

FASB final ASU

Leases: Common control arrangements

March 27, 2023



ASU 2023-01 amends Topic 842 for common control lease arrangements and related leasehold improvements.

Source and applicability

- ASU 2023-01, [Leases \(Topic 842\), Common Control Arrangements](#)
- Private entities (i.e. private companies, not-for-profit entities that are not conduit bond obligors and employee benefit plans that do not file or furnish financial statements with or to the SEC) – lessees and lessors – with common control arrangements that may contain or be leases
- All lessees (public or private) with leasehold improvements arising from common control leases

Fast facts, impacts, actions

ASU 2023-01 amends US GAAP for two issues that apply to arrangements between entities under common control (common control arrangements).

Issue 1: Identifying terms and conditions (applies to private entities only)

- A private entity may elect a practical expedient to use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, the classification of and accounting for that lease.
- If there are no written terms and conditions, a private entity cannot use the practical expedient; instead, it identifies the agreement's legally enforceable terms and conditions in applying Topic 842.

Issue 2: Amortizing leasehold improvements (applies to all entities)

- If the lessee in a common control lease is the accounting owner of related leasehold improvements, it amortizes the improvements over their estimated useful life to the common control group, regardless of the Topic 842 lease term, as long as it continues to control the use of the underlying leased asset. (See [New amortization period](#) for an exception.)
- If, before the end of the improvements' useful life to the common control group, the lessee relinquishes control over the use of the underlying leased asset, the improvements are deemed to be transferred to the lessor and an adjustment is made to equity (or net assets for not-for-profit entities).

All amendments in ASU 2023-01 are effective for fiscal years beginning after December 15, 2023. However, entities are permitted, and may wish, to adopt them early.

Issue 1: Identifying terms and conditions

Background

Pre-ASU 2023-01, entities use the legally enforceable terms and conditions in a related party arrangement to determine whether the arrangement is or contains a lease, and if so, the classification of and accounting for that lease. This requirement applies to all related party arrangements, including common control arrangements.

However, the FASB was informed that identifying the enforceable terms and conditions in a common control arrangement may be difficult because of its common control nature. For example, the terms and conditions may not be negotiated at arm's length and the common control parties can often choose not to enforce them. Because of this, in some cases, identifying the enforceable terms and conditions could necessitate a formal legal opinion.

New practical expedient

ASU 2023-01 creates a practical expedient under which the written terms and conditions of the arrangement (without regard to enforceability) can be used to determine whether a lease exists and, if so, determine the classification of and accounting for that lease. Only private entities (see [Source and applicability](#)) may elect the practical expedient.

Question	Answer
Can the practical expedient be elected for an arrangement that does not have written terms and conditions?	No. The practical expedient can be elected only for an arrangement that has written terms and conditions. However, a private entity is permitted to document the existing unwritten terms and conditions of an arrangement before the date on which its first interim (if applicable) or annual financial statements are available to be issued using the practical expedient (see Effective dates and transition).
When are terms and conditions considered to be written?	ASU 2023-01 does not prescribe a specific form or approach for documenting the terms and conditions of an arrangement. Instead, determining whether written terms and conditions exist is left to reasonable judgment.
Can the practical expedient be elected on an arrangement-by-arrangement basis?	Yes. The practical expedient can be elected on an arrangement-by-arrangement basis. Therefore, it may be elected for some common control arrangements with written terms and conditions and not for others.
How is a common control arrangement evaluated if the practical expedient is not elected?	If an arrangement does not qualify for the practical expedient or the expedient is not elected, the lessee must identify the arrangement's legally enforceable terms and conditions and use those to apply Topic 842.

Common control relationship ceases to exist after practical expedient elected

If the parties' common control relationship ceases to exist during the term of an arrangement, the practical expedient no longer applies. Consequently, the lessee adjusts its accounting as follows.

Nature of arrangement during and post-common control	Accounting for arrangement post-common control
Lease both during and post-common control	<ul style="list-style-type: none"> • Use the enforceable terms and conditions. • If the enforceable terms and conditions differ from the written terms and conditions, apply the lease modifications guidance in Section 842-10-25 – see sections 6.7 (lessees) and 7.6 (lessors) in KPMG Handbook, Leases.
Lease during common control; not a lease post-common control	<ul style="list-style-type: none"> • Lessee: apply the modification requirements for fully terminated leases in paragraph 842-20-40-1 (see section 6.8 in KPMG Handbook, Leases). • Lessor: <ul style="list-style-type: none"> – If the lease was classified as a sales-type or direct financing lease, apply the derecognition requirements for terminated leases in paragraph 842-30-40-2 (see paragraph 7.3.440 in KPMG Handbook, Leases); – If the lease was classified as an operating lease, derecognize any amounts that would not have existed if the arrangement had not been accounted for as a lease and account for those amounts under other US GAAP.
Not a lease during common control; a lease post-common control	Account for as a new lease.

Issue 2: Common control leasehold improvements

Background

A lessee recognizes a leasehold improvement when it controls that improvement – i.e. when it is the accounting owner of the improvement (see Questions 5.4.80 and 5.4.81 in in KPMG Handbook, [Leases](#)). Generally, under Topic 842 the lessee amortizes a leasehold improvement over the shorter of the remaining lease term and the useful life of the improvement.

