FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Leases (Topic 842)—Discount Rate for Lessees That Are Not Public Business Entities

September 15, 2021

Meeting Purpose

1. The purpose of this handout is to provide a summary of the 20 letters received in response to the proposed Accounting Standards Update, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*, which was issued for comment on June 16, 2021, with a 30-day comment period and serve as the basis for the Board's redeliberations.

Questions for the Board

Issue 1: Scope, Method, Effective Date, and Transition

1. Does the Board want to adjust the transition disclosure requirements for lessees that already adopted Topic 842 to require disclosure of the amount of the transition adjustment?

2. Does the Board want to affirm the following decisions from the April 14, 2021 Board meeting?

a. Allow a lessee that is not a public business entity to make the risk-free rate accounting policy election by class of underlying asset.

b. Require a lessee making the risk-free rate accounting policy election to disclose its election, including the asset class to which it has made the accounting policy election.

c. Retain a risk-free rate for the discount rate accounting policy election, rather than another specified rate.

d. Require a lessee that is not a public business entity to use the rate implicit in the lease when it is readily determinable instead of the risk-free rate.

e. Provide the transition methods and effective dates for entities that have adopted Topic 842 and those that have not yet adopted Topic 842 as described in Appendix A.

Issue 2: **Weighted-Average Discount Rate Disclosure**

3. Which alternative does the Board prefer for the weighted-average discount rate (WADR) disclosure?

a. *Alternative A*: Require a lessee that uses the risk-free rate election to separately disclose the WADR for the risk-free rate and all other discount rates (the incremental borrowing rate and rate implicit in the lease).

b. *Alternative B*: Continue to require a lessee to disclose a combined WADR for all leases.

Permission to Ballot

4. Does the Board believe that the benefits provided by the proposed amendments (including the staff's recommendations) justify the cost?

5. Does the Board give the staff permission to draft a final Update for vote by written ballot?

Project Background

2. This project relates to the accounting policy election in Topic 842, Leases, that allows lessees that are not public business entities to use a risk-free rate as the discount rate for all leases. A lessee's discount rate is essential because it directly affects lease classification (operating or finance) and the measurement of a lessee's lease liability and corresponding right-of-use (ROU) asset. For entities transitioning to Topic 842, the discount rate is determined as of the application date of the standard, and afterwards it is determined at the commencement date of the lease and subsequently is updated only upon the occurrence of certain types of lease modifications. In an operating lease, the discount rate does not affect the income statement or statement of cash flows because lease payments are recognized on a straight-line basis. In a finance lease, the discount rate does not affect total cost over the life of the lease but affects the amounts recognized as interest and amortization and the timing of this recognition, which affects both the income statement and the statement of cash flows. This project does not affect lessors who always use the rate implicit in the lease to record leasing transactions.

3. Topic 842 requires a lessee to use the rate implicit in the lease when it is readily determinable, and to use its incremental borrowing rate (IBR) if it is not. The staff understands that the application of both Topic 840, Leases, and Topic 842, in practice, have resulted in the rate implicit in the lease not being "readily determinable" in most lease arrangements.

The IBR is a collateralized rate that reflects the lessee's credit and the length of the lease. Topic 842 allows an entity-wide accounting policy election (the "risk-free rate election") for lessees that are not public business entities. The Board provided that election after concluding that it could be too costly for some of those entities to determine their IBRs. That election allows a lessee to use a risk-free rate, determined using a period comparable with that of the lease term, as the discount rate for all of its leases.

4. The risk-free rate election is limited to entities that are not public business entities. According to the definition of *public business entity* in the Master Glossary, not-for-profits (including a conduit bond obligor) and employee benefit plans are not public business entities and, therefore, are permitted to make the risk-free rate election. This handout refers to entities eligible to elect the risk-free rate election generally as "private companies," but the staff acknowledges that these other entities also would be affected by the discussion herein.

