FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2021-09
November 2021

Leases (Topic 842)

Discount Rate for Lessees That Are Not Public Business Entities

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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FASB

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Summary

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

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.

As part of the Board's post-implementation review of Topic 842, the Board and staff continue to assist stakeholders by responding to inquiries received and proactively seeking feedback on potential implementation issues that have arisen as public business entities began implementing Topic 842. Since the issuance of Update 2016-02, the Board has issued six Updates to assist stakeholders with implementation issues and two Updates deferring the effective date for private companies and certain not-for-profit organizations. The Board also has created a dedicated section on its website for post-implementation review. The staff continues to perform outreach with stakeholders to determine whether the standard is accomplishing its stated objective and to evaluate the implementation and continuing compliance costs and benefits related to Topic 842.

Additionally, in September 2020, the Board hosted two public roundtable sessions to solicit feedback from a cross section of stakeholder groups. During those sessions, some private company stakeholders discussed the costs and complexities of applying the standard. Those stakeholders suggested that the Board amend the practical expedient that allows the use of a risk-free discount rate as an accounting policy election (risk-free rate election) for entities that are not public business entities. The Board is issuing the amendments in this Update to provide lessees that are not public business entities with more flexibility in how they determine the discount rate for their leases and make the risk-free rate election to reduce their initial adoption and ongoing implementation costs associated with Update 2016-02.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect lessees that are not public business entities, including all not-for-profit entities (whether or not they are conduit bond obligors) and employee benefit plans (whether or not they file or furnish financial statements with or to the U.S. Securities and Exchange Commission).

What Are the Main Provisions?

Topic 842 currently provides lessees that are not public business entities with a practical expedient that allows them to elect, as an accounting policy, to use a risk-free rate as the discount rate for all leases. The amendments in this Update allow those lessees to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level. An entity that makes the risk-free rate election is required to disclose which asset classes it has elected to apply a risk-free rate. The amendments require that when the rate implicit in the lease is readily determinable for any individual lease, the lessee use that rate (rather than a risk-free rate or an incremental borrowing rate), regardless of whether it has made the risk-free rate election.

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

Under the current guidance, a lessee that is not a public business entity that makes the risk-free rate election is required to use a risk-free rate for all leases. The amendments in this Update provide more flexibility for those lessees by allowing them to make the election by class of underlying asset, rather than at the entity-wide level.

Stakeholders also noted that the interaction between the risk-free rate election and a lessee's use of the rate implicit in the lease is unclear under current GAAP. The amendments in this Update require that a lessee use the rate implicit in the lease when it is readily determinable, instead of a risk-free rate or incremental borrowing rate.

When Will the Amendments Be Effective and What Are the Transition Requirements?

The effective date for this Update is different for entities that have not yet adopted Topic 842 as of November 11, 2021, and those that have. Topic 842 becomes effective for private companies and not-for-profit organizations that are not conduit bond obligors for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Because earlier application is permitted (and Topic 842 is already effective for certain not-for-profit organizations that are conduit bond obligors), some private companies and not-for-profit organizations have already adopted Topic 842. Entities that have not yet adopted Topic 842 as of November 11, 2021, are required to adopt the amendments in this Update at the same time that they adopt Topic 842. Those entities should apply the existing transition provisions in paragraph 842-10-65-1.

Those provisions require that an entity use either of the following transition methods: (1) apply the guidance to existing leases retrospectively with the cumulative-effect adjustment from transition recognized at the beginning of the earliest period presented or (2) apply the guidance to existing leases on a modified retrospective basis with the cumulative-effect adjustment from transition recognized in the opening balance of retained earnings at the beginning of the period of adoption.

For entities that have adopted Topic 842 as of November 11, 2021, the amendments in this Update are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Earlier application is permitted. Entities are required to apply the amendments on a modified retrospective basis to leases that exist at the beginning of the fiscal year of adoption of a final Update. The adoption of the amendments should not be considered an event that would cause remeasurement and reallocation of the consideration in the contract (including lease payments) or reassessment of lease term or classification.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 842-20

2. Amend paragraph 842-20-30-3, with a link to transition paragraph 842-10-65-6, as follows:

Leases—Lessee

Initial Measurement

> Discount Rate for the Lease

842-20-30-3 A lessee should use the **rate implicit in the lease** whenever that rate is readily determinable. If the rate implicit in the lease is not readily determinable, a lessee uses its **incremental borrowing rate**. A lessee that is not a public business entity is permitted to use a risk-free discount rate for the lease <u>instead of its incremental borrowing rate</u>, determined using a period comparable with that of the **lease term**, as an accounting policy election <u>made by class of underlying asset</u> ~~for all leases~~.

