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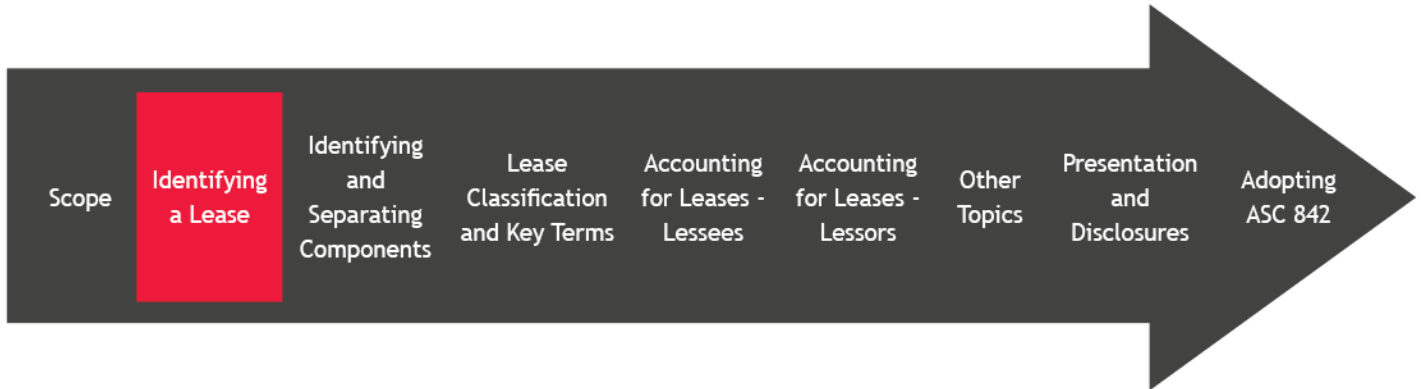
Accounting for Leases Under ASC 842

UPDATED SEPTEMBER 2021





BDO Knows Identifying a Lease



OVERVIEW

The Master Glossary defines a lease as:

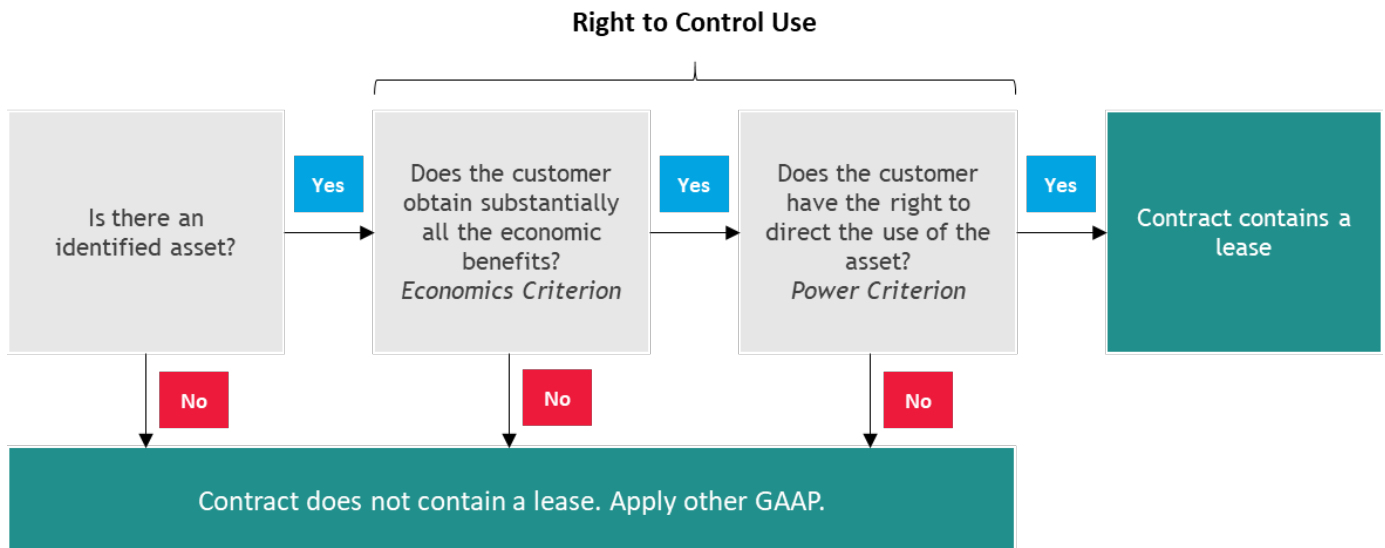
“A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.”

A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).

A contract is or contains a lease if there is an identified asset and the contract grants the customer throughout the period of use both:

- ▶ The right to obtain substantially all of the economic benefits from the asset’s use (the economic criterion), and
- ▶ The right to direct the use of the identified asset (the power criterion).

Accordingly, the definition of a lease focuses on three criteria as described in the following flowchart:



If the customer in the contract is a joint operation or a joint arrangement, the entity should consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

Also, for an entity to appropriately evaluate the three criteria in the above flowchart, it is important to understand the following:

- ▶ The contract must be for a period of time (See Example 1), and
- ▶ The evaluation of whether a contract is or contains a lease is performed based on the period of use, which is the total period of time an asset is used to fulfill the contract with the customer, including the sum of any nonconsecutive periods of time. That period is not always the same as the contract term (See Example 2). Once determined, this period of use is applied to evaluate whether supplier substitution rights are substantive, and whether the economics and power criteria are met. Accordingly, it is a key concept of the evaluation.

Example 1 - Contract Must Be for a Period of Time - Perpetual Land Easement

Electric Company obtained a series of easements from Southern Railroad after its adoption of ASC 842 (see previous article on [scope](#) for a practical expedient available in transition for certain land easements). The easements were obtained so that Electric Company could install poles to which its power lines would be attached. In addition to installing its poles, Electric Company has the right to access the poles via a corridor leading from the nearest road to the pole. Electric Company made an upfront payment under the easement agreement in return for perpetual access rights.

In this example, the agreement does not contain a lease. ASC 842-10-15-3 states that a lease conveys the right to control the use of identified property, plant or equipment *for a period of time* in exchange for consideration. The fact that the contract is perpetual means that it is not for a period of time, and, therefore, the agreement does not contain a lease. This view is consistent with conforming amendments made to the intangible assets' guidance in ASU 2018-01. Specifically, Example 10 of ASC 350-30 (paragraph 350-30-55-30) was amended to clarify that the perpetual easements that the entity owns were "evaluated under Topic 842 and determined to not meet the definition of a lease under that Topic (because those easements are perpetual and, therefore, do not convey the right to use the underlying land for a period of time)."

Example 2 - Period of Use - Customer Uses Asset During Nonconsecutive Periods

Calendar Co. sells calendars and holiday merchandise. In order to sell its products, it enters into a contract for the right to use a storefront in a mall for the months of November and December each year for five years.

Calendar Co. considers the "period of use" as defined in ASC 842-10-20 as "[t]he total period of time that an asset is used to fulfill a contract with a customer (including the sum of any nonconsecutive periods of time)." Because the periods of time are not consecutive, Calendar Co. must consider the aggregate term for which it has the right to use the storefront. In this example, the period of use is ten months (two months per year for five years); it is not the five-year contract term. Accordingly, the evaluation of whether the contract contains a lease considers the ten-month period that the storefront is used to fulfill the contract.

The evaluation of whether a contract contains a lease is performed at contract inception, and an entity does not subsequently reassess its conclusion unless the terms and conditions of the contract are modified.

