

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2017-13
September 2017

Revenue Recognition (Topic 605), Revenue from
Contracts with Customers (Topic 606), Leases
(Topic 840), and Leases (Topic 842)

Amendments to SEC Paragraphs Pursuant to
the Staff Announcement at the July 20, 2017
EITF Meeting and Rescission of Prior SEC Staff
Announcements and Observer Comments

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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September 2017

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

Securities and Exchange Commission (SEC) Content

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–20. 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~~.

Amendments Pursuant to the July 20, 2017 SEC Staff Announcement

This Accounting Standards Update adds SEC paragraphs pursuant to an SEC Staff Announcement made at the July 20, 2017 Emerging Issues Task Force (EITF) meeting.

2. The SEC Observer made the following SEC Staff Announcement, “Transition Related to Accounting Standards Updates No. 2014-09 and 2016-02,” at the July 20, 2017 EITF meeting.

Amendments to Topic 606

3. Amend paragraph 606-10-65-1, with no link to a transition paragraph, as follows:

Revenue from Contracts with Customers—Overall

Transition and Open Effective Date Information

> **Transition Related to Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, and**

No. 2017-05, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets

606-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, and No. 2017-05, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*: **[Note:** See paragraph 606-10-S65-1 for an SEC Staff Announcement on transition related to Update 2014-09.]

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

4. Add paragraph 606-10-S65-1 and its related headings, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > SEC Staff Announcement: Transition Related to Accounting Standards Updates No. 2014-09 and 2016-02

606-10-S65-1 The following is the text of SEC Staff Announcement: Transition Related to Accounting Standards Updates No. 2014-09 and 2016-02.

FASB Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, issued in May 2014 and codified in ASC Topic 606, *Revenue from Contracts with Customers*, and No. 2016-02, *Leases (Topic 842)*, issued in February 2016 and codified in ASC Topic 842, *Leases*, provide effective dates that differ for (1) **public business entities** and certain other specified entities and (2) all other entities. The SEC staff has received inquiries from stakeholders regarding the application of the effective dates of ASC Topic 606 and ASC Topic 842 for a public business entity^{FN1} that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC.

The transition provisions in ASC Topic 606 require that a public business entity and certain other specified entities adopt ASC Topic 606 for annual reporting

periods beginning after December 15, 2017, including interim reporting periods within that reporting period.^{FN2} All other entities are required to adopt ASC Topic 606 for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.

The transition provisions in ASC Topic 842 require that a public business entity and certain other specified entities adopt ASC Topic 842 for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.^{FN3} All other entities are required to adopt ASC Topic 842 for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

In response to the stakeholder inquiries outlined above, the SEC staff would not object to a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC adopting (1) ASC Topic 606 for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019, and (2) ASC Topic 842 for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

A public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC may still elect to adopt ASC Topic 606 and ASC Topic 842 according to the public business entity effective dates outlined above.

This announcement is applicable only to public business entities that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC. This announcement is not applicable to other public business entities.

FN 1 The definition of *Public Business Entity* in the FASB's ASC Master Glossary states, in part, the following:

A public business entity is a business entity meeting any one of the criteria below. . . .

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or

financial information are required to be or are included in a filing) . . .

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

FN 2 Early adoption of ASC Topic 606 is permitted for public business entities and certain other specified entities only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

FN 3 Early adoption of ASC Topic 842 is permitted for public business entities and certain other specified entities, as well as for all other entities.

Amendments to Topic 842

5. Amend paragraph 842-10-65-1, with no link to a transition paragraph, as follows:

Leases—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2016-02, *Leases (Topic 842)*

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-02, *Leases (Topic 842)*: **[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 because it is unchanged.]

6. Add paragraph 842-10-S65-1 and its related headings, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > SEC Staff Announcement: Transition Related to Accounting Standards Updates No. 2014-09 and 2016-02

842-10-S65-1 The following is the text of SEC Staff Announcement: Transition Related to Accounting Standards Updates No. 2014-09 and 2016-02.

FASB Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), issued in May 2014 and codified in ASC Topic 606, Revenue from Contracts with Customers, and No. 2016-02, *Leases* (Topic 842), issued in February 2016 and codified in ASC Topic 842, Leases, provide effective dates that differ for (1) **public business entities** and certain other specified entities and (2) all other entities. The SEC staff has received inquiries from stakeholders regarding the application of the effective dates of ASC Topic 606 and ASC Topic 842 for a public business entity^{FN1} that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC.

