

Hot Topic: ASC 842

Effect of renewal periods on measuring lease liabilities in transition

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New lease liabilities and ROU assets recognized in transition include the fixed payments required for all periods that are part of the 'lease term', which includes reasonably assured renewal periods.¹



Key impacts

In transition to Topic 842, at the date of initial application,² a lessee recognizes lease liabilities and right-of-use (ROU) assets for existing operating leases for the first time. The lease liabilities include the remaining minimum rental payments for all periods that are part of the 'lease term'. This is regardless of which transition practical expedients the lessee elects, if any.

A lessee is *not* permitted to measure the new lease liabilities based on only the minimum rental payments due under the non-cancellable period of the lease.



Measuring lease liabilities and ROU assets for existing leases in transition

Regardless of whether a lessee elects the 'package of practical expedients' or the use-of-hindsight practical expedient,³ lease liabilities for existing leases – i.e. leases that commenced before the lessee's date of adoption – are measured at the present value of the sum of: [842-10-65-1(l)]

- the remaining minimum rental payments (as defined under Topic 840); and
- any amounts probable of being owed by the lessee under a residual value guarantee.

1. 'Reasonably assured' and 'reasonably certain' are synonyms (see paragraphs 5.2.40 – 5.2.41 in KPMG's Handbook, [Leases](#)) [ASU 2016-02.BC195]
2. The lessee's date of adoption (if using the effective date transition method) or beginning of the earliest comparative period presented (if using the comparative transition method)
3. See section 13A.2 (if using the effective date transition method) or section 13B.2 (if using the comparative transition method) of KPMG's Handbook, [Leases](#) for detail on the transition practical expedients available under Topic 842

The 'minimum rental payments' for a lease under Topic 840 include those for all periods that are part of the accounting 'lease term', which is not limited to the non-cancellable period of the lease. [840-10-25-6(a)]

Therefore, it would be inappropriate to measure the new lease liabilities recognized in transition to Topic 842 based on minimum rental payments that do not include those not yet paid for periods that should be included in the lease term under Topic 840 (or Topic 842, if electing the use-of-hindsight practical expedient) – see 'Lease term considerations in transition'.



Lease term considerations in transition

A lessee that does not elect the use-of-hindsight practical expedient in transition continues to use the lease term it determined in accordance with Topic 840 when measuring the remaining minimum rental payments (assuming that lease term was appropriately determined) for purposes of transitioning to Topic 842 – i.e. the lessee does not reassess the lease term as part of its transition to Topic 842.⁴ The lease term under Topic 840 included the non-cancellable period of the lease *plus all of the following*.⁵ [840 Glossary]

- a. All periods, if any, covered by bargain renewal options;
- b. All periods, if any, for which failure to renew the lease imposes a penalty on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured;
- c. All periods, if any, covered by ordinary renewal options during which any of the following conditions exist:
 1. A guarantee by the lessee of the lessor's debt directly or indirectly related to the leased property is expected to be in effect.
 2. A loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding.
- d. All periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable; and
- e. All periods, if any, representing renewals or extensions of the lease at the lessor's option.

A lessee that elects the use-of-hindsight practical expedient reassesses the lease term as of its date of initial application (see footnote 2) in accordance with the lease term guidance in Topic 842.⁶ In doing so, the lessee takes into account all economic factors relevant to that assessment as of the adoption date: contract-based, asset-based, market-based and entity-based factors.⁷

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4. The Topic 842 transition guidance does not grandfather incorrect conclusions reached under Topic 840, including with respect to lease term (see Questions 13A.2.100 and 13B.2.100 in KPMG's Handbook, [Leases](#))
 5. Topic 840 also states that 'the lease term shall not be assumed to extend beyond the date a bargain purchase option becomes exercisable.'
 6. See section 5.3 of KPMG's Handbook, [Leases](#)
 7. See Question 13A.2.40 (effective date transition method) and Question 13B.2.40 (comparative transition method) in KPMG's Handbook, [Leases](#)

For further information

For more information about the transition requirements in Topic 842, see Chapter 13A (effective date transition method) and Chapter 13B (comparative transition method) of KPMG’s Handbook, [Leases](#).

This document is part of a series to highlight implementation issues that are discussed in KPMG’s Handbook, [Leases](#).

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