IDENTIFIED ASSET

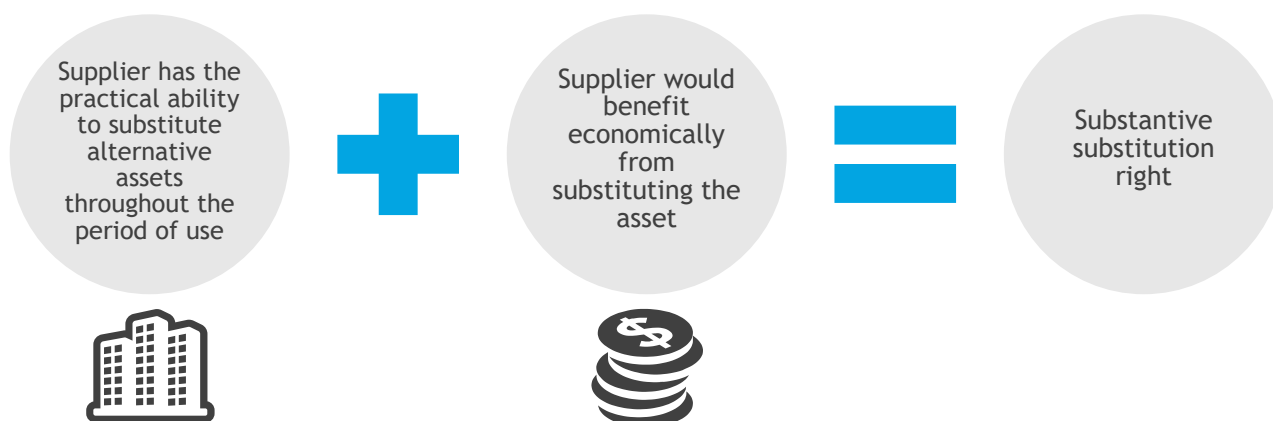
An asset is typically identified when it is either explicitly specified in the contract, or implicitly specified when the asset is made available for use by the customer. Importantly, paragraph BC128 of ASU 2016-02 notes that “when assessing whether there is an identified asset, an entity does not need to be able to identify the particular asset that will be used to fulfill the contract to conclude that there is an identified asset. Instead, the entity simply needs to know whether an asset is needed to fulfill the contract from commencement. If that is the case, an asset is implicitly specified.”

A capacity portion of an asset also can be an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct is not an identified asset unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. The following examples illustrate this requirement (assume for now that there are no supplier substitution rights).

Physically Distinct Asset	Capacity Portion of Asset	
A customer enters into a 15-year contract with a supplier for the right to use 3 of 10 specific strands of a fiber optic cable connecting Paris and London.	A customer enters into a 15-year contract with a supplier for the right to use a specified amount of capacity (95%) within a cable connecting Paris and London. The specified amount is equivalent to the customer having the full capacity of 14 fiber strands within a 15-strand cable.	A customer enters into a 15-year contract with a supplier for the right to use a specified amount of capacity (20%) within a cable connecting Paris and London. The specified amount is equivalent to the customer having the full capacity of 3 fiber strands within a 15-strand cable.
The strands of fiber optic cable are distinct from one another. Each strand is an identified asset.	The capacity specified is not physically distinct, but it represents substantially all the capacity of the cable. The cable is an identified asset.	The capacity specified is not physically distinct and does not represent substantially all the capacity of the cable. There is no identified asset.

However, even if an asset is specified, there is no identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. That is, when a supplier substitution right is considered substantive, the supplier (rather than the customer) controls the use of the asset.

Supplier substitution rights are considered substantive when the following two conditions are met:



The evaluation of supplier substitution rights is key because if it is determined that the supplier right is substantive, then there is no identified asset and thus the contract does not contain a lease.



A supplier has the practical ability to substitute alternative assets when, for example, the customer cannot prevent the supplier from exercising its right of substitution and the supplier has other alternative assets readily available (or the supplier could source alternative assets within a reasonable period of time).



A supplier would benefit economically from substituting the asset if the economic benefits of doing so exceed the related costs of substitution (e.g., transportation, installation costs, etc.). ASC 842 further states that if the asset is located at the customer's premises, the costs of substituting the asset are generally higher than when located at the supplier's premises, and therefore are more likely to exceed the related benefits. If the supplier costs to substitute exceed the related benefits, the substitution right is not substantive and, therefore, there is an identified asset.

ASC 842 provides additional guidance to evaluate whether supplier substitution rights are substantive.

Fact Pattern	Conclusion
Supplier can substitute the asset only in circumstances that are unlikely to occur at contract inception (for example, an agreement with a future customer to pay an above-market price for use of the asset).	Substitution right is not substantive.
Supplier can substitute the asset only on or after a specified future date or specified event.	Substitution right is not substantive because the supplier does not have the right to substitute the asset <i>throughout the period of use</i> .
Supplier can substitute the asset for repairs and maintenance or based on the availability of a technical upgrade.	Substitution right is not substantive.
Customer cannot readily determine whether a substitution right is substantive (for example, a customer may not have information about the supplier's costs of substitution).	Customer must presume that the substitution right is not substantive (that is, there is an identified asset).

Concept of Identified Asset under ASC 842 versus ASC 840

The concept of a lease contract being based on an identified asset is not new and existed in ASC 840. Under ASC 840 an asset could be explicitly specified or implicitly specified (for example, when the supplier owned or leased only one asset with which to fulfill its obligation to the customer/purchaser and it was not economically feasible or practicable for the supplier to perform its obligation through the use of alternative property, plant, or equipment). ASC 842 retains a similar concept on identifying an asset but is more explicit on the evaluation of supplier substitution rights, now requiring that the supplier benefit economically from substitution. Accordingly, more contracts may be leases under ASC 842, and this determination becomes more important under the new guidance due to the balance sheet implications for lessees.

Example 3A (Adapted from paragraph 842-10-55-52 through 55-54) - Concession Space**FACTS**

- ▶ Retailer enters into a contract with Airport Operator for the use of a space in an airport terminal for a five-year period.
- ▶ Retailer owns and utilizes a booth that is easily transferrable to different boarding areas.
- ▶ Airport Operator has many areas in the terminal that are available and would meet Retailer's specifications. Airport Operator can at its sole discretion relocate Retailer to different boarding areas in the terminal throughout the period of use. Airport Operator also would incur minimal costs associated with changing the space that Retailer uses.

ANALYSIS

Is there an identified asset? **No**

Although the contract specifies that Retailer will utilize a specific space in the airport to operate its booth:

- ▶ There are several other similar areas that Retailer may be assigned to, which Airport Operator has the right to change, without Retailer's approval, throughout the period of use. That is, Airport Operator has the practical ability to substitute Retailer's space.
- ▶ The costs to move Retailer's booth are minimal, and substitution allows Airport Operator to use its airport space in the most effective way, for example by relocating Retailer to other boarding areas to meet changing circumstances. Those conditions are likely to occur at contract inception considering Airport Operator's historical experience, business and operations. That is, Airport Operator would benefit economically from substituting Retailer's space.

Accordingly, Airport Operator's substitution right is substantive.

CONCLUSION

The contract does not contain a lease.

Example 3B (Adapted from paragraph 842-10-55-63 through 55-71) - Retail Space**FACTS**

- ▶ Retailer enters into a contract with Airport Operator for the use of retail unit A for a five-year period. Retail unit A is part of a terminal with many retail units.
- ▶ Airport Operator can require Retailer to relocate to another retail unit in the terminal. In that case, Airport Operator is required to provide Retailer with a retail unit of similar quality and specifications as retail unit A and to pay for Retailer's relocation costs, including reimbursement for any leasehold improvements that cannot be relocated.
- ▶ Airport Operator would benefit economically from relocating Retailer only if a major new tenant were to decide to occupy a large amount of retail space at a rate sufficiently favorable to cover the costs of relocating Retailer and other tenants for the space that the new tenant would occupy. Although it is possible that those circumstances will arise, at contract inception it is not likely that those circumstances will arise, and whether such circumstances occur is highly susceptible to factors outside of Airport Operator's control.

ANALYSIS

Is there an identified asset? **Yes**

Retail unit A is explicitly specified in the contract, and Airport Operator's substitution right is not substantive because Airport Operator would benefit economically from substitution only in specific circumstances that at inception of the contract are not likely to occur. That is, Airport Operator's substitution right is not substantive and, therefore, there is an identified asset.

CONCLUSION

The analysis continues to determine whether Retailer has the right to control the use of retail unit A. See Right to Control Use of Identified Asset section for additional discussion.

Example 4A (Adapted from paragraph 842-10-55-48 through 55-51) - Rail Cars**FACTS**

- ▶ Smith & Company (SmithCo) enters into an agreement with Freight Systems Limited (Freight) to transport a specified quantity of products by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of products specified are economically equivalent to SmithCo having the use of ten rail cars for five years.
- ▶ Freight has a large pool of similar rail cars that can be used to fulfill the requirements of the contract. The rail cars are stored at Freight's location when not in use.

ANALYSIS

Is there an identified asset? **No**

The rail cars used to transport SmithCo's products are not identified assets. Freight has the practical ability to substitute each rail car throughout the period of use without SmithCo's approval, and Freight would benefit economically from substituting each car because the costs to substitute, if any, would be minimal, and substitution allows Freight to use the cars in the most efficient way for the task, for example because cars are currently at a rail yard close to the point of origin. Those conditions are likely to occur at contract inception considering Freight's historical experience, business and operations. Accordingly, Freight's substitution right is substantive. Therefore, although SmithCo has the right to use the equivalent of ten rail cars for five years, Freight directs the use of those rail cars by determining which cars will be used for each particular delivery.

CONCLUSION

The agreement does not contain a lease.

Example 4B (Adapted from paragraphs 842-10-55-42 through 55-47) - Rail Cars**FACTS**

- ▶ Smith & Company (SmithCo) enters into an agreement with Freight Systems Limited (Freight) under which Freight provides SmithCo with the use of ten rail cars of a particular type for five years. The contract specifies the rail cars, which are owned by Freight.
- ▶ The agreement provides certain limitations on what types of goods SmithCo can transport, such as hazardous materials or explosives, but otherwise, SmithCo has the right to determine whether the rail cars are used, and if so, where, when and which products are transported using the rail cars. When the rail cars are not in use, they are stored at SmithCo's property.
- ▶ If a particular car needs to be serviced or repaired, Freight is required to substitute a rail car of the same type. Otherwise, Freight cannot retrieve the rail cars during the five-year period of the contract other than on default by SmithCo.

ANALYSIS

Is there an identified asset? **Yes**

There are ten identified rail cars. Once the cars are delivered to SmithCo, they can only be substituted when they need to be serviced or repaired, which is not considered a substantive substitution right based on the guidance in paragraph 842-10-15-14.

CONCLUSION

The analysis continues to determine whether SmithCo has the right to control the use of the rail cars. See Right to Control Use of Identified Asset section for additional discussion.

Example 5 - Contract for Hosting Arrangement

FACTS

- ▶ Bank Company (“Bank”) enters into a hosting arrangement with Regional Hosting Co. (“Regional Hosting”) under which Regional Hosting will provide a specific number of servers on which it will host software licenses owned by Bank. In addition, Regional Hosting will provide connectivity to allow Bank to access the software hosted by Regional Hosting.
- ▶ Because of the number of users in Bank’s environment and the complexity of the software environment, Regional Hosting must host Bank’s software on dedicated servers with specific security requirements, and no other customer can be hosted on the same servers. However, Regional Hosting has the right to rehome Bank’s software onto different servers with similar security requirements without Bank’s approval so long as access to its software licenses is uninterrupted.

ANALYSIS

Is there an identified asset? **No (Regional Hosting), Yes (Bank)**

Regional Hosting considers whether its arrangement with Bank contains identified assets (i.e., each server) and notes that:

- ▶ It has numerous servers that meet Bank’s security requirements and from which it can host Bank’s software. Bank cannot prevent Regional Hosting from switching servers so long as access to Bank’s software is uninterrupted. Accordingly, Regional Hosting concludes it has the practical ability to substitute Bank’s servers throughout the period of use.
- ▶ There are minimal costs to substitute servers, and Regional Hosting would benefit economically from substitution. Specifically, it is common for new hosting customers to be obtained, at which time Regional Hosting often reconfigures its server space. In addition, to maximize performance on its servers, Regional Hosting regularly adds or deletes servers and moves customers as needed. Accordingly, Regional Hosting concludes that its right of substitution is substantive.

Regional Hosting concludes that the contract does not include identified assets and thus is not a lease.

Bank, however, does not have visibility into Regional Hosting’s operations and business (including how many servers Regional Hosting has with similar security requirements and how many customers it serves). Therefore, it concludes pursuant to the guidance in paragraph 842-10-15-15 that Regional Hosting’s right of substitution is not substantive, which means the agreement includes identified assets.

CONCLUSION

Regional Hosting concludes that it does not have a lease.

Bank continues its evaluation to determine whether it has the right to control the use of each identified asset (i.e., each server). See Right to Control Use of Identified Asset section for additional discussion.

Example 6 - Contract for Medical Equipment

FACTS

- ▶ Outpatient Services, Inc. (“OSI”) signs a contract with Medical Equipment Company (“MEC”) under which OSI will use five chemotherapy machines for a period of three years. The contract does not explicitly identify specific machines, but instead only requires five machines to be available at all times. The machines are delivered to OSI’s location, and OSI has the right to use the machines in any way and at any time it deems appropriate during the three-year term of the agreement, subject to restrictions requiring the machines to be used pursuant to manufacturer-provided and FDA-approved use guidelines.
- ▶ Each machine is expected to be able to provide up to 1,000 treatments before needing maintenance, and each machine has an expected useful life of approximately 5,000 treatments, which normally equates to five to six years. However, each machine can only be used to provide up to 10 chemotherapy treatments before being recalibrated pursuant to FDA guidelines, at which time MEC is required to provide the services necessary to allow OSI to continue providing its chemotherapy services. When OSI contacts MEC to request recalibration of one of its machines, MEC retrieves that machine and replaces it with a fresh machine.
- ▶ MEC maintains a large pool of chemotherapy machines at specified locations (which are within a reasonable distance from its customers) which have been properly cleaned and calibrated.
- ▶ MEC also has the right to replace the machines at its convenience, which it regularly does when replacing other machines in the same geographic area.

ANALYSIS

Is there an identified asset? **No**

While the machines are housed at OSI’s location, MEC has the right to substitute another equivalent machine throughout the three-year period and that right is considered substantive because:

- ▶ MEC has the practical ability to substitute each machine throughout the period of use considering its large pool of machines and reasonable distance from its customers. MEC also does not need OSI’s approval to substitute the machines.
- ▶ MEC would benefit economically because MEC has centralized calibration operations in a single facility within a reasonable distance from its customers which allows it to reduce costs of calibration (including transportation) in excess of the costs that it otherwise would incur to calibrate the machines at the clients’ location, while ensuring constant access to calibrated machines for its customers as required per the agreement. In addition, MEC would benefit from replacing a machine prior to a customer’s request if MEC is replacing another machine in that customer’s general vicinity, as that further reduces MEC’s transportation costs. Those events are likely to occur at contract inception considering MEC’s historical experience, business and operations.

CONCLUSION

The contract does not contain a lease.

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Even if a contract includes an identified asset, a contract does not contain a lease unless the customer has the right to control the use of that asset, which is met when the customer has throughout the period of use both:

- ▶ The right to obtain substantially all of the economic benefits from the asset's use (the economics criterion), and
- ▶ The right to direct the use of the identified asset (the power criterion).

