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Technical Director, Financial Accounting Standards Board

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Re: Proposed Accounting Standards Update *Leases – Targeted Improvements* (Topic 842)

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 42,600 members. The Committee consists of 54 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

Committee's Views on the Proposed ASU

The Committee generally supports the improvements in the proposed ASU, although we do have a number of suggestions enumerated below.

We are concerned with the effect of these proposals on entities that issue financial statements in accordance with both generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS). The Board decided that the amendments in this proposed Update are expedient in order to simplify the implementation and ongoing application of Topic 842 for preparers and would either improve or maintain the decision usefulness of information provided in financial statements. The differences in the requirements in Topic 842 and IFRS 16 are one of the factors that create ongoing costs and complexity, primarily because preparers are required to maintain separate lease records for GAAP and IFRS Standards reporting purposes. In the proposed Update, the Board accommodated those who wish to avoid the costs of dual record keeping by making the adoption of the Remeasurement of the Lease Liability (Issue 2) optional, thereby allowing each entity to select the method that is most cost-effective for its circumstances.

However, with respect to accounting for Sales-Type Leases with Variable Lease Payments (Issue 1) and Modifications Reducing the Scope of a Lease Contract (Issue 3), the requirements under Topic 842 and IFRS 16 are not exactly the same. If the Board's proposal is adopted as exposed, it will create additional differences between Topic 842 and IFRS 16, and impose additional costs on entities that issue financial statements in accordance with both GAAP and IFRS. We recommend that the Board explore ways to avoid this; alternatives might be to make adoption of the accounting under Issues 1 and 3 optional, or to permit entities reporting under GAAP to use IFRS for those transactions.

More desirable would be to try to work with the International Accounting Standards Board to converge the standards in these two areas.

The following are our responses to the Questions in the proposal.

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?

Yes. They are reasonably clear and should not be difficult to comply with.

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?

Yes, for the reasons in the proposed ASU.

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.

Yes. It should allow a reasonable amount of judgment in implementation and is not unduly rigid. However, several members of the Committee are concerned with how "predominant" is to be interpreted. The term may not be as well understood as "substantially all," which might be too high a threshold, and "majority" which might be too quantitative. These members suggest that the Board provide explanation or examples of how the term is to be applied.

Several members of the Committee voiced a concern that a lease with a mix of fixed and variable payments where the fixed payments were less than the cost of the assets under lease, and the variable payments are expected to result in profit on the transaction but were not the predominant part of the lease payments. (E.g., an asset costing $60 is leased for $55 fixed payments and estimated $45 variable payments.) They believe the scope of the proposed ASU should be expanded to include these situations. The issue is essentially the same as the core issue dealt with in the proposal.

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

Yes. It is better than the current requirement which can result in an accounting loss when, in fact, a loss has not been incurred.

Issue 2: Option to Remeasure Lease Liability—Lessee Only

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

Yes. Implementation of IFRS 16 has demonstrated that they are operable.

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?

Yes. While some might believe it is conceptually preferable to have one method for all changes in a reference index or a rate on which payments are based, we prefer that if an entity considers it more cost effective to not remeasure, it should be able to maintain the more cost-effective measurement. If the difference is material, it can be disclosed in the notes to the financial statements.

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?

It should be adopted on an entity-wide basis. An entity should determine what accounting policy it is adopting and apply it across the entity. To not do it entity-wide complicates analysis by users of the financial statements.

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

The information might be more decision-useful for some users of the financial statements, but it can be imparted in the notes to the financial statements so it can be available to those users.

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 do not know how broad this issue is, but if the information is provided either on the face of the financial statements or notes thereto, any comparability concerns would be met.

Issue 3: Modifications Reducing the Scope of a Lease Contract

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

Yes, we believe the proposed amendments are operable, and may be easier to comply with than the current requirements.

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

Yes, they will provide a more faithful representation of a transaction than the existing requirements.

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?

The Committee has not studied the other aspects of the modification accounting model in Topic 842 sufficiently to make any comment.

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 agree with the Board that it should be applied as of the first date that the entity applies Topic 842.

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?

The transition options proposed are appropriate. Calculations can be complex, and retrospective application may be unduly costly.

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We thank you for the opportunity to comment on these matters. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

Nancy A. Rix, Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants