Ms. Susan M. Cosper
Technical Director
File Reference No. 2018-310
Financial Accounting Standards Board
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15 January 2019

Proposed Accounting Standards Update, Leases (Topic 842) — Codification Improvements for Lessors (File Reference No. 2018-310)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), Leases (Topic 842) — Codification Improvements for Lessors, issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB’s objective to address stakeholders’ concerns by adding guidance in Accounting Standards Codification (ASC) 842 that is similar to the guidance in ASC 840-10-55-44 and would allow lessors that are not manufacturers or dealers to use their cost, less any volume or trade discounts, as the fair value for the underlying asset as long as there isn’t a significant amount of time between the acquisition of the asset and lease commencement.

We also support the FASB’s objective to address stakeholders’ concerns about a conflict between the guidance in ASC 842 and ASC 942, Financial Services — Depository and Lending, on how to classify principal payments received from sales-type and direct financing leases in the statement of cash flows.

We do not believe the proposed amendments would result in a reduction of decision-useful information. We also agree with the FASB’s decision on the effective date of the proposed amendments, including the option for early application.

In addition, we believe the proposed amendments would be operable since they do not represent a change from existing practice followed by many of the affected lessors. However, we encourage the Board to consider any feedback provided by those lessors.

Finally, we agree with the FASB’s decision on the application date and transition methodology of the proposed amendments. However, we believe certain aspects of the proposal relating to the transition guidance should be clarified.

This cover letter addresses our responses to the questions in the proposed ASU as well as two additional items unrelated to the proposed amendments (below) that are time sensitive because many entities have already adopted the new leases standard.
The appendix includes our recommendations of three areas where we believe the FASB should edit the language relating to the transition guidance.

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We recommend that the FASB take this opportunity to clarify whether the guidance in ASU 2018-20, Leases (Topic 842) — Narrow Scope Improvements for Lessors, applies broadly to all variable payments related to lessor costs paid by lessees to third parties.

We agree that the amendments in ASU 2018-20 address concerns raised by stakeholders about the accounting for certain lessor costs paid directly by lessees to third parties on the lessor’s behalf.

However, we believe the FASB should clarify whether or not it intended this guidance to be applied broadly (i.e., beyond variable payments related to insurance and taxes on the leased property). For example, questions have arisen in practice about whether a sublessor could apply the amendments in ASU 2018-20 when, under the terms of a separately negotiated sublease contract, the sublessee makes variable payments based on its operations (e.g., variable payments based on a percentage of the sublessee’s retail sales) directly to the head lessor. That is, it is unclear whether the FASB intended the exception to apply to the sublessor’s lease accounting as a lessee.

We also recommend that the FASB take this opportunity to clarify the transition guidance in ASC 842-10-65-1(i) related to interim disclosures provided in the year in which the new leases standard is adopted. We believe the issue is particularly time sensitive because it relates to transition guidance and it can be easily implemented along with the proposed codification improvements.

ASC 842-10-65-1(i) requires an entity to provide the transition disclosures required by Topic 250, Accounting Changes and Error Corrections, except for annual period disclosures otherwise required by ASC 250-10-50-1(b)(2) relating to the effect of the change on continuing operations and net income (and affected per share amounts). However, since the transition guidance does not explicitly exclude similar interim disclosures required by ASC 250-10-50-3, it may appear that such interim disclosure information is required.

We recommend that the Board revise ASC 842-10-65-1(i) as follows: “An entity shall provide the transition disclosures required by Topic 250 on accounting changes and error corrections, except for the requirements in paragraph 250-10-50-1(b)(2) and paragraph 250-10-50-3. An entity that elects the transition method in (c)(2) shall provide the transition disclosures in paragraph 250-10-50-1(b)(3) as of the beginning of the period of adoption rather than at the beginning of the earliest period presented.”

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP
Appendix – Recommendations to clarify transition guidance

We have the following recommendations related to the proposed guidance:

► We recommend that the FASB make the following edit to proposed ASC 842-10-65-4(a) to match the language in ASC 842-10-65-1(a) that makes a specific distinction between public business entities and certain not-for-profit entities and employee benefit plans and “all other entities”:

“All entities A public business entity, a not-for-profit entity that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years for those entities within the scope of paragraph 842-10-15-1(a). All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted.”

► We recommend that the Board revise proposed ASC 842-10-65-4(b) to say: “An entity shall apply the pending content that links to this paragraph at the date that an entity first applied or applies the pending content that links to paragraph 842-10-65-1 and shall apply the same transition method elected for the pending content that links to paragraph 842-10-65-1 in accordance with paragraph 842-10-65-1(c).”

► To be consistent with the transition guidance in ASC 842-10-65-1(a) and with our suggested edits to proposed ASC 842-10-65-4(a), we recommend that the Board revise the paragraph in the “What Are the Transition Requirements and When Would the Amendments Be Effective?” section and paragraph BC17 of the Background Information and Basis for Conclusions of the proposed ASU to say: “An employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission (SEC).”