Right to Control Use under ASC 842 similar to ASC 606 and ASC 810

Although the right to control the use of an identified asset is not a new concept, the application in ASC 842 is different than in ASC 840. Specifically, under the guidance in ASC 840, a contract contained a lease if:



- (a) The customer controlled the operation of the asset while obtaining more than a minor portion of the output of the asset,
- (b) The customer controlled physical access to the asset while obtaining more than a minor portion of the output of the asset, or
- (c) It was remote that any other party would receive more than a minor portion of the output of the asset and the price for the output was neither fixed per unit nor equal to the market price at time of delivery.

Accordingly, under ASC 840 a customer could have the right to control the use of an asset solely based on obtaining substantially all the output from that asset, assuming the contract is priced in a certain way. This criterion defined control based on a benefits element only. However, ASC 606 on revenue from contracts with customers and ASC 810 on consolidation define control based on a benefits element and a power element. Likewise, ASC 842 now requires a customer to have throughout the period of use not only the right to obtain substantially all the economic benefits from use of an asset (the economics criterion), but also the ability to direct the use of that asset (the power criterion). In other words, a customer must have decision-making rights over the use of the asset that give it the ability to influence the economic benefits derived from the asset's use. Without such decision-making rights, the customer has no more control over the use of an asset than any customer purchasing supplies or services. As a result, certain contracts that met the definition of a lease under ASC 840 (for example certain power purchase agreements) may no longer meet the definition of a lease under ASC 842.

RESTRICTIONS AND SUPPLIER PROTECTIVE RIGHTS

Both the economic and power criteria are evaluated within the defined scope of the customer's right to use the asset. Terms that limit the use of the asset a certain way (for example, specifying a maximum amount of usage of the asset) or that protect the supplier's interest in the asset (such as requiring the customer to follow industry-standard operating procedures, or requiring notification of changes in how or where the asset will be used) do not, in isolation, prevent the customer from having the right to direct the use of the identified asset.

Accordingly, the analysis should focus on what the customer can do within that scope of use of the asset. Consider the following examples:

	Corporate Jet	Commercial Truck	Retail Unit
Contract	Contract for the use of a corporate jet for a two-year period.	Contract for the use of a commercial truck for a five-year period.	Contract for the use of a retail unit within a larger mall for a five-year period.
 Defines the scope of use	Restrictions within the contract limit the number of hours the jet can fly and/or which territories the aircraft can fly over.	Restrictions within the contract limit the number of miles the truck can be driven, and customer cannot transport hazardous or explosive goods.	Restrictions within the contract limit the hours of operations of the store from 10am to 10pm.
 But within that scope of use	Customer has exclusive use of the corporate jet and decides whether the aircraft flies, where and when the aircraft flies (subject to the limits) and whether to transport passengers and/or cargo.	Customer has exclusive use of the truck and decides where and when the truck will be used, how many miles (subject to the limit) and what cargo (other than explosives) it will transport.	Customer has exclusive use of the retail unit and decides when to open (subject to the limit), the mix of goods to sell, and at what price to sell the goods.

In all the above examples, even though the contract includes restrictions or limitations on the use of the asset, the contracts would include a lease as further explained in the Economic Criterion and Power Criterion sections below.

ECONOMIC CRITERION

A customer can obtain economic benefits from use of an asset directly or indirectly in various ways, including by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third-party.

ASC 842 clarifies that only the economic benefits arising from *use* of an asset should be considered when assessing whether a customer has the right to obtain substantially all economic benefits. In many cases, the evaluation will be straightforward. For example, when the customer has exclusive use of an identified asset, it typically obtains 100% of the economic benefits from use of that asset. This is true for the corporate jet, commercial truck, and retail unit examples previously presented in the Restrictions and Supplier Protective Rights section. However, in other situations this evaluation will require the use of professional judgment.

Economic benefits arising from ownership of an asset (for example, tax benefits from owning an asset) are excluded in the evaluation. This is because a lease does not convey ownership of an underlying asset, but instead conveys the right to use that asset. To illustrate this, consider a utility company (customer) that enters into a contract with a power company (supplier) to purchase all electricity produced by a specific solar farm. Supplier owns the solar farm and will receive tax credits related to its ownership of the solar farm. Customer will receive renewable energy credits related to the use of the farm. The following table summarizes the relevant outputs to consider in determining whether the customer obtains substantially all the economic benefits from use of the asset.

Include	Exclude
<ul style="list-style-type: none"> ▶ Electricity produced by the solar farm (customer), ▶ Renewable energy credits because they relate to the <i>use</i> of the solar farm (customer). 	<ul style="list-style-type: none"> ▶ Tax credits because they relate to the <i>ownership</i> of the asset, not the use of the asset (supplier).

In the above example, the customer receives 100% of the economic benefits from use of the asset, and therefore the economic criterion is met. If, instead, the supplier was to receive the renewable energy credits, the entity should determine whether the customer obtains substantially all of the economic benefits from use of the solar farm, which may require the use of professional judgment.

Also, if a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of the asset, those cash flows paid as consideration are considered economic benefits that the customer obtains from use of the asset. For example, if a retailer is required to pay a mall owner a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. The cash flows arising from those sales are considered economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the mall owner as consideration for the right to use that retail space.

Meaning of Substantially All

In practice, the term “substantially all” is generally interpreted to be at or around 90% or more. This term is also used in the lease classification test (see paragraphs 842-10-25-2 and 25-3), and paragraph 842-10-55-2c notes that a reasonable approach is to conclude that 90% or more amounts to substantially all. That threshold also is mentioned in many other areas of U.S. GAAP and generally has been applied in a similar manner.

Example 3B - Retail Space (Continued)**FACTS**

- ▶ Retailer enters into a contract with Airport Operator for the use of retail unit A for a five-year period. Retail unit A is part of a larger airport terminal with many retail units.
- ▶ Retailer is required to use retail unit A to operate its well-known store brand to sell its goods during the hours that the airport terminal is open.
- ▶ Retailer pays Airport Operator \$50,000 per month plus 6% of monthly net sales.

ANALYSIS

Is there an identified asset? **Yes**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes**

Retailer has exclusive use of retail unit A and therefore obtains substantially all of the economic benefits from use of the retail unit throughout the period of use. Although Retailer will pay Airport Operator a portion of the cash flows derived from sales in retail unit A (i.e., 6% of monthly net sales), this represents consideration that Retailer pays to Airport Operator for the use of retail unit A and it does not affect the evaluation of the economic criterion in accordance with paragraph 842-10-15-19.

CONCLUSION

The analysis continues to determine whether Retailer has the right to direct the use of retail unit A. See Power Criterion section for additional discussion.

Example 4B - Rail Cars (Continued)**FACTS**

- ▶ Smith & Company (SmithCo) enters into an agreement with Freight Systems Limited (Freight) under which Freight provides SmithCo with the use of ten rail cars of a particular type for five years.
- ▶ The contract specifies the rail cars, which are owned by Freight. When the rail cars are not in use, they are stored at SmithCo's property.

ANALYSIS

Is there an identified asset? **Yes**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes**

SmithCo has the right to obtain substantially all of the economic benefits related to the use of the rail cars over the five-year period of use because SmithCo has exclusive use of the cars during that period.

CONCLUSION

The analysis continues to determine whether SmithCo has the right to direct the use of the rail cars. See Power Criterion section for additional discussion.

Example 5 - Contract for Hosting Arrangement (Continued)**FACTS**

- ▶ Bank Company (“Bank”) enters into a hosting arrangement with Regional Hosting Co. (“Regional Hosting”) under which Regional Hosting will provide a specific number of servers on which it will host software licenses owned by Bank. In addition, Regional Hosting will provide connectivity to allow Bank to access the software hosted by Regional Hosting.
- ▶ Because of the number of users in Bank’s environment and the complexity of the software environment, Regional Hosting must host Bank’s software on dedicated servers with specific security requirements, and no other customer can be hosted on the same servers.