Some stakeholders commented that leasehold improvements in a common control lease arrangement can benefit the common control group not only through the lessee's use of the improvements during the lease term but also from their use by other parties in the common control group (e.g. the common control lessor or the parent entity). Those stakeholders asserted that limiting the amortization period of those leasehold improvements to the lease term can yield results that do not faithfully represent the economics underlying their construction or installation.

New amortization period

ASU 2023-01 changes the amortization period of leasehold improvements in common control lease arrangements for all lessees (public, private and not-for-profit entities). It requires a lessee to amortize

leasehold improvements over their useful life *to the common control group*, as long as the lessee continues to control the use of the underlying asset through a lease.

Question	Answer
<p>Are there exceptions to this new amortization period?</p>	<p>Yes. If the lessor obtained control over the use of the underlying asset through a lease with an unrelated party, then the lessee’s amortization period cannot exceed the lease term of the lease between the lessor and the unrelated party.¹</p> <p>Note 1: If the lease between the lessor and unrelated third party transfers ownership of the underlying asset to the lessor or the lessor is reasonably certain to exercise an option to purchase the underlying asset, the lessee amortizes the leasehold improvements to the end of their useful life to the common control group.</p>
<p>Are common control leasehold improvements subject to impairment?</p>	<p>Yes. Common control leasehold improvements are subject to the long-lived asset impairment model in Topic 360, with specific reference in the amendments to paragraph 360-10-40-4.</p>
<p>What happens if the lessee no longer controls the use of the underlying asset (e.g. the lessee vacates the leased building and returns control over its use to the lessor)?</p>	<p>The improvements are deemed to be transferred to the lessor. The lessee derecognizes the remaining carrying amount of the improvements and makes a corresponding adjustment to equity (or net assets for not-for-profit entities).</p>
<p>What happens if after lease commencement the lease either becomes or ceases to be between parties under common control?</p>	<p>In these instances, any change in the amortization period for leasehold improvements is accounted for prospectively as a change in accounting estimate.</p>
<p>What disclosures are required?</p>	<p>When the useful life of leasehold improvements to the common control group exceeds the related lease term, the lessee discloses:</p> <ul style="list-style-type: none"> • the unamortized balance of those leasehold improvements; • the remaining useful life of the improvement to the common control group; and • the remaining lease term.

Effective dates and transition

The following effective dates apply to Issue 1 and Issue 2. An entity can select different adoption dates and transition methods for Issue 1 and Issue 2. For example, an entity can (1) early adopt only Issue 1 or Issue 2 and (2) elect a prospective transition method for one issue and a retrospective transition method for the other.

	Issue 1 (private entities only)	Issue 2 (all entities)
Annual periods – Fiscal years beginning after	Dec 15, 2023	Dec 15, 2023
Interim periods – In year of adoption	Dec 15, 2023	Dec 15, 2023
Early adoption permitted?	Yes, in any annual or interim period as of the beginning of the related fiscal year	

Issue 1 transition

The following transition provisions apply to the Issue 1 amendments.

- **Entity is adopting these amendments concurrently with Topic 842** (e.g. adopting Topic 842 and these amendments as of January 1, 2022) – follow the transition provisions for adopting Topic 842 – see chapter 13A (effective date transition method) or chapter 13B (comparative transition method) in KPMG Handbook, [Leases](#).
- **Entity has already adopted Topic 842** (e.g. adopted Topic 842 on January 1, 2022 and is adopting these amendments on January 1, 2024) – elect to apply the practical expedient either:
 - prospectively to arrangements that commence or are modified on or after the date the Issue 1 amendments are adopted; or
 - retrospectively (i.e. to the beginning of the period in which Topic 842 is first applied) to arrangements that still exist at the adoption date of the Issue 1 amendments.
- An entity is permitted to document any previously unwritten terms and conditions of an existing arrangement between it and the other party under common control, and therefore use the Issue 1 practical expedient, any time before the first interim or annual financial statements applying the amendments are available to be issued.
- An entity is not required to apply the ‘package’ of transition practical expedients (see sections 13A.2.3 and 13B.2.3 in KPMG Handbook, [Leases](#)) to common control arrangements for which it elects the Issue 1 practical expedient.

Issue 2 transition

The following transition provisions apply to the Issue 2 amendments.

- **Entity is adopting these amendments concurrently with Topic 842** – elect to either:
 - follow the transition provisions for adopting Topic 842; or
 - use either of the prospective approaches described below.
- **Entity has already adopted Topic 842** – elect to:
 - prospectively apply the amendments to all new leasehold improvements recognized on or after the Issue 2 adoption date;

- prospectively apply the amendments to all new *and existing* leasehold improvements recognized on or after the Issue 2 adoption date, with any remaining unamortized balance of existing leasehold improvements amortized over their remaining useful life to the common control group (as determined at that date); or
- retrospectively (i.e. to the beginning of the period in which Topic 842 is first applied – e.g. *January 1, 2022 for a private calendar year entity that did not early adopt Topic 842*) apply the amendments to existing leasehold improvements at the Issue 2 adoption date (e.g. *January 1, 2024 for a calendar year entity that does not early adopt those amendments*), with a cumulative-effect adjustment to the opening balance of retained earnings at the beginning of the earliest period presented (e.g. *January 1, 2023 if the entity is presenting 2023 and 2024 in its financial statements*) for any leasehold improvements recognized as a result of adopting the ASU.

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