3. Amend paragraph 842-20-50-1 and add paragraph 842-20-50-10, with a link to transition paragraph 842-10-65-6, as follows:

Disclosure

842-20-50-1 The objective of the disclosure requirements is to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from **leases**. To achieve that objective, a **lessee** shall disclose qualitative and quantitative information about all of the following:

a. Its leases (as described in paragraphs 842-20-50-3(a) through (b) and 842-20-50-7 through <u>50-10</u>~~50-8~~)

b. The significant judgments made in applying the requirements in this Topic to those leases (as described in paragraph 842-20-50-3(c))
c. The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-20-50-4 and 842-20-50-6).

842-20-50-10 A lessee that makes the accounting policy election in paragraph 842-20-30-3 to use a risk-free rate as the discount rate shall disclose its election and the class or classes of underlying assets to which the election has been applied.

4. Amend paragraphs 842-40-50-1 through 50-2, with a link to transition paragraph 842-10-65-6, as follows:

Leases—Sale and Leaseback Transactions

Disclosure

842-40-50-1 If a seller-lessee or a buyer-lessor enters into a sale and leaseback transaction that is accounted for in accordance with paragraphs 842-40-25-4 and 842-40-30-1 through 30-3, it shall provide the disclosures required in paragraphs 842-20-50-1 through 50-10~~50-9~~ for a seller-lessee or paragraphs 842-30-50-1 through 50-13 for a buyer-lessor.

842-40-50-2 In addition to the disclosures required by paragraphs 842-20-50-1 through 50-10~~50-9~~, a seller-lessee that enters into a sale and leaseback transaction shall disclose both of the following:

a. The main terms and conditions of that transaction
b. Any gains or losses arising from the transaction separately from gains or losses on disposal of other assets.

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

Leases—Overall

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), and Leases (Topic 842): Effective Dates*, ~~and~~ 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

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*, ~~and~~ 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*: [**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. 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*

842-10-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities:*

a. An entity that has not yet adopted the pending content that links to paragraph 842-10-65-1 as of November 11, 2021, shall apply the pending content that links to this paragraph to all new and existing leases when the entity first applies the pending content that links to paragraph 842-10-65-1. That entity shall apply the same transition method elected for the pending content that links to paragraph 842-10-65-1.
b. An entity that has adopted the pending content that links to paragraph 842-10-65-1 as of November 11, 2021, shall:
    1. Apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after

December 15, 2022. Earlier application is permitted as of the beginning of the fiscal year of adoption.

2. Apply the pending content that links to this paragraph on a modified retrospective basis to leases affected by the amendments existing as of the beginning of the fiscal year of adoption by adjusting the lease liability, which shall be calculated based on the discount rate and remaining lease term at the beginning of the fiscal year of adoption. An entity shall recognize the amount of the change in the lease liability as an adjustment to the corresponding right-of-use asset, unless:
    i. The carrying amount of the right-of-use asset is reduced to zero, in which case the entity shall recognize any remaining amount of the adjustment to opening retained earnings at the beginning of the fiscal year of adoption.
    ii. The adjustment would increase a right-of-use asset that was previously impaired, in which case the entity shall record the adjustment to opening retained earnings at the beginning of the fiscal year of adoption.

c. An entity within the scope of (b) shall not treat the adoption of the pending content that links to this paragraph as an event that would require the entity to:
    1. Remeasure and reallocate the consideration in the contract in accordance with paragraph 842-10-15-36.
    2. Reassess the lease term or a lessee option to purchase the underlying asset in accordance with paragraph 842-10-35-1.
    3. Remeasure the lease payments in accordance with paragraph 842-10-35-4.
    4. Reassess lease classification in accordance with paragraph 842-10-25-1.

d. An entity within the scope of (b) that has adopted the pending content that links to this paragraph shall disclose the following as of the beginning of the fiscal year of adoption (rather than at the beginning of the earliest period presented):
    1. The information required by paragraph 250-10-50-1(a) and (b)(3), if applicable
    2. The recognized amount of changes in lease liabilities and corresponding right-of-use assets resulting from the transition adjustment.

For an entity within the scope of (b), at the date of adoption of the pending content that links to this paragraph, the entity may choose to apply or discontinue using the risk-free rate for any class of underlying asset.

Amendments to Status Sections

6. 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
842-10-65-1	Amended	2021-09	11/11/2021
842-10-65-6	Added	2021-09	11/11/2021

7. 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
842-20-30-3	Amended	2021-09	11/11/2021
842-20-50-1	Amended	2021-09	11/11/2021
842-20-50-10	Added	2021-09	11/11/2021

8. Amend paragraph 842-40-00-1, by adding the following items to the table, as follows:

842-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
842-40-50-1	Amended	2021-09	11/11/2021
842-40-50-2	Amended	2021-09	11/11/2021

The amendments in this Update were adopted by the unanimous vote of the seven 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. Cosper
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.

BC2. On February 25, 2016, the Board 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 inquiries received and proactively seeking feedback on potential implementation issues that have arisen as public business entities began implementing Topic 842. Since the issuance of Update 2016-02, the Board has issued six Updates to assist stakeholders with implementation issues and two Updates deferring the effective date for private companies and certain not-for-profit organizations. The Board also has created a dedicated section on its website for post-implementation review. The staff continues to perform outreach with stakeholders to determine whether the standard is accomplishing its stated objective and to evaluate the implementation and continuing compliance costs and benefits related to Topic 842.

BC4. The Board and staff also continue to perform outreach with various stakeholders to learn about any additional issues that have arisen since the adoption of Topic 842 by public business entities. The amendments in this Update address some of the feedback received from stakeholders through this process. Specifically, the amendments allow entities that are not public business entities to, as an improvement to the existing practical expedient, make the risk-free discount rate accounting policy election (the risk-free rate election) by class of underlying asset, rather than at the entity-wide level.

Background Information

BC5. Topic 842 requires that a lessee discount its lease payments using the rate implicit in the lease when that rate is readily determinable. When the rate implicit in the lease is not readily determinable, a lessee is required to use its incremental borrowing rate. A lessee's discount rate directly affects lease classification and the measurement of a lessee's lease liability and corresponding right-of-use asset. In an operating lease, the discount rate does not affect the income statement because lease payments are recognized on a straight-line basis over the lease term. In a finance lease, the discount rate does not affect total cost over the lease term. However, the discount rate affects the amounts recognized as interest and amortization and the timing of that recognition, which affects the income statement. For entities transitioning to Topic 842, the discount rate is determined as of the application date of the guidance in the Topic, and afterwards it is determined at the commencement date of the lease. Entities subsequently update that rate only upon the occurrence of a lease modification not accounted for as a separate contract and certain types of remeasurement events (for example, changes in the lease term or the assessment of a lessee purchase option).

BC6. Topic 842 allows, as a practical expedient, that lessees that are not public business entities use a risk-free rate as the discount rate for all leases. The Board provided that election after concluding that it could be too costly for some of those entities to determine their incremental borrowing rates. The election allows a lessee to use a risk-free rate, calculated for a period that is comparable to the lease term, as the discount rate for all of its leases.

BC7. During implementation of Topic 842 by public companies, and through the post-implementation review process, preparers and practitioners provided feedback that the processes for determining and substantiating a lessee's incremental borrowing rate were both costly and complex to implement. They indicated that those processes likely would be more burdensome for entities that are not public business entities because those entities may not have sophisticated treasury functions or readily available information (such as quoted or comparable credit spreads) to use in developing their incremental borrowing rates. Because of this, stakeholders noted that entities that are not public business entities may have an even greater need than their public company counterparts to engage external valuation experts to comply with the incremental borrowing rate requirements in Topic 842, which would disproportionately increase implementation costs for those entities. For those reasons, stakeholders indicated that calculating and using an incremental borrowing rate to discount all lease liabilities may not be a cost-effective option for many lessees that are not public business entities.