ANALYSIS

Is there an identified asset? **Yes (Bank), No (Regional Hosting)**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes (Bank Only)**

Regional Hosting must host Bank’s software on dedicated servers, which means no other customer can be hosted on those servers. Accordingly, Bank has exclusive use of the servers and therefore it obtains substantially all of the economic benefits from use of those servers.

CONCLUSION

The analysis continues to determine whether Bank has the right to direct the use of the servers. See Power Criterion section for additional discussion.

Example 7 (Adapted from paragraph 842-10-55-100 through 55-107) - Contract for Shirts**FACTS**

- ▶ Brand X enters into an agreement with Contract Manufacturing Company (“CMC”) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of shirts are specified in the contract.
- ▶ CMC has only one factory that can meet the needs of Brand X and it is unable to supply the shirts from another factory or source the shirts from a third-party supplier. The capacity of the factory significantly exceeds the output for which Brand X has contracted.
- ▶ CMC makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfill with the output of the factory that is not used to fulfill Brand X’s contract.

ANALYSIS

Is there an identified asset? **Yes**

The agreement contains an implicitly specified asset because CMC can only fulfill the contract through the use of this factory.

Is the economic criterion met? **No**

Brand X does not have the right to obtain substantially all of the economic benefits from use of the factory. CMC could decide to use the factory to fulfill orders from other customers during the three-year term of the agreement, and the capacity of the factory significantly exceeds the output for which Brand X has contracted.

Note that Brand X’s rights are also limited to specifying output from the factory in its contract, and it has only the same rights regarding use of the factory as do any other customers purchasing shirts or other products from the factory. CMC has the right to direct the use of the factory because it can decide how and for what purpose the factory is used. Accordingly, the power criterion also would not be met.

CONCLUSION

The agreement does not contain a lease.

Example 8 - Contract for Gas Gathering

FACTS

- ▶ Midstream Company (“Midstream”) owns and operates an oil and gas gathering system in a specific area within the Permian basin. Midstream enters into a gas gathering agreement with Oil & Gas Company (“O&G”) to provide gathering services for O&G in the area covered by Midstream’s gathering system for a period of 10 years. The pipeline lateral used to fulfill the contract is connected to Midstream’s integrated pipeline system.
- ▶ The contract provides Midstream with the exclusive right to receive, gather and transmit all gas produced by O&G in the area, and the system must always be available to transmit the gas produced by O&G. However, Midstream retains certain rights associated with the pipeline lateral. For example, Midstream can use the pipeline lateral to store other customers products, to use it for system balancing purposes, or to take advantage of market price fluctuations through park and loan services. Midstream also has the right to connect other pipelines to the pipeline lateral without O&G’s consent as long as Midstream continues to service the volumes produced by O&G.

ANALYSIS

Is there an identified asset? **Yes**

The pipeline lateral is explicitly identified, and Midstream does not have an alternative asset that could be used to fulfill the contract. Paragraph 842-10-15-16 also describes “a segment of a pipeline that connects a single customer to the larger pipeline” as one example that is considered an identified asset.

Is the economic criterion met? **No**

Although Midstream’s system must always be available to transmit the gas produced by O&G, O&G does not have exclusive use of the pipeline lateral because Midstream has the right to use the pipeline for other purposes. The pipeline lateral can handle more capacity than the capacity requested by O&G and Midstream also can increase the capacity of the pipeline lateral through various mechanisms. Midstream has the right to use that excess capacity for its own economic benefits throughout the 10 years (for example, to store other customers’ products, for system balancing purposes, to take advantage of market price fluctuations through park and loan services, etc.) and those economic benefits are considered significant.

Note that O&G also can only request that Midstream transports the quantity of gas that it produces and does not have the right to direct how and for what purpose the pipeline is used. Midstream retains the relevant decisions about the use of the pipeline lateral throughout the 10 years. Those decisions include whether to store other customers’ products or use excess capacity for other purposes, whether to connect additional pipelines, etc. Midstream makes those decisions throughout the 10-year contract. Accordingly, the power criterion also would not be met.

CONCLUSION

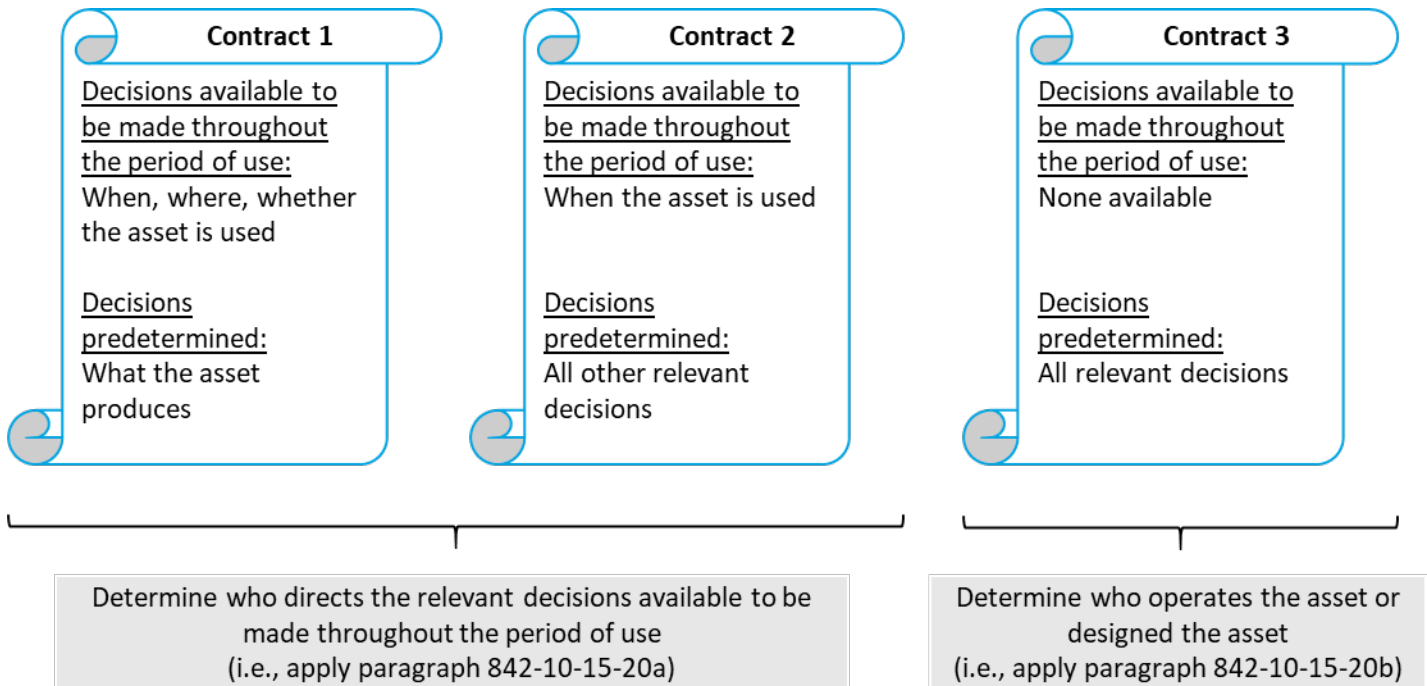
The agreement does not contain a lease.

POWER CRITERION

Paragraph 842-10-15-20 notes that the power criterion is met if:

- a) The customer can direct how and for what purpose the asset is used throughout the period of use (i.e., the customer directs the relevant decisions during the period of use), or
- b) When *all* the relevant decisions are predetermined (for example, by design of the asset or contractual restrictions), either:
 1. The customer has the right to operate (or direct others in operating) the asset throughout the period of use with the supplier having no right to change those operating instructions, or
 2. The customer designed the asset (or specific aspects of it) in a way that predetermined the relevant decisions throughout the period of use.