5. While the risk-free rate election was intended to reduce the costs of applying Topic 842 for private companies, some private company stakeholders expressed reluctance to use the election. The reason for that reluctance is that in the current economic environment, the risk-free rate (such as the treasury rate) is low compared with the average IBR. The low risk-free rate can cause an overstatement of an entity's lease liabilities and leases that otherwise would be classified as operating being classified as financing leases. The risk-free rate will be lower than an entity's IBR because the IBR reflects its credit standing. Both rates are expected to be lower than the rate implicit in the lease, which reflects the lessor's pricing of the lease. During the pandemic, the risk-free rate reached a very low level, and some have argued that using the risk-free rate election provides similar results to using undiscounted cash flows.

6. At the September 18, 2020 public roundtable sessions on leases, a private company stakeholder proposed amending the accounting policy to allow a private company to elect the risk-free rate by class of underlying asset. Additionally, during outreach some private company stakeholders questioned using a risk-free rate as the discount rate in the accounting policy instead of another specified rate, such as a corporate bond upper medium grade rate or lower medium grade rate (generally interpreted as A or BBB ratings).

7. Through initial research for the project, another question regarding the risk-free rate election came to the staff's attention. Stakeholders noted that there was ambiguity in the standard about whether an entity using the entity-wide risk-free rate election should use the rate implicit in the lease, when readily determinable, or whether they would be precluded from doing so. The staff agreed that there was ambiguity in the current standard and included the topic within the scope of the project.

8. The Board added the project to the agenda in April 2021. A proposed Update was issued on June 16, 2021, with a 30-day comment period. The proposed Update would allow a lessee to use the risk-free rate election by asset class rather than at the entity-level and require a lessee to use the rate implicit in the lease whenever readily determinable, rather than the incremental borrowing rate or the risk-free rate.

Comment Letter Feedback Summary

9. Twenty comment letters were received on the proposed Update. The level of detail in the feedback received from each respondent varied. Not all respondents addressed every question. Some focused on specific questions, while others provided comments on all questions. The following table provides the composition of the comment letter respondents by respondent type:

Type of Respondent	Number of Respondents
Practitioners	**11**
Preparers	**1**
State CPA Societies	**3**
Trade Group Representatives	**4**
Other	**1**
Total Respondents	**20**

10. All respondents commenting on the operability of the amendments in the proposed Update agreed that they are operable (Question 1 in the proposed Update). Respondents also generally agreed that the additional flexibility provided by the proposed Update would reduce both implementation costs and ongoing costs to the extent that more entities that are not public business entities make the risk-free rate election (Question 2 in the proposed Update).

11. General comment letter feedback on the proposed Update is presented in Issue 1. Comment letter feedback on the questions in the proposed Update specific to weighted-average discount rate (WADR) disclosures, along with feedback from additional outreach on the disclosures in question, are presented in Issue 2.

Issue 1: Scope, Method, Effective Date, and Transition

Comment Letter Summary—Election and Disclosure by Class of Underlying Asset

12. Questions 3 and 4 in the proposed update asked whether a lessee that is not a public business entity should be allowed to make the risk-free rate election by class of underlying asset and whether it should be required to disclose to which classes of assets is has been

applied. Eighteen respondents commented on those questions. Nearly all respondents supported the Board's decision to allow an entity that is not a public business entity to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level. The following comment is an example of typical feedback received:

> We support the ability for entities that are not a public business entity to be permitted to make the risk-free rate election by class of underlying asset because we believe it will reduce cost. In addition, we believe it is likely that the overall accuracy and comparability of financial statements will be improved because many entities that would have otherwise applied the risk-free rate to all leases to save costs that would have been incurred on small leases that are frequently entered into or modified will elect to determine an incremental borrowing rate for their most significant leases that are large and infrequently entered into. [CL #19]

13. One trade group recommended that the Board consider further enhancing the flexibility by allowing entities to make the risk-free rate election on a lease-by-lease basis. The respondent asserted that the ability to make the election on a lease-by-lease basis may create a smaller recognition and measurement difference between public and private entities, while providing additional flexibility. This trade group asserted that this flexibility would allow an entity to use the risk-free rate on an immaterial lease within an asset class and to determine the IBR on a material lease within the same asset class. However, the trade group supported making the election at the asset class level if the Board decided not to pursue this alternative.