The transition provisions in ASC Topic 606 require that a public business entity and certain other specified entities adopt ASC Topic 606 for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period.^{FN2} All other entities are required to adopt ASC Topic 606 for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.

The transition provisions in ASC Topic 842 require that a public business entity and certain other specified entities adopt ASC Topic 842 for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.^{FN3} All other entities are required to adopt ASC Topic 842 for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

In response to the stakeholder inquiries outlined above, the SEC staff would not object to a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC adopting (1) ASC Topic 606 for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019, and (2) ASC Topic 842 for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

A public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC may still elect to adopt ASC Topic 606 and ASC Topic 842 according to the public business entity effective dates outlined above.

This announcement is applicable only to public business entities that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC. This announcement is not applicable to other public business entities.

FN 1 The definition of *Public Business Entity* in the FASB's ASC Master Glossary states, in part, the following:

A public business entity is a business entity meeting any one of the criteria below. . . .

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing). . . .

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

FN 2 Early adoption of ASC Topic 606 is permitted for public business entities and certain other specified entities only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

FN 3 Early adoption of ASC Topic 842 is permitted for public business entities and certain other specified entities, as well as for all other entities.

Amendments Pursuant to the Rescission of Prior SEC Staff Announcement upon Adoption of Topic 606

This Accounting Standards Update supersedes SEC paragraphs pursuant to the initial adoption of Topic 606, Revenue from Contracts with Customers.

7. In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The SEC staff is rescinding one SEC Staff Announcement that is codified in Topic 605, Revenue Recognition, effective upon the initial adoption of Topic 606. Specifically, registrants should not rely on the following SEC Staff Announcement upon the initial adoption of Topic 606:

- a. Accounting for Management Fees Based on a Formula, which is codified in paragraph 605-20-S99-1.

Amendments to Topic 605

8. Supersede paragraphs 605-20-S25-2, 605-20-S50-1, and 605-20-S99-1 and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

Revenue Recognition—Services

Recognition

~~> Accounting for Management Fees Based on a Formula~~

~~605-20-S25-2 Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 605-20-S99-1, SEC Staff Announcement: Accounting for Management Fees Based on a Formula, for SEC Staff views on revenue recognition under arrangements that contain a performance-based incentive fee.~~

Disclosure

~~> Accounting for Management Fees Based on a Formula~~

~~605-20-S50-1 Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 605-20-S99-1, SEC Staff Announcement: Accounting for Management Fees Based on a Formula, for SEC Staff views on disclosures pertaining to arrangements that contain a performance-based incentive fee.~~

SEC Materials

~~> SEC Staff Guidance~~

~~>> Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings~~

~~>>> SEC Staff Announcement: Accounting for Management Fees Based on a Formula~~

~~605-20-S99-1 Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Staff Announcement: Accounting for Management Fees Based on a Formula.~~

~~The SEC staff has been asked to provide its views on revenue recognition under arrangements (other than those covered by Subtopic 605-35) that contain a performance-based incentive fee that is not finalized until the end of a period of time specified in the contract. These arrangements are common in the investment advisory and real estate management businesses. For~~

example, an investment advisor may receive a base fee for managing a fund plus a variable incentive fee based on the extent by which the fund's investment performance exceeds a benchmark index, such as the return on the S&P 500. Similarly, a hotel management company may receive a bonus of a portion of any operating income generated above a specified level.

The SEC staff has been asked to consider the accounting for the incentive fee at interim dates before the end of the measurement period specified in the arrangement. The issue arises because of the possibility that fees earned by exceeding performance targets early in the measurement period may be reversed due to missing performance targets later in the measurement period. Consequently, if, for example, a property manager performing services under an arrangement with a one-year measurement period records revenue in the first three quarters of the year based on the property exceeding a level of operating profit, it may have to reverse all or a portion of that revenue before year-end if there is an operating loss.

To illustrate, assume the following example:

Investment Advisor A manages Fund B and is paid a flat fee per month ("base fee"). In addition, Advisor A also will receive 20 percent of Fund B's returns in excess of the return on the S&P 500 for the year. The contract is terminable by either party with reasonable notice at the end of each quarter. In the event of a termination, the amount due for the incentive fee will be calculated at the termination date based on the fund and S&P 500 returns to date. Assume that Fund B's returns exceed the returns of the S&P 500 by \$200,000 in the first quarter, \$100,000 in the second quarter, and \$50,000 in the fourth quarter, and that the return on the fund is \$75,000 less than the S&P 500 return in the third quarter. Thus, the total return of Fund B for the year exceeds the comparable S&P 500 return by \$275,000. Advisor A's share of the \$275,000 is \$55,000.

