

Memorandum

To: Accounting Files

Date: [DATE]

Re: Implementation of Topic 842 - Leases

BACKGROUND

Note: This memo has been converted to US GAAP from an IFRS 16 – Leases memo. While the standards are basically converged there may be some differences.

This memo provides a summary of the implementation considerations for *Topic 842 – Leases* (“Topic 842”). Topic 842 is effective for reporting periods beginning after December 15, 2018. Earlier adoption is permitted but only if the new standard on revenue recognition (*Topic 606 – Revenue from Contracts with Customers*), which is effective for annual reporting periods beginning on December 15, 2017 for public companies or after December 15, 2018 for private companies, has also been adopted.

Topic 842 specifically excludes the following leases (Topic 842-10-15-1):

- Leases of intangible assets (*Topic 350, Intangibles – Goodwill and Other*)
- Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (*Topic 930, Extractive Activities, and 932, Extractive Activities – Oil and Gas*)
- Leases of biological assets within the scope of *Topic 905 - Agriculture*
- Leases of inventory (*Topic 330, Inventory*)
- Leases of assets under construction (*Topic 360 – Property, Plant and Equipment*)

The definition of a lease under Topic 842 is not significantly different from the previous definition of a lease. The single most significant change that will result from Topic 842 is the elimination of two categories of leases from the lessee’s perspective - operating and financing. From the lessee’s perspective Topic 842 requires capitalization of all leases. Note that lease accounting by lessors is largely unchanged and will not be addressed in this memo. Accounting for sale and lease back arrangements are also not discussed in this memo although they are subject to the requirements of Topic 842, as they are considered relatively nuanced and unusual transactions that are not often encountered in normal business operations.

This memo should be read in conjunction with Topic 842 as the standard includes definitions and additional discussion that may not be included in this memo.

Topic 842 ACCOUNTING REQUIREMENTS

Topic 842 defines a lease as a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration. Topic 842 fundamentally changes how a lease is accounted for. Specifically, Topic 842 sets out detailed criteria in determining whether an arrangement is, or contains, a lease. In addition, it provides specific guidance on accounting for variable lease payments, options periods and sale and lease-back arrangements and requires several new disclosures. However, the most significant change arising out of Topic 842 is the concept of a “right-of-use” asset and liability as it is these “right-of-use” assets and liabilities that should be reflected on the balance sheet of a lessee; not the underlying asset itself which remains an asset