BDO

Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

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Via email to director@fasb.org

Ms. Hillary H. Salo, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Leases (Topic 842): Targeted Improvements (File Reference No. 2020-700)

Dear Ms. Salo:

We appreciate the opportunity to respond to the Board's exposure draft on targeted improvements to Topic 842, *Leases*, and support the efforts to address application issues arising under the new standard.

We agree with the Board's proposed changes on classification by lessors for certain leases with variable payments, as well as the proposed option for lessees to remeasure the lease liability when a change to the lease payments resulting from a change in a reference index or a rate takes effect. In our view, both proposed amendments would result in improvements to the guidance in Topic 842.

We also support the Board's efforts to simplify and reduce costs in the application of the lease modification guidance. However, we are concerned that the proposed amendments may result in increased costs of compliance for all entities that outweigh the potential benefits if the number of modifications that qualify for relief under the simplified modification model is not sufficiently large. We also note that the modification guidance in Topic 842 is generally consistent with the contract modification guidance in Topic 606, *Revenue from Contracts with Customers*. We therefore ask the Board to consider a more holistic approach for changing the modification guidance, including other potential changes. Nevertheless, should the Board decide to finalize the proposed amendments, we believe the Board should provide additional guidance to promote consistent application in practice. Our detailed responses and suggestions to the Questions for Respondents are contained in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Thomas Faineteau at (214) 243-2924 or Angela Newell at (214) 689-5669.

Very truly yours,

BDO USA, LLP

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Appendix

Issue 1: Sales-Type Leases with Variable Lease Payments – Lessor Only

Question 1—Are the amendments in this proposed Update operable? Why or why not?

We believe the amendments in this proposed update are operable because the threshold (predominant) is already used by lessors in evaluating the practical expedient not to separate under paragraph 842-10-15-42B and is intended to mean "majority." We also note lessors generally should be able to perform the assessment without undue costs since they typically have the information necessary to assess variable lease payments in their contracts.

Question 2—Should a lessor be required to classify and account for a sales-type lease with predominantly variable lease payments that do not depend on a reference index or a rate as an operating lease? Why or why not?

We believe the proposed requirement for a lessor to classify and account for a sales-type lease with predominantly variable lease payments that do not depend on a reference index or rate as an operating lease is a practical solution to address the day-one loss that would otherwise be recognized under Topic 842. We do not believe the day-one loss currently recognized for certain leases aligns with the economics of the transaction when the lessor expects the arrangement to be profitable overall and, therefore, we support the proposed changes.

Question 3—Should "predominant" be the threshold for determining when a lessor should classify a lease with variable payments that do not depend on a reference index or a rate as an operating lease? Alternatively, would another threshold be more appropriate and operable (for example, "substantially all")? Please provide your rationale.

In our view, "predominant" is an appropriate threshold that should address most leases with the day one loss issue. It is possible that a day one loss may still arise for some leases. For example, certain leases with variable payments that represent less than the majority of payments may still result in a day one loss. Conversely, a lease in which a majority of the payments are variable payments may nonetheless result in a day one gain. While the use of "predominant" may not capture all instances in which a lessor may incur a day one loss, and may capture situations in which a day one gain is currently being recognized, in our view it would still nonetheless represent an appropriate balance.

Question 4—Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

We generally defer to users of financial statements for this question. However, as noted above, the proposed amendments would align the transaction more closely with the economics which we think will be helpful for users of financial statements. Further, we suggest that the Board consider a requirement that lessors disclose the fact that certain leases were classified as operating leases based on paragraph 842-10-25-3A.

Issue 2: Option to Remeasure Lease Liability—Lessee Only

Question 5— Are the proposed amendments operable? Why or why not?

We agree that the proposed amendments are generally operable considering that the proposed changes permitting lessees under Topic 842 to remeasure the lease liability for a change in a reference index or a rate upon which some or all of the variable lease payments are based are intended to be consistent with the requirements under IFRS 16, and those requirements are already applied by entities reporting under IFRS. However, we ask the Board to consider aligning the proposed amendment in paragraph 842-10-35-4A with paragraph IFRS 16.42(b) and the proposed language in Example 25, Case A (paragraphs 842-10-55-226 through 55-231A) with the language in Example 14A (IFRS 16: *Leases - Illustrative Examples*) to promote consistent application between U.S. GAAP and IFRS as it relates to when the change in payments "takes effect."

Question 6— Should a lessee be provided with an option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based? Why or why not?

While the Board in ASU 2016-02, *Leases (Topic 842)* initially decided to prohibit remeasuring lease liabilities solely for changes in a reference index or a rate based on feedback that the benefits of remeasurement would not justify the costs, we believe lessees should be provided with an option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based. This would allow entities reporting under both U.S. GAAP and IFRS to simplify their accounting and system requirements. The lease liabilities reported under the proposed election also would more closely align with the future payment obligations at the reporting date.

Question 7— Should a lessee be required to make an entity-wide accounting policy election to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based? Why or why not? If not, at what level should that accounting policy election be required to be applied?

We generally believe that an entity-wide accounting policy election would be appropriate as this would maintain the quality and consistency of financial information provided to users of the financial statements. Further, this would eliminate cost burdens on preparers for maintaining potentially different policies at lower levels, such as at an operating entity level.

Question 8— Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

In our view, the proposed amendments would generally provide improved decision-useful information on the statement of financial position. As noted above, for entities that elect to apply the proposed amendments, the lease liabilities would more closely align with the future payment obligations at the reporting date.

Question 9— Would the comparability of information be significantly affected by the option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based?

We note that there would be differences when comparing entities that elect or do not elect the proposed amendments applying U.S. GAAP. However, these differences would relate to the reported lease liabilities and would not affect the total lease cost recognized in a reporting period. Further, there are other aspects of Topic 842 for which entities may make different elections and which already impact comparability (e.g., election to not separate lease and nonlease components, election related to short-term leases, both of which are made by asset class).

Issue 3: Modifications Reducing the Scope of a Lease Contract

Question 10— Are the proposed amendments operable? Why or why not?

As discussed in our cover letter, if the Board believes that changes to the existing modification model in Topic 842 are needed, we encourage the Board to consider a more holistic approach. In particular, we believe the Board should consider other potential changes to the modification guidance resulting from feedback received on this proposed Update, and consider the alignment in modification guidance that currently exists with Topic 606. See our response to Question 12 for further details.

However, should the Board decide to continue with the proposed changes, we ask that the Board provide additional guidance and clarifications to ensure that the proposed amendments are applied consistently. In particular, we believe the proposed guidance in paragraph 842-10-25-8B(c) is not sufficiently clear and may result in inconsistent application or further application issues. For example, there may be modifications that reduce the term (e.g., from eight to five years) of one or more but not all lease components without terminating that component(s), while also changing the payments for the remainder of the revised lease term. The original contract may also contain a single payment for all components of the contract, such that after the change, the modified contract provides a single revised payment for the remaining components. In those situations, it is unclear whether and how the change in payments would be considered under paragraph 842-10-25-8B(c). That analysis could be further complicated if the contract includes nonlease components that are accounted for separately by the entity, or the contract provides for variable payments (for example, payments based on usage of the underlying asset). Lessees currently are not required to estimate variable payments under Topic 842, but entities do estimate variable payments under Topic 606. Because the Board notes in paragraph BC26 that the analysis of the payments is a critical element of the proposed guidance, we encourage the Board to provide additional guidance, including illustrations, to clarify those aspects, including the interaction with the modification model in Topic 606, and to promote consistency in application.

We also note that the proposed amendments would be a requirement (as opposed to an option). Therefore, entities would need to implement additional processes and controls to address this new requirement, while it is unclear whether the proposed amendments would address a sufficiently large number of modifications to justify those costs. Accordingly, there would be additional costs to implement the proposed requirements with unclear benefits if many arrangements would not qualify for the proposed amendments.

Question 11— Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

We defer answering this question pending further consideration of question 10 above.

Question 12— Are there other aspects of the modification accounting model in Topic 842 that could be improved without compromising the decision usefulness of the information provided?

There are other modifications for which the changes in terms and conditions to the lease contract result in changes in scope or consideration that are insignificant. However, if the contract includes only one lease component, those modifications would not meet the scope conditions of the proposed amendments, and therefore an entity would be required to reassess classification and reconsider inputs such as the economic life and fair value of the underlying asset, using an updated discount rate. Those lease classification reassessments may also result in a change in classification solely based on the passage of time. In other words, the issues identified in the accounting for modifications to master lease agreements may also exist for other modifications. We would therefore ask the Board to consider potential changes to the modification guidance holistically, rather than addressing solely (or first) modifications reducing the scope of a lease contract, and to develop a framework or principle-based approach that would apply to more modifications rather than just a subset of modifications. However, we also acknowledge that the current guidance is generally aligned with Topic 606 and therefore believe that the Board should perform additional research and outreach prior to making changes to the modification guidance.

Transition

Question 13— For entities that have not adopted Topic 842 by the effective date of a final Update of these proposed amendments, should the proposed amendments be applied at the date that an entity first applies Topic 842 using the same transition methodology in accordance with paragraph 842-10-65-1(c)? Why or why not?

We generally agree that the proposed amendments should be applied at the date that an entity first applies Topic 842 using the same transition methodology in accordance with paragraph 842-10-65-1(c).

Question 14— For entities that have adopted Topic 842 by the effective date of a final Update of these proposed amendments, should the proposed amendments be applied either retrospectively or prospectively as described in this proposed Update? Why or why not?

We support giving entities that have already adopted Topic 842 by the effective date the option to apply the final amendments either retrospectively or prospectively, as this will allow entities to assess which adoption method is most cost-effective based on their specific circumstances.