14. Nearly all respondents supported the Board's decision to require that an entity making the risk-free rate election disclose that fact and to which asset classes it has elected to apply the risk-free rate.

15. One trade group disagreed with the Board's decision to require the disclosure and instead recommended a "red-flag approach," as described in the Private Company Decision Making Framework (PCDMF). One state CPA society did not object to adding the disclosure but said it will provide limited useful information to users. That respondent noted that the disclosure could be misleading when an underlying asset class is significantly affected by the requirement to use the rate implicit in the lease.

Comment Letter Summary—Another Specified Discount Rate

16. Question 6 in the proposed Update asked stakeholders to comment on whether replacing the risk-free rate in the election with another specified rate would be operable and what effect doing so would have on the cost of applying Topic 842. Most respondents supported the Board's decision to retain the risk-free rate as the discount rate in the accounting policy election. Many cited the reasons provided in paragraph BC18 of the proposed Update as support for not considering another rate. Those respondents commented that the use of another specified rate, such as a corporate bond rate, would add additional cost and

complexity. This is because those rates are typically not publicly available and represent a composite rate that could generate questions about the population and methods used to derive it. They also noted that although the risk-free rate is an arbitrary rate, choosing another rate would not represent a significant improvement over the use of the risk-free rate because it also would be arbitrary. One state CPA society commented that another rate would be preferable but acknowledged that it has not identified how to make an alternative rate operable. The following are two representational comments:

> We do not believe the use of another rate, such as a corporate bond rate, would be operable. We believe it would increase complexity of application by reporting entities as well as create unnecessary complexity for auditors. Risk-free rates tend to be made publicly available by reliable sources, while corporate bond rates might not be. Even if available, a corporate bond rate might need to be adjusted for the characteristics (e.g., prepayment options) of the instrument used to determine the published rate. [CL #8]

> We believe there are a number of practical issues that would make the use of [a corporate bond rate or an average of corporate bond rates] difficult. For example, including corporate bonds that are prepayable would presumably not be appropriate for determining the discount rate because it would not reflect the terms of the financing provided by the lease (i.e., the lease liability is not prepayable). While the use of a corporate bond rate rather than the risk-free rate would be closer to the incremental borrowing rate, we do not believe it would represent a significant improvement over the use of the risk-free rate. [CL #20]

Comment Letter Summary—Rate Implicit in the Lease

17. The amendments in the proposed Update would require a lessee that has made the risk-free rate election to use the rate implicit in the lease when that rate is readily determinable. Question 7 in the proposed Update solicited feedback on this proposed amendment. Nearly all respondents agreed with the Board's decision that the rate implicit in the lease should be required when it is readily determinable for lessees applying the risk-free rate election. Many respondents also asserted that the rate implicit in the lease best reflects the economics of the transaction and that it provides financial statement users with the most decision-useful information. Therefore, those respondents noted that the rate implicit in the lease should be used when the rate is readily determinable. One practitioner, one trade group representative, and one state CPA society commented that the rate implicit in the lease is not readily determinable for most leases; therefore, making this determination should not place a burden on lessees because it will be applicable only in limited circumstances.

18. One trade group disagreed with the Board's decision and commented that the rate implicit should not be used, even when readily determinable, when the risk-free rate election is made. This commenter asserted that the cost to apply the rate implicit is significant because entities may need to hire external resources to determine the rate implicit in the lease. The respondent also expressed concern about requiring using the rate implicit in the lease in related party transactions, which are more common among private entities. The trade group

also stated that those transactions are typically not at arm's length, already required to be disclosed by Topic 850, Related Party Disclosures, and required to be accounted for under Topic 842 using the legally enforceable rights and obligations.

Comment Letter Summary—Transition and Effective Date

19. The proposed Update would provide different effective dates and transition provisions for entities that have not yet adopted Topic 842 and those that have (before the issuance of a final Update). For entities that have not yet adopted Topic 842, the proposed amendments would be effective when the entity adopts Topic 842. For entities that have adopted Topic 842 (before the issuance of a final Update of these proposed amendments), the proposed amendments would be effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with earlier application permitted. Lessees that have already adopted Topic 842 would transition to the proposed amendments using a modified retrospective transition method whereby a transition adjustment to the lease liability and ROU asset would be calculated as of the beginning of the fiscal year of adoption, using the lease payments, lease term, and discount rate calculated as of the application date. The adoption of the proposed amendments would not be considered an event that would cause remeasurement and reallocation of the consideration in the contract (including lease payments) or reassessment of lease term or classification.

20. Nearly all respondents agreed with the Board's decision to require entities that have not yet adopted Topic 842 to adopt the proposed amendments at the same time that it adopts Topic 842, using the existing transition provisions in paragraph 842-10-65-1. Respondents noted that requiring a single adoption date rather than permitting later adoption of the proposed amendments would provide consistency, reduce diversity in practice, and be the most effective and efficient solution. One state CPA society commented that users would not benefit from a separate adoption of the proposed amendments after an entity has adopted Topic 842. One practitioner also encouraged the Board to finalize the proposed Update as soon as possible to give entities sufficient time to include the amendments in their implementation process.

21. One state CPA society disagreed with the Board's decision to require entities that have not yet adopted Topic 842 to adopt the proposed amendments at the same time it adopts Topic 842, citing concerns about an insufficient educational period. The following comment notes their concern:

> If the proposed Update is issued prior an entity's year end when the entity is planning to early adopt Topic 842, they may not have time to learn about and consider this proposed update. We believe a requirement to adopt at the same time as adoption of Topic 842 that excludes early adopters would be operable. [CL #19]

22. Seventeen respondents answered the question in the proposed Update about the proposed effective date for entities that have adopted Topic 842 before the issuance of a final Update. All of those respondents agreed with the Board's decision to make the proposed amendments for an entity that has adopted Topic 842 before the issuance of a final Update to be effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with early application permitted.

23. Most respondents agreed with the Board's transition decision that an entity that has adopted Topic 842 before the issuance of a final Update should apply the proposed amendments on a modified retrospective basis through an adjustment to the lease liability and corresponding ROU asset for affected leases existing at the beginning of the year of adoption of a final Update.

24. One practitioner, two trade groups, and one state CPA society disagreed with the Board's decision to use the modified retrospective method, citing concerns about reduced comparability in the comparative periods presented in the financial statements. Those respondents noted that under the proposed method an entity could recognize a lease differently in the comparative periods if the entity changes from using the IBR in earlier periods to the risk-free rate in the current period or vice versa. In addition, they noted that the proposed amendments could cause a significant change in an entity's lease liability without sufficient transition disclosures because the change typically would not affect net assets, retained earnings, or another equity component if the change was only a result of a change in discount rate. To avoid comparability issues, those respondents recommended that the Board allow entities to choose to apply the proposed amendments on a prospective or modified retrospective basis.

25. One practitioner observed that the proposed amendments would require entities to calculate the adjustment to the lease liability based on the discount rate and remaining lease term at the beginning of the fiscal year of adoption. That practitioner further notes:

> Where the adjustment required by this proposed amendment occurs at a date other than the commencement date, we do not believe that lessees would be able to "readily determine" the rate implicit in the lease. Accordingly, entities that previously adopted Topic 842, but did not use the rate implicit in the lease, would apply an alternate discount rate (i.e., the IBR or risk-free rate, as applicable) and remaining lease term at the beginning of the fiscal year of adoption. If this was the Board's intention, it may be helpful to clarify this in the Basis for Conclusions. [CL #16]

26. Some practitioners noted that the proposed guidance states that the lease liability should be calculated based on the discount rate and the remaining lease term at the beginning of the fiscal year of adoption. However, previous technical inquiries with FASB staff and SEC staff views relating to initial adoption of Topic 842 have interpreted that entities are able to make an accounting policy election to use either the original lease term and lease payments or the remaining lease term and lease payments as of the date of transition to determine the discount rate. Those respondents recommended that the Board clarify its intent in the basis for conclusions.

27. One state CPA society encouraged the Board to consider permitting an unconditional one-time transition election consistent with that allowed for other private-company alternatives:

> However, we encourage the Board to consider permitting election of the risk-free rate by class of underlying asset in the same manner as the private company accounting alternatives. We believe an entity that is not a public business entity should be able to make an unconditional one-time election, without consideration of preferability, for the use of the risk-free rate for a class of underlying assets. Permitting this transition method will enable more companies to utilize the practical expedient. [CL #19]

28. One practitioner noted that the transition disclosure requirements included in the proposed amendments would not require a lessee that had already adopted Topic 842 to disclose the transition effect on the lease liability and ROU asset. That practitioner highlighted that only the effect on retained earnings at the transition date would be required, which is expected to be minimal because the transition adjustment will involve offsetting adjustments to the lease liability and ROU asset.

Issue 2: Weighted-Average Discount Rate Disclosure

29. This issue discusses whether the required WADR disclosure in Topic 842 should be amended to require a lessee using the risk-free rate election to disclose its WADR separately for leases measured using the risk-free rate and for leases measured using the incremental borrowing rate or the rate implicit in the lease ("all other leases"). The WADR is currently required to be calculated separately for finance and operating leases by using the discount rate used to calculate the lease liability and the remaining balance of the lease payments for each lease as of the reporting date.

Background

30. During initial project outreach, certain practitioners raised a question about whether separate disclosure should be required for the WADR for entities that elect the risk-free rate election for some, but not all, asset classes. Those stakeholders expressed concern that under the current disclosure requirements in Topic 842, the WADR would be a composite of the risk-

free and other rates, which could reduce the decision usefulness of the disclosed information. Other stakeholders expressed concern that requiring separate disclosure of the WADR could increase the cost and complexity of applying the expedient. Those stakeholders questioned whether the additional information would be useful for private company or not-for-profit organization financial statement users who may have different informational needs than public company users.

31. While the separate WADR disclosure requirement was not included in the proposed amendments, the proposed Update included two questions to gather more information about the cost and usefulness of a separate WADR disclosure. Question 5 asked whether an entity should be required to separately disclose the WADR for leases using the risk-free rate and all other leases and for specific feedback on how that rate would be used by users. Question 5a asked for feedback on whether the separate WADR disclosure would add cost for preparers and the nature and extent of that cost. The staff also performed outreach with advisory groups and with users of private company financial statements to better understand the costs and benefits of requiring separate disclosure of the WADR.

Comment Letter Summary—Weighted-Average Discount Rate Disclosure

32. Respondents were mixed in their comments about whether an entity should be required to disclose the WADR separately for leases for which a risk-free rate is used and all other leases (those that are measured using an incremental borrowing rate or the rate implicit in the lease). Some respondents commented that a single blended rate would be sufficient and provide investors and other financial statement users with decision-useful information. The following are some example comments:

> …We believe requiring disaggregated disclosures under Topic 842 is inconsistent with the Private Company Decision-Making Framework. While [respondent] acknowledges that many users of non-public entity financial statements will consider disclosures related to Topic 842 to be important, the Board has provided significant disclosure relief to non-public entities related to Topic 606, which [respondent] believes is a more broad decision relevant standard than Topic 842 for many users of non-public entity financial statements. As a result, we would not support requiring such a disclosure as we do not believe that it would influence or otherwise significantly benefit users of financial statements. [CL #6]
>
> We note that oftentimes a user of an entity's financial statements that qualifies for this election will have the ability to inquire with management to obtain a better understanding of the impact of the election if it is relevant to their needs. We also question how the weighted-average rate would be useful to financial statement users without matching disclosures of the amount of cash flows by underlying class of assets; however, we defer to financial statement users for the decision-usefulness of the information and the ways in which it would be used. [CL #19]

> We believe one weighted average for the risk-free rate, incremental borrowing rate, and rates implicit would be just as useful than presenting multiple weighted averages. We do not see significant benefit in providing more than one weighted average to the users of the financial statements. [CL #1]

33. Those respondents and two additional practitioners and a trade group commented that requiring the disaggregated WADR disclosure would add cost to preparers relative to the current requirement. Two of the respondents who opposed additional disclosure focused on the expected benefits, rather than the expected costs. They stated that costs would be expected to be minimal. Here are some example comments:

> Any requirement for a weighted-average disclosure adds significant preparation and audit costs. [Respondent] also does not believe that such a disclosure would provide value to users given the additional costs. [Respondent] also suggests that the Board reach out to lease software providers to inquire if existing lease software has the ability to make disclosures as described in question 5. If existing lease software is not capable of making those calculations, [Respondent] is concerned that entities would be required to use Excel based spreadsheets to make these calculations, which introduces an additional cost in preparing the spreadsheet as well as a greater potential for calculation errors than would be present in a software package which has been tested. [CL #6]
>
> We believe that requiring disclosure of the disaggregated weighted-average discount rates would add cost relative to the current requirement. We believe that such calculations would often be performed by entities that are not public business entities through manual computations that will require pulling together disaggregated summary schedules that would not otherwise be necessary. This will increase preparation and audit cost. In comparison, the current requirement is expected to be performed at the same aggregated level used to accumulate disclosures. [CL #19]
>
> For entities that are using, or intend to use, a leasing system that calculates their weighted-average discount rates, we believe software updates may be needed for many existing systems to be able to separately identify lease liabilities discounted using the lessee's incremental borrowing rate and those discounted using a risk-free rate. Entities may need to make adjustments outside of their systems for a period of time to produce the separate weighted-average rates, depending on whether and how quickly leasing system providers release an update. [CL #4]
>
> We believe that requiring disclosure of the disaggregated weighted-average discount rates would add cost for preparers, due to the process of gathering information on a disaggregated basis. We defer to reporting entities to comment on the significance of the costs that would be incurred to meet such a disclosure requirement. [CL #8]

34. Five practitioners and one trade group supported requiring disclosure of the WADR separately for leases for which a risk-free rate is used and all other leases that are measured using an incremental borrowing rate or the rate implicit in the lease. Here are some example comments:

> We support a requirement to disclose the weighted-average discount rate separately for (a) leases for which a risk-free rate is used and (b) all other leases that are measured using an IBR or the rate implicit in the lease. While this question may best be answered by financial statement users and analysts, we believe this requirement would provide better decision-useful information for financial statements users. [CL #16]

> We believe disclosure of the weighted-average discount rate for leases for which a risk-free rate is used separately from the weighted-average discount rate for all other leases would provide financial statement users with decision-useful information. That is, disclosure of an aggregate weighted-average discount rate for all leases may provide information that is less meaningful to a financial statement user who focuses on a lessee's cost of borrowing. However, we defer to financial statement users on which approach would provide better information. [CL #7]

> The weighted-average discount rate that combines risk-free rates, incremental borrowing rates, and rates implicit in the lease into one measure does not provide decision-useful information to the vast majority of financial statement users of small business entities, because the meaning of the metric is ambiguous. [CL #18]

35. However, despite the preference for a disaggregated WADR, one trade group, and one practitioner acknowledged that the additional disclosure requirements may add cost relative to the current requirement.

Additional Outreach

Private Company Financial Statement Users

36. The staff sent outreach requests to five private company users. Of those requests, one user shared views about the usefulness of the WADR disclosure. That user noted that few, if any, entities that it analyzes have adopted Topic 842; therefore, any feedback on disclosures is preliminary. The user noted that the WADR is not used as an input for any calculations in its analysis. The user stated that it looks at interest rates on debt to analyze creditworthiness and borrowing ability of an entity. Consequently, it expressed that the company likely would track the WADR as a data point over time to compare the disclosure within an entity over time and to compare between similar entities. The user expressed interest in having a separate WADR for risk-free and all other rates but noted that without knowing what proportion of the portfolio the separate WADRs applied to, a separate disclosure may not be useful. This is because it may not be possible or useful to compare the separate WADRs reported by an entity over time or to compare those WADRs between entities without understanding the composition of the portfolios to which the rates applied.

Post-Implementation Review Outreach with Public Company Users

37. The staff performed outreach with financial statement users in the fall of 2020 as a part of the Post Implementation Review (PIR) activities for Topic 842. Because the majority of private entities have not yet adopted Topic 842, the PIR outreach with users focused on users' experiences with public companies, although a couple of users (primarily credit analysts) provided feedback on both public entities and private companies.

38. In that outreach, the staff asked users if the disclosure of the WADR provides decision-useful information and how the information is used in their analyses. Most users said that they found the WADR informative. The users of the WADR identified in this outreach fell into three broad categories: those who used the WADR to convert operating leases to finance leases, those who used the WADR in calculations to determine other metrics (such as upcoming maturity of leases), and those who used the WADR as an indication of an entity's credit quality or ability to borrow.

39. Of the users that stated that the WADR disclosure is informative, about half stated that they use the WADR in their analyses. The staff highlighted that entities within the same industry may use a wide range of discount rates or disclose a wide range of lease terms resulting in materially different lease liabilities. In response to this observation, four users noted that this is not necessarily troublesome. They encouraged the continued disclosure of entity-specific information, noting that, if necessary, users can investigate further to understand what is driving the differences. Most users noted that the WADR is used in conjunction with other information. One user stated that the WADR is used in conjunction with the undiscounted cash flows to analyze leases expiring in the near term. Users from credit rating agencies, who rate both private entities and public companies, stated that they use the WADR in conjunction with the lease liability and weighted-average lease term to convert operating leases into finance leases. This is done to create comparability with IFRS Standards.

40. A couple of users noted that they were not concerned about the precision of the discount rate. One of those users stated that it calculates a rent multiple of five to seven times base rent to create a floor and ceiling for the lease liability. If amounts reported are outside that range, that would trigger further investigation of an entity's disclosed WADR. Similarly, several users perform sensitivity analyses on the rate to determine if adjustments should be made. One user stated that it compares the reported WADR with the expectation based on credit rating, secured borrowing rates, and the term of leases.

Issue 2: Alternatives

41. The following alternatives have been identified for the WADR disclosure:

    (a) Alternative A: Require a lessee that uses the risk-free rate election to separately disclose the WADR for the risk-free rate and all other discount rates (the incremental borrowing rate and rate implicit in the lease)

    (b) Alternative B: Continue to require a lessee to disclose a combined WADR for all leases.

Appendix A - Summary of Tentative Board Decisions Reached to Date

This appendix provides a summary of Board decisions reached to date on the project, as posted on the project's webpage.

Discount Rate for Lessees That Are Not Public Business Entities
Tentative Board Decisions Reached to Date
as of April 14, 2021

Topic	Decisions Reached	Meeting Date
Measurement	The Board decided: • That a lessee that is not a public business entity may make the risk-free rate accounting policy election by class of underlying asset. • To require a lessee to disclose its election, including the asset class to which it has made the accounting policy election. • To retain a risk-free rate for the discount rate accounting policy election, rather than another specified rate, such as a corporate bond rate or the prime rate. • That a lessee using the discount rate accounting policy election should be required to use the rate implicit in the lease when it is readily determinable instead of the risk-free rate.	April 14, 2021
Transition and Effective Date	• For a lessee that is not a public business entity that has not adopted Topic 842 as of the issuance of a final Update, the Board decided that the transition and	April 14, 2021

	effective date provisions in paragraph 842-10-65-1 would apply. • For a lessee that is not a public business entity that has adopted Topic 842 as of the issuance of a final Update, the Board decided to require the use of a modified retrospective transition method. That transition method would require a lessee to: ○ Remeasure affected lease liabilities and right-of-use assets for existing leases at the beginning of the period of adoption and record the cumulative effect of transition in retained earnings ○ Calculate the transition adjustment using the discount rate and remaining lease term as of the adoption date ○ Not otherwise remeasure or reclassify leases as a result of transition ○ Disclose the fact that the amendments have been adopted and the amount of the transition adjustment. • For a lessee that is not a public business entity that has adopted Topic 842 as of the issuance of a final Update, the Board decided that the amendments should be effective for annual reporting periods beginning after December 15, 2021, including interim reporting periods beginning after December 15, 2022, with early application permitted.	