

# Regulatory Notice

19-08

## FOCUS Reporting

### Guidance on FOCUS Reporting for Operating Leases

#### Summary

In October 2018, the staff of the SEC Division of Trading and Markets (the SEC staff) issued no-action relief<sup>1</sup> (the no-action relief letter) regarding the treatment of operating leases under SEA Rule 15c3-1 (Rule 15c3-1) in connection with the Financial Accounting Standards Board's (FASB) Accounting Standards Update for Leases (the Lease Accounting Update).<sup>2</sup> Based on discussions with the SEC staff, and in response to member inquiries, FINRA is issuing this *Notice* to provide guidance to members for reporting lease assets and lease liabilities on their FOCUS reports.<sup>3</sup>

Members should apply the guidance in this *Notice* going forward when preparing their FOCUS reports. Members are not required to refile any FOCUS reports that they have already submitted to comply with this guidance.

Questions concerning this *Notice* should be directed to:

- ▶ Yui Chan, Senior Director, Risk Oversight & Operational Regulation (ROOR), at (646) 315-8426 or [Yui.Chan@finra.org](mailto:Yui.Chan@finra.org);
- ▶ Ann Duguid, Senior Director, ROOR, at (646) 315-7260 or [Ann.Duguid@finra.org](mailto:Ann.Duguid@finra.org); or
- ▶ Anthony Vinci, Director, ROOR, at (646) 315-8335 or [Anthony.Vinci@finra.org](mailto:Anthony.Vinci@finra.org).

#### Background & Discussion

##### SEC Staff's No-Action Relief

The FASB's Lease Accounting Update introduced changes to the treatment of operating leases by requiring that a lessee must include on its balance sheet an asset and liability arising from an operating lease.<sup>4</sup> However, in the no-action relief letter, the SEC staff noted that under paragraph (c)(2)(iv) of Rule 15c3-1,<sup>5</sup> the operating lease asset would be a non-allowable asset for purposes of determining net worth. As such, absent relief, a broker-dealer lessee would need to deduct the operating lease asset from its net worth when computing net capital. Further, the SEC staff noted that a broker-dealer

March 19, 2019

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Finance
- ▶ Legal
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Senior Management

#### Key Topics

- ▶ FOCUS Reporting

#### Referenced Rules & Notices

- ▶ SEA Rule 15c3-1
- ▶ SEA Rule 17a-5
- ▶ Form X-17A-5



Financial Industry Regulatory Authority

lessee using the aggregate indebtedness standard under Rule 15c3-1 to determine its minimum net capital requirement would be required to include the operating lease liability in its aggregate indebtedness calculation.

In the no-action relief letter, the SEC staff stated that it will not recommend enforcement action to the Commission under Rule 15c3-1 in the following circumstances:

- ▶ if a broker-dealer computing net capital adds back an operating lease asset to the extent of the associated operating lease liability. The SEC staff stated that a broker-dealer cannot add back an operating lease asset to offset an operating lease liability unless the asset and the liability arise from the same operating lease and the amount of the asset as to each lease may not exceed the liability arising from that lease;
- ▶ if a broker-dealer determining its minimum net capital requirement using the aggregate indebtedness standard does not include in its aggregate indebtedness an operating lease liability to the extent of the associated operating lease asset. The SEC staff stated that if the value of the operating lease liability exceeds the associated operating lease asset, the amount by which the lease liability exceeds the lease asset must be included in the broker-dealer's aggregate indebtedness.

### FOCUS Reporting Guidance

To assist members in their FOCUS reporting obligations, and in response to member inquiries, FINRA is providing the following guidance to members for reporting lease assets and lease liabilities on their FOCUS reports based on discussions with the SEC staff.

#### To Report the Operating Lease Asset on FOCUS Report Part II, Part IIA and Part II CSE

- ▶ Members should report the *operating lease asset* on the line "Property, furniture, equipment, leasehold improvements and rights under lease agreements" as follows:
  - ▶ report the portion of the asset to be added back in Box 490 (under the "Allowable" column);
  - ▶ report any non-allowable portion of the asset in Box 680 (under the "Non-Allowable" column).

#### To Report the Operating Lease Liability...

...On FOCUS Report Part II

- ▶ Members should report the *operating lease liability* on the line "Accounts payable and accrued liabilities and expenses – F. Other" as follows:
  - ▶ report the portion that is not an aggregate indebtedness liability in Box 1380 (under the "Non-A.I. Liabilities" column);
  - ▶ report the portion that is an aggregate indebtedness liability in Box 1200 (under the "A.I. Liabilities" column).

...On FOCUS Report Part IIA

- ▶ Members should report the *operating lease liability* on the line “Accounts payable, accrued liabilities, expenses and other” as follows:
  - ▶ report the portion that is not an aggregate indebtedness liability in Box 1385 (under the “Non-A.I. Liabilities” column);
  - ▶ report the portion that is an aggregate indebtedness liability in Box 1205 (under the “A.I. Liabilities” column).

...On FOCUS Report Part II CSE

- ▶ Members should report the *operating lease liability* on the line “Accounts payable and accrued liabilities and expenses – F. Other” in Box 1680.

As noted above, members should apply the guidance in this *Notice* going forward when preparing their FOCUS reports. Members are not required to refile any FOCUS reports that they have already submitted to comply with this guidance.

## Endnotes

1. See letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, SEC, to Securities Industry and Financial Markets Association (SIFMA) (October 23, 2018), available on the [SEC website](#).
2. See FASB ASU No. 2016-02, Leases (Topic 842) (February 2016), available on the [FASB website](#). For broker-dealers generally, the Lease Accounting Update is effective for fiscal years beginning after December 15, 2018.
3. “FOCUS” stands for Financial and Operational Combined Uniform Single. Pursuant to SEA Rule 17a-5, members are required to file with FINRA, through the eFOCUS System, reports concerning their financial and operational status using SEC Form X-17A-5 (referred to as the FOCUS Report). Members must submit their FOCUS Reports electronically through the eFOCUS System via the FINRA Firm Gateway.
4. The SEC staff noted that, under U. S. generally accepted accounting principles (GAAP) prior to the effectiveness of the Lease Accounting Update, a lessee was not required to record an asset or liability on its balance sheet with respect to an operating lease.
5. Paragraph (c)(2)(iv) generally requires broker-dealers to deduct fixed assets and assets which cannot be readily converted into cash from their net worth for purposes of computing net capital.