BC8. Although lessees that are not public business entities may use the existing risk-free rate election to avoid calculating an incremental borrowing rate, some private company stakeholders expressed reluctance to use the risk-free rate election for all leases. Those stakeholders noted that a risk-free rate (for example, a U.S. Treasury rate) is low compared with the average incremental borrowing rate based on public company disclosures. They expressed concern that using the risk-free rate election would result in recognizing lease liabilities and right-of-use assets that are greater than those recognized using the lessee's incremental borrowing rate or the rate implicit in the lease (if that rate is readily determinable). It also could cause leases that otherwise would be classified as operating leases to be classified as finance leases.

BC9. At the September 2020 leases public roundtable sessions, certain stakeholders proposed amending the guidance to allow a lessee to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level. Stakeholders noted that some lessees that are not public business entities may want to use their incremental borrowing rates to calculate lease liabilities for material asset classes (such as real estate) but prefer the simpler and less costly option of using a risk-free rate for asset classes that have lower values or greater volumes of leases (such as office equipment). Many stakeholders, including private company preparers and practitioners, supported that alternative.

BC10. The Board issued proposed Accounting Standards Update, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities,* on June 16, 2021, and received 20 comment letters. Overall, respondents supported the amendments in the proposed Update, noting that they would provide greater flexibility to lessees that are not public business entities in applying the risk-free rate election.

Benefits and Costs

BC11. 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.

BC12. Overall, the Board concluded that the amendments in this Update will reduce the cost and complexity of implementing Topic 842 for lessees that are not public business entities. The Board concluded that amending the risk-free rate election to make it an election by class of underlying asset provides entities that are not public business entities with more flexibility when making the risk-free rate election. Consequently, the Board expects that more entities that are not public business entities will make the election. Furthermore, the amendments maintain the decision usefulness of information provided to present and potential investors, creditors, donors, and other users. That is, the Board has already allowed the use of the risk-free rate but as an entity-wide election. The amendments allow a lessee making the election to use the incremental borrowing rate for some asset classes and also require that a lessee use its rate implicit in the lease for a lease when that rate is readily determinable. The Board believes that this results in financial reporting that better reflects the economics of the associated lease transactions. Further discussion of the costs and benefits of the amendments is provided below.

Basis for Conclusions

Scope

BC13. The amendments in this Update are limited to entities that are not public business entities. According to the definition of *public business entity* in the Master Glossary, not-for-profit entities (including conduit bond obligors) and employee benefit plans are not public business entities. Therefore, those entities are permitted to make the risk-free rate election and are within the scope of this Update.

Increasing the Flexibility of the Risk-Free Rate Election

BC14. At the April 14, 2021 meeting, the Board decided to improve the application of the existing practical expedient by allowing a lessee that is not a public business entity to make an accounting policy election to use a risk-free rate as the discount rate for its leases by class of underlying asset, rather than at the entity-wide level. Additionally, the Board decided to require a lessee that is not a public business entity to disclose that fact and the asset classes to which it has elected to apply a risk-free discount rate.

BC15. The Board concluded that the amendments in this Update provide lessees that are not public business entities with more flexibility than do the current requirements. The Board acknowledged that a lessee may prefer to use its incremental borrowing rate for more significant leases, such as real estate leases, for which transactions may be less frequent and of higher dollar value. However, the lessee may prefer to use a risk-free rate for less significant leases, such as office equipment leases, for which the transaction volume is higher and the dollar value is generally lower. The Board concluded that eliminating the “all or nothing” nature of the election may result in wider use of the election by entities that are not public business entities, while maintaining the information provided to investors.

BC16. Respondents to the proposed Update broadly supported the Board’s decision to allow the risk-free rate to be elected by class of underlying asset. For the reasons described above, the Board affirmed its decision to allow a lessee that is not a public business entity to make an accounting policy election to use a risk-free rate as the discount rate for its leases by class of underlying asset, rather than at the entity-wide level.

Rate Implicit in the Lease

BC17. The Board also considered the interaction of the risk-free rate election with the guidance on a lessee's use of the rate implicit in the lease. During outreach, several practitioners questioned whether a lessee applying the risk-free rate election is required or permitted to use the rate implicit in the lease when that rate is readily determinable. Those stakeholders noted that there are two supportable interpretations of that guidance. One interpretation is that the guidance requires that a lessee use the rate implicit in the lease when it is readily determinable, even if it has applied the risk-free rate election. Another interpretation is that because the guidance states that the risk-free rate election applies to all leases, an entity making the risk-free rate election cannot use the rate implicit in the lease.