Determining which guidance in paragraph 842-10-15-20 to apply (i.e., a or b above) is key. So long as there is at least one relevant decision to be made throughout the period of use, the guidance in (a) above should be applied. In other words, the guidance in (b) applies only in situations in which *all* relevant decisions are predetermined in the contract. We illustrate these considerations through the following scenarios:



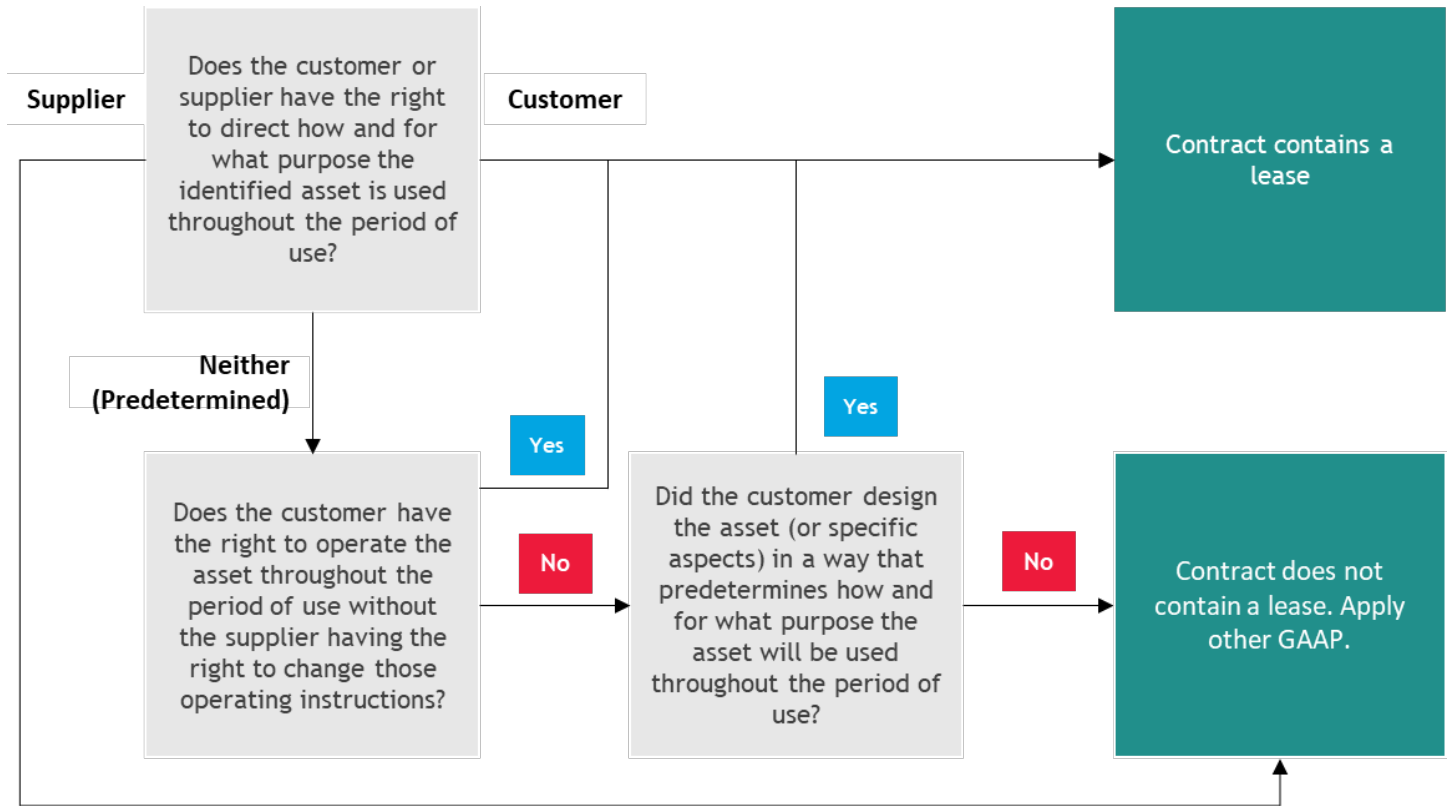
Accordingly, appropriately identifying the relevant decisions and determining whether those are predetermined or not will be important. Example of relevant decision-making rights to consider in the analysis include the following:

Example Relevant Decisions About How and For What Purpose an Asset Is Used	Corporate Jet	Commercial Truck	Retail Unit
Right to change the type of output produced by the asset	Deciding whether to transport passengers and/or cargo.	Deciding on the mix of goods to transport.	Deciding on the mix of products sold in the retail store.
Right to change when the output is produced	Deciding when the aircraft flies.	Deciding when the truck is used.	Deciding when the retail store is open to customers.
Right to change where the output is produced	Deciding where the aircraft flies.	Deciding where the truck will transport goods.	Not applicable.
Right to change whether the output is produced and how much output is produced	Deciding whether to fly the aircraft, how many times the aircraft flies in a specific period, and how much cargo to transport.	Deciding whether to use the truck, how many times the truck is used, and how much goods it transports.	Deciding whether to open the retail store, how long it is open, and how much goods to sell to customers during that period.

These rights are examples only and are neither determinative nor prescriptive. For example, a requirement to use an asset in a specified location does not necessarily imply that the customer does not direct the use of the asset.

Example of decision-making rights that are not relevant include maintaining the asset or operating the asset (unless all relevant decision-making rights are predetermined). While a right to operate the asset is essential to the use of the asset, it is dependent on the decisions about how and for what purpose the asset is used. Accordingly, rights to maintain or operate the asset can be held by the customer or the supplier but typically will not affect the analysis. However, a right to operate the asset is a relevant decision when all relevant decision-making rights are predetermined.

The following flowchart summarizes the thought process for determining whether the customer has the right to direct the use of an identified asset, and whether there is a lease (assuming all other conditions are met).



Example 3B - Retail Space (Continued)**FACTS**

- ▶ Retailer enters into a contract with Airport Operator for the use of retail unit A for a five-year period. Retail unit A is part of a larger airport terminal with many retail units.
- ▶ Retailer is required to use retail unit A to operate its well-known store brand to sell its goods during the hours that the airport terminal is open.
- ▶ Retailer makes all the decisions about the use of retail unit A during the period that the airport terminal is open (e.g., deciding on the mix of goods to sell, and at what price to sell the goods).
- ▶ Retailer pays Airport Operator \$50,000 per month plus 6% of monthly net sales.

ANALYSIS

Is there an identified asset? **Yes**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes**

See Economic Criterion section for additional discussion.

Is the power criterion met? **Yes**

The contractual restrictions on the types of goods that can be sold and when the store must be open define the scope of Retailer's use of retail unit A. Within that scope, Retailer makes the relevant decisions about how and for what purpose the space is used (for example, how much inventory to hold at the store, the mix of its goods to sell, the price of goods sold, etc.).

CONCLUSION

The contract contains a lease of retail space.

Example 4B - Rail Cars (Continued)**FACTS**

- ▶ Smith & Company (SmithCo) enters into an agreement with Freight Systems Limited (Freight) under which Freight provides SmithCo with the use of ten rail cars of a particular type for five years. The contract specifies the rail cars, which are owned by Freight.
- ▶ The agreement provides certain limitations on what types of goods SmithCo can transport, such as hazardous materials or explosives, but otherwise, SmithCo has the right to determine whether the rail cars are used, and if so, where, when and which products are transported using the rail cars. When the rail cars are not in use, they are stored at SmithCo's property.
- ▶ If a particular car needs to be serviced or repaired, Freight is required to substitute a rail car of the same type. Otherwise, Freight cannot retrieve the rail cars during the five-year period of the contract other than on default by SmithCo.

ANALYSIS

Is there an identified asset? **Yes**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes**

See Economic Criterion section for additional discussion.

Is the power criterion met? **Yes**

SmithCo has the right to direct the use of the cars throughout the five-year period of use. The contractual restrictions on the cargo that can be transported are protective rights of Freight and those define the scope of SmithCo's right to use the rail cars. Within that scope, SmithCo has the right to determine whether the rail cars are used, and if so, where, when and which products are transported using the rail cars.

CONCLUSION

The contract contains a lease of ten rail cars.

Example 5 - Contract for Hosting Arrangement (Continued)**FACTS**

- ▶ Bank Company (“Bank”) enters into a hosting arrangement with Regional Hosting Co. (“Regional Hosting”) under which Regional Hosting will provide a specific number of servers on which it will host software licenses owned by Bank. In addition, Regional Hosting will provide connectivity to allow Bank to access the software hosted by Regional Hosting.
- ▶ Because of the number of users in Bank’s environment and the complexity of the software environment, Regional Hosting must host Bank’s software on dedicated servers with specific security requirements, and no other customer can be hosted on the same servers. However, Regional Hosting has the right to rehome Bank’s software onto different servers with similar security requirements without Bank’s approval so long as access to its software licenses is uninterrupted.
- ▶ Although Regional Hosting will provide monitoring services, Bank makes all decisions about which software to load onto the servers, and what types and how much data to transmit using the servers.

ANALYSIS

Is there an identified asset? **Yes (Bank), No (Regional Hosting)**

See Identified Asset section for additional discussion.

Is the economic criterion met? **Yes (Bank Only)**

See Economic Criterion section for additional discussion.

Is the power criterion met? **Yes (Bank Only)**

Bank makes all decisions about which software to load onto the servers, and what types and how much data to transmit using the servers. Those are the relevant how and for what purpose decisions.

CONCLUSION

Bank concludes the contract contains a lease of the servers.

Example 9A (Adapted from paragraph 842-10-55-108 through 55-111) - Solar Farm**FACTS**

- ▶ County Electric Company (“CEC”) enters into a contract with Solar Power Co. (“Solar”) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract, Solar has no substitution rights, and the energy cannot be provided from another asset.
- ▶ CEC designed the solar farm before it was constructed - CEC hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Solar is responsible for building the solar farm to CEC’s specifications and then operating and maintaining it on a daily basis in accordance with industry-approved operating practices.
- ▶ Solar will receive tax credits related to the construction and ownership of the solar farm, while CEC receives renewable energy credits that accrue from the use of the solar farm.

ANALYSIS

Is there an identified asset? **Yes**

There is an identified asset because the solar farm is explicitly specified in the contract, and Solar does not have the right to substitute the specified solar farm.

Is the economic criterion met? **Yes**

CEC takes all the electricity produced by the farm, as well as receives the renewable energy credits that are a by-product from the *use* of the farm. Although Solar receives economic benefits from the solar farm in the form of tax credits, those credits relate to the *ownership* of the solar farm rather than from its *use*, and thus are not considered in the evaluation of the economic criterion. Accordingly, CEC receives 100% of the economic benefits from use of the solar farm.

Is the power criterion met? **Yes**

There are no decisions to be made during the period of use about whether, when, or how much electricity will be produced because the design of the asset has predetermined these decisions.

Although CEC does not operate the solar farm, its design of the farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, CEC’s control over that design is substantially no different from CEC controlling those decisions.

CONCLUSION

The contract contains a lease.

Example 9B (Adapted from paragraph 842-10-55-112 through 55-116) - Solar Farm**FACTS**

- ▶ Assume the same fact pattern as in Example 9A, except that Solar designed the solar farm when it was constructed prior to entering into the contract with CEC, and CEC had no involvement in that design.

ANALYSIS

Is there an identified asset? **Yes**

Same as Example 9A.

Is the economic criterion met? **Yes**

Same as Example 9A.

Is the power criterion met? **No**

As in Example 9A, the relevant decisions about how and for what purpose the solar farm is used are predetermined. However, in contrast to Example 9A, CEC is not considered to direct the relevant decision-making rights about the use of the solar farm because it did not design the solar farm and it does not operate the solar farm. Solar designed the solar farm and operates it, and therefore Solar has the right to direct the use of the farm.

CONCLUSION

The contract does not contain a lease.

OTHER ILLUSTRATIONS

The three concepts (identified asset, economic criterion and power criterion) are explored further through various additional examples below. Note that some of the examples may include nonlease components (which is discussed further in the next article on [Identifying and Separating Components](#)). The examples provided herein, and conclusions reached focus solely on whether the contract is or contains a lease.

Example 10 - Contract for Printer

FACTS

- ▶ Paper Co enters into a contract with Printers R Us for the exclusive use of a copy machine for three years. Under the contract, the copier is explicitly specified by serial number, but Printers R Us has the right to replace the copier at any time during the agreement, including in lieu of repairing it, without Paper Co's approval.
- ▶ While the contract specifies a location for the copier, Paper Co has the right to move the copier to any of its facilities upon three days written notice to Printers R Us which approval cannot be unreasonably withheld, conditioned or delayed. Paper Co also has the right to decide when to use the copier and when it uses it, how many copies it makes (subject to a limit of 5,000 copies per month).

ANALYSIS

Is there an identified asset? **Yes**

Although Printers R Us has the right to replace the copy machine at any time and without Paper Co's approval, such substitution would likely not generate an economic benefit for Printers R Us. As noted in paragraph 842-10-15-12, if the asset is located at the customer's premises, then the costs associated with substitution are likely to exceed the benefits associated with substituting the asset. Specifically, in this example Printers R Us would incur costs to substitute the copy machine, such as employee time and costs of transporting and installing another copy machine and removing and transporting back the original copy machine. It is not likely that events or circumstances would arise at contract inception from which Printers R Us would generate more cash flows by substituting the copy machine than the costs it would incur. In addition, as noted in paragraph 842-10-15-14, rights to substitute identified equipment solely for repairs and maintenance are not substantive. Accordingly, Printers R Us' substitution right is not substantive and there is an identified asset.

Is the economic criterion met? **Yes**

Paper Co has the right to obtain substantially all of the economic benefits from the use of the copier because it has exclusive use of the copier.

Is the power criterion met? **Yes**

While Printers R Us has the right to approve before Paper Co can move the printer to another location, Printers R Us' right is protective in nature. The 5,000-copy limit per month also protects Printers R Us' copier and in effect defines the scope of the contract. Within that scope, Paper Co has the right to direct the use of the copier, including when to use it and for how long, how many copies to make (subject to the limit) and where to use it throughout the three-year period. Those decisions are the relevant decisions that impact the economic benefits from use of the copier.

CONCLUSION

Therefore, the contract contains a lease.

Example 11 - Contract for Syrup Dispensers and Supplies

FACTS

- ▶ Pizzeria Co. enters into a syrup supply agreement with Beverage Co. under which Beverage Co. agrees to supply soft drink syrup to Pizzeria Co. for three years. In addition, Beverage Co. will provide dispensers that combine the syrup with CO₂ to deliver soft drinks to Pizzeria Co.'s customers.
- ▶ Pizzeria Co. is responsible for purchasing the CO₂ and for maintaining the dispensers, and the agreement prohibits Pizzeria Co. from using the dispensers with another supplier's syrup.
- ▶ Beverage Co. will provide two maintenance services per year per store to repair the dispensers at no charge, but additional maintenance visits will be charged on a time and materials basis.
- ▶ The contract stipulates a fixed monthly payment and a variable payment based on the volume of syrup purchased by Pizzeria Co.¹

ANALYSIS

Is there an identified asset? **Yes**

While the agreement does not explicitly specify the individual beverage dispensers, the units are implicitly specified because the dispensers are required for Beverage Co. to fulfill its promise under the arrangement, and once installed, Beverage Co. has no right to substitute the installed equipment.

Is the economic criterion met? **Yes**

Pizzeria Co. has exclusive use of the beverage dispensers.