Based on informal surveys received, the SEC staff understands that a majority of property managers and investment advisors apply an accounting policy in which the manager does not record any incentive fee income until the end of the contract year (Method 1). The result of that method in the example is that Advisor A would record \$55,000 in incentive fee revenue in the fourth quarter. Other companies record as revenue the amount that would be due under the formula at any point in time as if the contract was terminated at that date (Method 2). Accordingly, Advisor A would record \$40,000 of incentive fee revenue in the first quarter and \$20,000 in the second quarter. In the third quarter, however, \$15,000 of the previously recognized revenue would be reversed in revenue. Finally, \$10,000 of incentive fee revenue would be recognized in the fourth quarter.

The SEC staff would not object to either Method 1 or Method 2 as described above; however, the SEC staff considers Method 1 to be the preferable

accounting policy. The SEC staff believes that Method 1 is more consistent with the analysis presented in Staff Accounting Bulletin Topic 13.A, which states that “the staff does not believe that it is appropriate to recognize revenue based upon the probability of a factor being achieved.” Furthermore, Method 1 eliminates the potential that revenue will be recognized in one quarter and reversed in a future quarter.

The SEC staff also would not object to Method 2. The calculated revenue may be viewed as realizable at an interim date due to the termination provisions in the arrangement. Furthermore, this approach results in revenue recognition that reflects the performance of the manager revenue is higher in periods in which the manager’s performance has exceeded the specified performance target(s), while revenue is lower in periods in which the manager’s performance has not exceeded the specified performance target(s). This method also does not involve a consideration of future performance, as it relies only on the calculated fee at the interim measurement date.

However, some companies apply a variation on Method 2 that the SEC staff would object to. This variation reduces the amount of revenue that would be recognized under Method 2 to the extent management believes it is likely that a portion of the calculated amount will be lost due to future performance. The SEC staff would object to this method because it explicitly considers future performance in determining how much revenue to recognize, which is inconsistent with both the requirement that the fee must be fixed or determinable before revenue is recognized and SAB Topic 13.A.

Disclosure

Disclosure of the accounting policy used with regard to these arrangements should be made in accordance with Section 235.10-50 and SAB Topic 13. Registrants should disclose whether the company has recorded any revenue that is at risk due to future performance contingencies, the nature of the contracts giving rise to the contingencies, and, if material, the amount of any such revenue recorded.

Variations

The SEC staff has been asked about its views on several variations to the basic fact pattern described in the above example. Although it is not possible to address every situation, the SEC staff is providing the following additional guidance:

Amounts that would be receivable upon termination pursuant to penalty or liquidated damage provisions (that is, amounts in addition to the amount that would be payable under the specified measurement formula) are not an appropriate basis on which to recognize revenue, unless a termination has occurred.

~~If the customer could avoid all or part of a payment by terminating the contract at will, revenue may only be recorded at an interim date up to the amount that the customer would be required to pay in the event of termination.~~

~~If the incentive fee is a fixed amount, rather than a variable amount (for example, a flat fee for exceeding the S&P 500), those applying Method 2 should only recognize revenue in an interim period when the target has been exceeded and should limit the amount of revenue to be recognized to a ratable portion of the fixed incentive payment.~~

~~The SEC staff's views would not change if the manager or advisor did not have termination rights during the term of the contract.~~

~~The SEC staff would encourage registrants with questions about contracts that are similar to, but vary from, the above example to submit those questions to the SEC staff for pre clearance.~~

Amendments Pursuant to the Rescission of Prior SEC Staff Announcement and SEC Staff Observer Comments upon Adoption of Topic 842

This Accounting Standards Update supersedes SEC paragraphs and moves certain SEC paragraphs pursuant to the initial adoption of Topic 842, Leases.

9. In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)*. The SEC staff is rescinding one SEC Staff Announcement and three SEC Staff Observer comments that are codified in Topic 840, *Leases*, effective upon the initial adoption of Topic 842. One SEC Staff Observer comment is being moved to Topic 842. Specifically, registrants should not rely on the following SEC Staff Announcement and three SEC Staff Observer comments upon the initial adoption of Topic 842:

- a. Lessor Consideration of Third-Party Value Guarantees, which is codified in paragraph 840-30-S99-1
- b. Sale Treatment in Sale-Leaseback Transactions with a Repurchase Option, which is codified in paragraph 840-40-S99-1
- c. The Effect of Lessee Involvement in Asset Construction, which is codified in paragraph 840-40-S99-2
- d. Application of Sales-Leaseback Guidance to Certain Sales-Leaseback Transactions, which is codified in paragraph 840-40-S99-3.