BC18. At the April 14, 2021 Board meeting, the Board decided that a lessee should be required to use the rate implicit in the lease when it is readily determinable, regardless of whether the lessee has made the risk-free rate election. For example, if a lessee has applied the risk-free rate election to its equipment asset class but can readily determine the rate implicit in the lease for an individual equipment lease, the lessee would use the rate implicit in the lease instead of the risk-free rate for that particular lease. In making that decision, the Board acknowledged that the rate implicit in the lease best reflects the economics of the transaction and that practice has consistently interpreted the "readily determinable" threshold as a high bar. Therefore, the Board does not expect that an entity would have to expend much effort substantiating that it cannot readily determine the rate implicit in the lease.

BC19. Comment letter respondents broadly agreed that requiring a lessee to use the rate implicit in the lease when readily determinable, regardless of whether it uses the risk-free rate election, is operable and should not add costs for preparers. For the reasons described above, the Board affirmed its decision to require a lessee to use the rate implicit in the lease when it is readily determinable, regardless of whether the lessee has made the risk-free rate election.

BC20. The amendments in this Update do not change the guidance on and are not intended to change practice for a lessee's determination of whether the rate implicit in the lease is readily determinable.

Discount Rate

BC21. Some stakeholders who provided feedback on the risk-free rate election supported replacing the risk-free rate in that expedient with another specified rate. At the December 2, 2020 Board meeting, the Board directed the staff to perform research on whether another specified rate should replace a risk-free rate.

BC22. The Board considered the characteristics that make a risk-free rate an operable rate, including that the rate is publicly published by a reliable source and available for differing maturities (lease terms). The Board considered specifying a corporate bond rate as the discount rate, noting that such rates are used in other Codification Topics. However, corporate bond rates are not publicly published by a reliable source. Rather, an average corporate bond rate is made up of underlying data (individual bond issues) that are not aggregated in a publicly available forum. The underlying data (for example, general data or specific industry data) used to calculate a corporate bond rate affect the rate. Those factors caused the Board to conclude that specifying a corporate bond rate instead of a risk-free rate would add cost and complexity to the application and auditing of that rate, especially for smaller entities. The Board also questioned the basis for choosing a specific credit-rating category (for example, low investment grade or high yield) that would apply to the broad range of sizes and types of entities that are not public business entities.

BC23. Comment letter respondents generally agreed that using a corporate bond rate would add costs for preparers. Respondents did not suggest any alternative rate that would meet the operability criteria considered by the Board. For those reasons, the Board affirmed its decision to retain a risk-free rate in the election.

Weighted-Average Discount Rate

BC24. Under Topic 842, lessees are required to disclose the weighted-average discount rate, separately for operating and finance leases, calculated using the discount rate and remaining lease payments for each lease. In the initial phases of the project, stakeholders questioned whether allowing lessees that are not public business entities to disclose a weighted-average discount rate that combined risk-free rates with other rates (the incremental borrowing rate and the rate implicit in the lease, when readily determinable) used by a lessee to discount its lease liabilities would result in less decision-useful information for users of financial statements. Those stakeholders questioned whether separate disclosure of the weighted-average discount rate for leases that use a risk-free rate and other rates would provide more decision-useful information.

BC25. The amendments in the proposed Update did not include a separate weighted-average discount rate disclosure. However, the Board included a question asking for feedback on the costs of providing such a disclosure and whether that disclosure would provide users with more decision-useful information. Most respondents to the proposed Update expressed that such a disclosure would impose additional cost on preparers; however, there was mixed feedback on the extent of that cost.

BC26. Because many lessees that are not public business entities have not yet adopted Topic 842, users of those entities' financial statements could not yet provide detailed feedback on the decision usefulness of the weighted-average discount rate disclosure. However, in additional outreach, some users indicated that (a) a separate weighted-average discount rate disclosure might not provide much utility without other quantitative disclosures about the asset classes to which the risk-free rate election has been applied and (b) other information may be available to users of financial statements of entities that are not public business entities.

BC27. On the basis of the feedback summarized in paragraphs BC25 and BC26, the Board decided not to require disclosure of separate weighted-average discount rates for leases measured using a risk-free discount rate and all other leases (those using the lessee's incremental borrowing rate or rate implicit in the lease, when readily determinable, as the discount rate for the lease). However, the Board directed the staff to continue to broadly monitor the disclosure needs of users of financial statements as part of the ongoing post-implementation review of Topic 842.