Is the power criterion met? **Yes**

Pizzeria Co. has the right to direct the use of the dispensers including determining when and how often to use them. The fact that the agreement prohibits Pizzeria Co. from using the dispensers with another supplier's products is a protective right that defines the scope of the contract but does not prevent Pizzeria Co. from controlling the use of the dispensers.

CONCLUSION

The contract contains a lease.

¹ Other contract types with only variable payments and the right, but not the obligation, for Pizzeria Co. to purchase syrup from Beverage Co. require careful consideration of the specific facts and circumstances, including the price at which the consumables are sold and the significance of the equipment in the context of the contract.

Example 12 - Contract for Servers and Other IT Equipment Space**FACTS**

- ▶ The owner of a co-location warehouse (“Co-Lo”) enters into an agreement with Software Company (“Software”) under which Software will install its servers and other IT equipment used to host and run its software platform.
- ▶ The agreement identifies specific space within the larger warehouse for Software to use, and indicates that Co-Lo does not have the right to relocate Software’s equipment once it is installed.
- ▶ The space that Software will occupy does not represent substantially all of the capacity of the warehouse. However, Software is required to install cages and other barriers that segregate its equipment from the rest of the warehouse, thus effectively physically segregating the space it is using.

ANALYSIS

Is there an identified asset? **Yes**

Although the space is not initially a physically distinct portion of the larger warehouse and the space occupied does not represent substantially all of the capacity of the warehouse, the caging and other barriers required to be installed by Software render the space physically distinct and allow Software to control access to that specific space. In addition, Co-Lo has no ability to substitute comparable space throughout the term of the contract. Therefore, there is an identified asset.

Is the economic criterion met? **Yes**

Because Software has the right to control access to the specified space, it has the right to obtain substantially all of the economic benefits from use of the space (it has exclusive use of it).

Is the power criterion met? **Yes**

Software has the ability to make decisions about whether to use the space, and if so, when, how and how much to use the space.

CONCLUSION

The contract contains a lease.

Example 13 - Contract for Smart Safes

FACTS

- ▶ EZ Co owns and operates a group of convenience stores. EZ Co enters into an agreement with State Bank in which State Bank will provide armored car services to EZ Co for three years.
- ▶ During the term of the contract, State Bank will collect cash and checks from each store location three times per week, and those dates and times are predetermined in the contract and cannot be changed absent emergency situations.
- ▶ Assume that the armored car services do not include a lease because State Bank serves many customers with the armored cars and therefore those are not the subject of this example.
- ▶ State Bank also provides one smart safe for each store location. Once installed at EZ Co's locations, State Bank cannot substitute the smart safe. The smart safe is connected electronically to State Bank's system and will transmit the value of cash and checks deposited into the safe to State Bank such that EZ Co receives credit in its bank account with State Bank within 24 hours of that deposit.
- ▶ Only State Bank has the right and ability to access the smart safes. Once an EZ Co employee deposits cash or checks into the safe, EZ Co cannot retrieve those items prior to State Bank's armored car service collecting them. However, EZ Co decides when to make deposits, as well as how much cash to deposit versus how much to retain for operating purposes.

ANALYSIS

Is there an identified asset? **Yes**

Each smart safe is implicitly specified once it is installed at the convenience store location, and State Bank does not have any substitution rights.

Is the economic criterion met? **Yes**

EZ Co obtains substantially all of the economic benefits from use of the safes throughout the three-year period of use because it has exclusive use of those safes. No other customer of State Bank can use the safes.

Is the power criterion met? **Yes**

Although State Bank has the right to access the safes to collect the funds deposited in them, that access is predetermined in the contract (the dates and times are predetermined in the contract and cannot be changed absent emergency situations). The ability to access the safes also would not grant State Bank the right to determine how and for what purpose the safe is used given the fact that State Bank gives EZ Co access to funds deposited in the safe in EZ Co's bank account prior to the funds actually being collected by State Bank. On the other hand, EZ Co determines whether to use the safe, and if so, when to use it and how much cash and checks to deposit into the safe throughout the period of use. Those are the most relevant decision-making rights that affect the economic benefits from use of the safes, and EZ Co (the customer) controls them.

CONCLUSION

The contract contains a lease (each smart safe is a lease).

Example 14 - Contract for Offshore Drilling Rig

FACTS

- ▶ Big Oil Inc. (“BOI”) enters into an agreement with Drilling Company (“DrillCo”) whereby DrillCo will provide BOI with a specific offshore drilling rig for use in a specified geographical area in the Gulf of Mexico in which BOI has exclusive exploration rights. DrillCo has no other drilling rig in the Gulf of Mexico which could be used to fulfill the contract and DrillCo could not source another similar drilling rig within a reasonable period of time.
- ▶ DrillCo will provide the employees and management expertise necessary to operate the drilling rig. However, DrillCo will operate the rig under BOI’s instructions (for example, where to drill, how long to drill and at what depth, and where to drill next).
- ▶ The initial term of the agreement is two years and the agreement automatically renews for additional three-month periods unless either party provides a notice of non-renewal.
- ▶ During the period of the agreement, DrillCo will provide drilling services to BOI using the identified drilling rig.

ANALYSIS

Is there an identified asset? **Yes**

The agreement specifies the drilling rig and DrillCo has no other rig which can be used to fulfill the contract or that DrillCo could source within a reasonable period of time.

Is the economic criterion met? **Yes**

BOI receives substantially all of the output from use of the drilling rig because it has exclusive use of the rig. DrillCo cannot use the rig to provide services to any other customer during the term of the agreement, both contractually and practically, because BOI has exclusive exploration rights in that geographical area.

Is the power criterion met? **Yes**

Although DrillCo operates the drilling rig, and operating the rig is essential to the efficient use of the rig, the right to operate the rig is *dependent on* the relevant how and for what purpose decisions the rig is used (which are where to drill, how long to drill and at what depth, and where to drill next, etc.). BOI is the party that controls those relevant decisions throughout the period of use.

CONCLUSION

The contract contains a lease.

Example 15 - Contract for Processing Return of Handsets**FACTS**

- ▶ Telco enters into an agreement with Logistics Company which requires Logistics Company to build a warehouse in a specified geographic area. Logistics Company is the legal owner of the warehouse and continues to be throughout the term of the contract.
- ▶ Assume that the agreement does not result in Telco controlling the warehouse under construction based on the guidance in paragraph 842-40-55-5.
- ▶ While Logistics Company has some latitude in selecting the location of the warehouse, it must be located in the specified area, and once constructed it cannot be relocated or substituted, even within the specified area, absent extraordinary circumstances (for example, destruction by fire).
- ▶ For the five-year term of the agreement, Logistics Company will process all returned handsets directed by Telco to this warehouse pursuant to repair instructions provided by Telco. If Telco does not direct handsets to the warehouse, then the warehouse does not operate. Logistics Company is not allowed to service any customers other than Telco in the warehouse under the agreement.
- ▶ Logistics Company is required to operate and maintain the warehouse daily in accordance with industry-approved operating procedures.

ANALYSIS

Is there an identified asset? **Yes**

Once the location is selected and the warehouse constructed, Logistics Company does not have the right to substitute the specified warehouse location.

Is the economic criterion met? **Yes**

If Telco does not direct handsets to the warehouse, the warehouse does not operate because Logistics Company is not allowed to service other customers. In other words, Telco has exclusive use of the warehouse.

Is the power criterion met? **Yes**

Telco makes the relevant decisions about how and for what purpose the warehouse is used because it has the right to determine whether, when and how many handsets are processed in the warehouse. Because Logistics Company is precluded from using the warehouse for any other customer or purpose, Telco's decision making about the timing and quantity of handsets processed in effect determines whether and when the warehouse will be utilized.

CONCLUSION

The contract contains a lease.

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