Amendments to Topic 840

10. Supersede paragraphs 840-30-S35-1, 840-30-S55-1, and 840-30-S99-1 through S99-2 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Capital Leases

Subsequent Measurement

> ~~Effect of a Change in Tax Law or Rates on Leveraged Leases~~

840-30-S35-1 ~~Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 840-30-S99-2, SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leverage Leases, for SEC Staff views on the effect of a change in tax law or rate on leveraged leases. [Content amended and moved to paragraph 842-50-S35-1]~~

Implementation Guidance and Illustrations

> ~~Lessor Consideration of Third-Party Residual Value Guarantees~~

840-30-S55-1 ~~Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 840-30-S99-1, SEC Staff Announcement: Lessor Consideration of Third-Party Residual Value Guarantees, for SEC Staff views on consideration of certain residual value guarantees when applying paragraphs 840-10-25-1 and 840-10-25-4 at lease inception.~~

SEC Materials

> ~~SEC Staff Guidance~~

>> ~~Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings~~

>>> ~~SEC Staff Announcement: Lessor Consideration of Third-Party Value Guarantees~~

840-30-S99-1 ~~Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Staff Announcement: Lessor Consideration of Third-Party Value Guarantees.~~

The SEC staff has been asked to provide its views on a lessor's application of paragraphs 840-10-25-1(d) and 840-10-25-5 for certain lease arrangements that involve a guarantee of the expected residual value of leased property by an unrelated third party. These arrangements are common in the equipment

leasing industry. For example, an automobile leasing company may obtain a guarantee for the full or partial recovery of the expected residual value of an automobile at the expiration of the lease term from an unrelated third party.

The SEC staff has been asked to consider whether a lessor, when applying paragraph 840-10-25-1(d) at lease inception, should include, in minimum lease payments, residual value guarantees for a portfolio of leased assets for which settlement is not solely based upon the residual value of the individual leased assets. In such cases, the lessor is economically assured of receiving a minimum residual value for a portfolio of assets that are subject to separate leases but not for each individual asset. Accordingly, when an asset has a residual value in excess of the "guaranteed" amount, such excess is offset against shortfalls in residual value that exist in other assets in the portfolio. The SEC staff believes that residual value guarantees of a portfolio of leased assets preclude a lessor from determining the amount of the guaranteed residual value of any individual leased asset within the portfolio at lease inception and, accordingly, no such amounts should be included in minimum lease payments.

The SEC staff also has been asked for its views on situations in which a lessor had not obtained a residual value guarantee at inception, yet had assumed such a guarantee existed when determining the minimum lease payments. The staff would view that situation as an error, which would require restatement as described in paragraphs 250-10-45-23 and 250-10-50-7, regardless of whether a residual value guarantee is subsequently obtained.

>> Comments Made by SEC Observer at EITF Meetings

>>> SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leveraged Leases

840-30-S99-2 Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leveraged Leases.

Section 840-30-35 requires that all components of a leveraged lease be recalculated from inception of the lease based on the revised after-tax cash flows arising from the change in the tax law, including revised tax rates. The difference between the amounts originally recorded and the recalculated amounts must be included in income of the year in which the tax law is enacted.

This accounting may have distortive effects on the ratio of earnings to fixed charges ("the ratio") as calculated. For example, a favorable after-tax effect might consist of an unfavorable adjustment to pretax income that is more than offset by a favorable adjustment to income tax expense. In those circumstances, despite the overall favorable effect, the ratio as calculated

pursuant to the applicable instructions to Item 503(d) of Regulation S-K would be affected negatively because the “earnings” component of the ratio is based on pretax income.

In filings with the Commission the SEC staff will expect the cumulative effect on pretax income and income tax expense, if material, to be reported as separate line items in the income statement. SEC staff will not object to exclusion of an unfavorable pretax adjustment from the “earnings” component of the ratio, in cases in which the after tax effect is favorable, provided that (1) such exclusion is adequately identified and explained in connection with all disclosures and discussions relating to the ratio and (2) supplemental disclosure is made of the ratio as calculated in accordance with the applicable instructions. **[Content amended and moved to paragraph 842-50-S99-1]**

11. Supersede paragraphs 840-40-S55-1 through S55-3 and 840-40-S99-1 through S99-3 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Sale-Leaseback Transactions

Implementation Guidance and Illustrations

> ~~Sale Treatment in Certain Sale-Leaseback Transactions with a Repurchase Option~~

840-40-S55-1 Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 840-40-S99-1, SEC Observer Comment: Sale Leaseback Transaction with Repurchase Option, for SEC Staff views on sale treatment in sale leaseback transaction with a repurchase option.

