further acknowledged that no separate GAAP exists for making that determination. The Board observed that practice has developed various approaches for determining the accounting owner of improvements made to an underlying asset. The Board decided not to develop requirements for determining the owner of improvements made to an underlying asset as part of the amendments in this Update and noted that this determination is not unique to the application of Topic 842 or to common control leases.

Effective Date

BC41. The amendments in this Update for both Issue 1 and Issue 2 are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been made available for issuance. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

BC42. For Issue 1, the Board noted that many entities within the scope of the practical expedient will be adopting the expedient concurrently with the adoption of Topic 842. For entities that have adopted Topic 842, the Board observed that those entities are already applying Topic 842 on the basis of enforceable terms and conditions, which can be readily documented in writing. Therefore, the Board concluded that a delayed effective date and staggered interim reporting requirements for private entities were unnecessary.

BC43. For Issue 2, the Board concluded that additional time or staggered effective dates for annual and interim reporting periods were not warranted for any entities. Although some comment letter respondents suggested delayed effective dates for entities within the scope of Issue 1, the Board expects that those entities will adopt the amendments for Issue 2 concurrently with adopting Topic 842 to avoid applying the requirements in a future reporting period. For entities that have adopted Topic 842, the Board concluded that requiring all calendar-year-end entities to apply the amendments for Issue 2 on January 1, 2024 (at the earliest) provides sufficient time to understand and obtain the information necessary to apply the amendments.

Transition

Issue 1: Terms and Conditions to Be Considered

BC44. The Board decided that entities adopting the practical expedient in this Update concurrently with the adoption of Topic 842 are required to follow the same transition requirements used to apply Topic 842.

BC45. The Board decided that all other entities are required to apply the practical expedient in this Update either:

- a. Prospectively to arrangements that commence or are modified on or after the date that the entity first applies the practical expedient
- b. Retrospectively to the beginning of the period in which the entity first applied Topic 842 for arrangements that exist at the date of adoption of the practical expedient. The practical expedient does not apply to common control arrangements no longer in place at the date of adoption of this Update.

BC46. The Board also decided to provide specific transition guidance for:

- a. Changes in terms and conditions resulting from applying the amendments in this Update for arrangements that continue to be a lease
- b. Situations in which an arrangement previously not considered a lease becomes a lease as a result of applying the amendments in this Update.

BC47. Regardless of an entity's transition approach, the Board also concluded that an entity is permitted to document any existing unwritten terms and conditions of an arrangement between entities under common control before the date on which the entity's first interim (if applicable) or annual financial statements are available to be issued in accordance with the amendments in this Update.

BC48. Some comment letter respondents questioned whether the entity-wide election of the Topic 842 transition practical expedients in paragraph 842-10-65-1(f) or (g) would limit an entity's ability to utilize the practical expedient in this Update. Therefore, the Board clarified that an entity is not required to apply those

Topic 842 transition practical expedients to common control arrangements for which the practical expedient is being applied.

Issue 2: Accounting for Leasehold Improvements

BC49. The Board decided that entities adopting the amendments in this Update concurrently with the adoption of Topic 842 may follow the same transition requirements used to apply Topic 842 or may use either of the prospective approaches described below to avoid retrospectively accounting for leasehold improvements.

BC50. The Board decided that all other entities are required to apply the amendments in this Update using one of the following methods:

- a. Prospectively to all new leasehold improvements recognized on or after the date that an entity first applies the amendments in this Update
- b. Prospectively to all new and existing leasehold improvements recognized on or after the date that the entity first applies the amendments in this Update, with any remaining unamortized balance of existing leasehold improvements amortized over their remaining useful life to the common control group determined at that date
- c. Retrospectively to the beginning of the period in which the entity applied Topic 842 for leasehold improvements that exist at the date of adoption of this Update, with any leasehold improvements that otherwise would not have been amortized or impaired recognized through a cumulative-effect adjustment to the opening balance of retained earnings (or net assets of a not-for-profit entity) at the earliest period presented in accordance with Topic 842.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the “GAAP Taxonomy”). Those improvements, which will be incorporated into the proposed 2024 GAAP Taxonomy, are available through [GAAP Taxonomy Improvements](#) provided at www.fasb.org, and finalized as part of the annual release process.