Effective Date and Transition

BC28. Topic 842 will become effective for private companies and not-for-profit entities that are not conduit bond obligors for fiscal years beginning after December 15, 2021, and for interim periods within fiscal years beginning after December 15, 2022. However, some lessees that are not public business entities have elected earlier application of (or, in the case of not-for-profit organizations that are conduit bond obligors and employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission, were required to undertake application of) the guidance in Topic 842. Accordingly, the Board provided separate effective date and transition provisions for entities that have not yet adopted Topic 842 and those that have.

Entities That Have Not Adopted Topic 842

BC29. For entities that have not adopted Topic 842 by November 11, 2021, the Board decided that the amendments in this Update are effective upon an entity's adoption of Topic 842. The Board decided that those entities should follow the existing transition requirements of Topic 842 so that the entities do not need to perform a separate transition to adopt the amendments. That transition is applied either (a) retrospectively to existing leases with the cumulative effect of transition recognized at the beginning of the earliest period presented or (b) on a modified retrospective basis to existing leases with the cumulative effect of transition recognized at the beginning of the period of adoption. For the reasons described by the Board, most comment letter respondents supported those effective date and transition provisions for entities that have not adopted Topic 842.

Entities That Have Adopted Topic 842

BC30. For entities that have adopted Topic 842 by November 11, 2021, the Board decided that the amendments in this Update are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Earlier application is permitted as of the beginning of the fiscal year of adoption.

BC31. The Board decided to provide a modified retrospective transition method, whereby an entity is required to recognize a cumulative-effect adjustment to its opening balance of lease liabilities with the corresponding effect to the opening balance of the entity's right-of-use assets at the beginning of the fiscal year in which the entity adopts the amendments in this Update. The cumulative-effect adjustment should be calculated for leases existing as of the beginning of the fiscal year of adoption using the remaining lease term and a discount rate assessed at the beginning of the fiscal year of adoption. Most comment letter respondents supported those effective date and transition provisions for entities that have already adopted Topic 842.

BC32. To simplify the transition, the Board decided to require that a lessee determine the discount rate using the remaining lease term at the date that the lessee adopts the amendments in this Update. This requirement is different from the transition requirements in paragraph 842-10-65-1(l) for a lessee adopting Topic 842, which do not specify whether a lessee is required to use the remaining lease term or the original lease term to determine the discount rate to be used in transition. The FASB staff provided an interpretation that either the remaining or original lease term would be acceptable when adopting Topic 842. The Board noted that the guidance in this Update does not change the transition guidance for Topic 842 and is not intended to change practice or previous interpretations in applying paragraph 842-10-65-1(l) for the overall adoption of Topic 842.

BC33. To further simplify transition, the Board also decided that adopting the amendments in this Update should not be considered an event that would cause an entity to remeasure or reallocate the consideration in the contract (including lease payments) or reassess lease payments or classification. The Board decided this so that a lessee will not incur additional cost and deal with additional complexity in reevaluating the inputs to its affected lease liabilities and right-of-use assets when adopting the amendments.

BC34. The Board decided to require certain disclosures in Topic 250, Accounting Changes and Error Corrections, about the nature of and the reason for the change in accounting principle and the cumulative effect of the change on retained earnings to provide users of the financial statements with transparency about the effect of adopting the amendments. In response to comment letters on the proposed Update, the Board added a requirement that a lessee disclose the transition effect on the balances of its lease liabilities and right-of-use assets. That disclosure was added to provide greater transparency for users of the financial statements on the effect of adopting this Update.

BC35. Upon adopting this Update, an entity may choose to apply or discontinue the use of a risk-free discount rate previously made for any class of underlying asset. After adopting this Update, a change in the application of the risk-free rate election would be a change in accounting policy that would need to be evaluated under the appropriate guidance in Topic 250, unless that election to use or not use a risk-free discount rate had been for an immaterial asset class because accounting policies do not apply to immaterial transactions.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update do not require improvements to the GAAP Financial Reporting Taxonomy and the SEC Reporting Taxonomy because the Securities and Exchange Commission requirements to provide financial statements in interactive format using eXtensible Business Reporting Language do not apply to entities that are not public business entities.