> ~~The Effect of Lessee Involvement in Asset Construction~~

840-40-S55-2 Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 840-40-S99-2, SEC Observer Comment: The Effect of Lessee Involvement in Asset Construction, for the SEC Staff views on whether a loan by a lessee to an owner lessor represents, in substance, an investment in real estate that would indicate that the lessee should be considered the owner of the real estate project during construction.

> ~~Application of Sales Leaseback Guidance to Certain Sales Leaseback Transactions~~

840-40-S55-3 Paragraph superseded by Accounting Standards Update No. 2017-13. See paragraph 840-40-S99-3, SEC Observer Comment: *Application of Sales-Leaseback Guidance to Certain Sales-Leaseback Transactions*, for the SEC Staff views on accounting for certain sales leaseback transactions in which the lessee bears construction risk, the lessor is lacking in substance, or the lease involves special purpose property.

SEC Materials

> ~~SEC Staff Guidance~~

>> ~~Comments Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings~~

>>> ~~SEC Observer Comment: Sale Treatment in Sale-Leaseback Transactions with a Repurchase Option~~

~~840-40-S99-1 Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Observer Comment: Sale-Leaseback Transaction with Repurchase Option.~~

~~The SEC staff will assess sale-leaseback transactions on a case-by-case basis and will challenge sales treatment if it is clear that such treatment does not reflect the substance of the transaction. The SEC staff believes important criteria to be considered—individually and in the aggregate—in making this assessment include the initial and continuing investment by the buyer, the seller's continuing involvement with the property, repurchase options at other than fair value at date of exercise, residual guarantees by the seller, and other evidence indicating that the risks and rewards of ownership may not have passed from the seller to the buyer. When determining the appropriate accounting, the SEC staff will expect registrants to consider all of the terms of the transaction. These views apply to both transactions that have a material income-statement effect and a material balance sheet effect.~~

>>> ~~SEC Observer Comment: The Effect of Lessee Involvement in Asset Construction~~

~~840-40-S99-2 Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Observer Comment: The Effect of Lessee Involvement in Asset Construction.~~

~~With respect to item (1) [paragraph 840-40-55-15(a)] above, the SEC Observer noted that the SEC staff believes that a loan by the lessee to the lessor would be considered an ADC arrangement [Acquisition, Development, and Construction Arrangements] within the scope of Practice Bulletin 1, Exhibit I, whenever the lessee is entitled to participate in the expected residual profit regardless of whether that arrangement is incorporated in the loan, lease, a remarketing arrangement, or other agreement. In addition, the staff believes that a lessee/lender would be considered entitled to participate in the expected residual profit when the lessee holds an option to purchase the leased asset at a fixed price. Paragraph 16(a) of Practice Bulletin 1, Exhibit I, [paragraph 310-10-25-27(a)]~~

specifies that if the [lender/lessee] is expected to receive over 50 percent of the expected residual profit, the [lender/lessee's] loan would, in substance, represent an investment in real estate. Paragraph 16(b) [paragraph 310-10-25-27(b)] specifies that if the [lender/lessee] is expected to receive 50 percent or less of the expected residual profit, the classification of the loan would depend on the circumstances. That paragraph notes that at least one of the characteristics identified in paragraphs 9(b) through 9(e) of Practice Bulletin 1 [paragraph 310-10-25-20(b) through (e)] or a qualifying personal guarantee should be present for the arrangement to be accounted for as a loan and not as an investment in real estate. The characteristic identified in paragraph 9(b) [paragraph 310-10-25-20(b)] is that the borrower has an equity investment, substantial to the project, not funded by the lender. The SEC Observer stated that the SEC staff will look to the guidance provided in Appendix A of Statement 66 [paragraphs 360-20-55-1 through 55-2] for determining whether the borrower has a sufficient equity investment. It was observed that leases within the scope of this Issue involving special-purpose entities as lessors generally contain a fixed-price purchase option or a remarketing agreement in which the lessee is entitled to a majority of the sales proceeds in excess of the original cost of the leased asset when it is sold. Thus, the existence of either of those provisions when the lessee has made a loan to the lessor during the construction period would cause the lessee to be considered the owner of the real estate project as specified above.

>>> SEC Observer Comment: Application of Sales-Leaseback Guidance to Certain Sales-Leaseback Transactions

840-40-S99-3 Paragraph superseded by Accounting Standards Update No. 2017-13. The following is the text of SEC Observer Comment: Application of Sales-Leaseback Guidance to Certain Sales-Leaseback Transactions

Although certain leasing transactions fall outside the scope of Subtopic 840-40, the SEC staff believes that the principles in that guidance are applicable for transactions in which the lessee bears construction risk, the lessor is lacking in substance, or the lease involves special-purpose property. Other factors also may be relevant. The SEC staff will challenge the accounting for those types of transactions when it is clear that the economic risks and rewards of ownership rest with the lessee.

Amendments to Topic 842

12. Add paragraphs 842-50-S35-1 and 842-50-S99-1 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Leveraged Lease Arrangements

Subsequent Measurement

> Effect of a Change in Tax Law or Rates on Leveraged Leases

842-50-S35-1 See ~~paragraph 840-30-S99-2~~**842-50-S99-1**, SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leverage Leases, for SEC Staff views on the effect of a change in tax law or rate on leveraged leases. **[Content amended as shown and moved from paragraph 840-30-S35-1]**

SEC Materials

> SEC Staff Guidance

> > Comments Made by SEC Observer at EITF Meetings

> > > SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leveraged Leases

842-50-S99-1 The following is the text of SEC Observer Comment: Effect of a Change in Tax Law or Rates on Leveraged Leases.

Section ~~840-30-35~~**842-50-35** requires that all components of a leveraged lease be recalculated from inception of the lease based on the revised after-tax cash flows arising from the change in the tax law, including revised tax rates. The difference between the amounts originally recorded and the recalculated amounts must be included in income of the year in which the tax law is enacted.

This accounting may have distortive effects on the ratio of earnings to fixed charges (“the ratio”) as calculated. For example, a favorable after-tax effect might consist of an unfavorable adjustment to pretax income that is more than offset by a favorable adjustment to income tax expense. In those circumstances, despite the overall favorable effect, the ratio as calculated pursuant to the applicable instructions to Item 503(d) of Regulation S-K would be affected negatively because the “earnings” component of the ratio is based on pretax income.

In filings with the Commission the SEC staff will expect the cumulative effect on pretax income and income tax expense, if material, to be reported as separate line items in the income statement. SEC staff will not object to exclusion of an unfavorable pretax adjustment from the “earnings” component of the ratio, in cases in which the after-tax effect is favorable, provided that (1) such exclusion is adequately identified and explained in connection with all disclosures and discussions relating to the ratio and (2) supplemental

disclosure is made of the ratio as calculated in accordance with the applicable instructions. **[Content amended as shown and moved from paragraph 840-30-S99-2]**

Amendments to Status Sections

13. Amend paragraph 605-20-S00-1, by adding the following items to the table, as follows:

605-20-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
605-20-S25-2	Superseded	2017-13	09/29/2017
605-20-S50-1	Superseded	2017-13	09/29/2017
605-20-S99-1	Superseded	2017-13	09/29/2017

14. Amend paragraph 606-10-00-1, by adding the following item to the table, as follows:

606-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
606-10-65-1	Amended	2017-13	09/29/2017

15. Add paragraph 606-10-S00-1 as follows:

606-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
606-10-S65-1	Added	2017-13	09/29/2017

16. Amend paragraph 840-30-S00-1, by adding the following items to the table, as follows:

840-30-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
840-30-S35-1	Superseded	2017-13	09/29/2017
840-30-S55-1	Superseded	2017-13	09/29/2017
840-30-S99-1	Superseded	2017-13	09/29/2017
840-30-S99-2	Superseded	2017-13	09/29/2017

17. Add paragraph 840-40-S00-1 as follows:

840-40-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
840-40-S55-1 through S55-3	Superseded	2017-13	09/29/2017
840-40-S99-1 through S99-3	Superseded	2017-13	09/29/2017

18. Amend paragraph 842-10-00-1, by adding the following item 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
842-10-65-1	Amended	2017-13	09/29/2017

19. Add paragraph 842-10-S00-1 as follows:

842-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-10-S65-1	Added	2017-13	09/29/2017

20. Add paragraph 842-50-S00-1 as follows:

842-50-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-50-S35-1	Added	2017-13	09/29/2017
842-50-S99-1	Added	2017-13	09/29/2017

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2018 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.