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ASU 2018-01 Lessens the Blow of Accounting for Land Easements Under New Lease Requirements

ENERGY & RESOURCES, LEASES
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Back in February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 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 arrangements. After this issuance, however, numerous questions surfaced concerning the application of the lease requirements on land easements.

Easements represent the right to use, access or cross another entity’s land for a specified purpose. An example is when a company is given the right to pass a pipeline through a field or run an electric cable over a farm while the landowner continues to use the property as before. Currently, entities are varied in their approach to accounting for land easements; some choose to represent them under lease guidance, while others do so under intangible or property, plant and equipment guidance.

Because of this difference, many entities that don’t currently account for land easements under lease guidance have indicated that the process of evaluating all existing or expired easements to determine if they meet the definition of a lease under the new requirements is both costly and complex. These same entities note that most of their existing easements would not meet the definition of a lease or, if they did meet the definition, many are prepaid and already recognized on the balance sheet.

In response, the FASB has issued ASU 2018-01, which clarifies the new lease accounting standard (2016-02) with regard to land easements. The new ASU includes an optional transition practical expedient that, if elected, would not require an organization to reconsider its accounting for existing or expired land easements not currently accounted for under the old lease accounting standard. All new or modified land easements would have to be evaluated for recognition as a lease once a company adopts ASU 2016-02. If a company does not elect this practical expedient, all existing or expired land easements will have to be evaluated with respect to ASU 2016-02.

This update provides relief to utility and oil and gas companies with existing property rights of way for gas pipelines and electric power lines when they make the transition to the new lease accounting standard. The ASU will have the same effective date as the new lease standard. For public companies, this means effective for annual reporting periods beginning after December 15, 2018. All other entities would have an additional year. For more information on this ASU or others, contact us.

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