Committee on Corporate Reporting

December 4, 2020

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

Re: File Reference No. 2020-700

Dear Ms. Salo,

This letter is submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Financial Accounting Standards Board's (FASB or "Board") Proposed Accounting Standards Update (ASU), *Leases (Topic 842): Targeted Improvements* (proposed ASU).

FEI is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives, and other senior-level financial executives. CCR is a technical committee of FEI comprised of approximately 50 Chief Accounting Officers and Corporate Controllers from Fortune 100 and other large public companies, representing approximately $12.3 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the SEC, FASB, and PCAOB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary

We commend the Board for its responsiveness in addressing stakeholder feedback and appreciate the Board's objective of simplifying the implementation and ongoing application of Topic 842 for preparers. We agree that the amendments in this proposed ASU will reduce the ongoing costs of applying Topic 842 while improving or maintaining the decision usefulness of information provided to users. We have included in this letter several comments and suggestions that we believe will further these objectives.

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

We support the Board's decision to require that lessors classify and account for a lease with lease payments that are predominantly variable and do not depend on a reference index or rate as an operating lease. We agree that this requirement results in an outcome that is more faithfully representative of the economics of such transactions.

We also support the use of "predominant" as a reasonable threshold that captures most leases that are expected to be profitable over the lease term but have a day-one accounting loss, and we do not believe that a "predominant" threshold will facilitate the structuring of lease agreements to achieve operating lease accounting. The Board's acknowledgment in the proposed ASU's Basis for Conclusions that "predominant" is considered equivalent in meaning to "majority" for purposes of applying the amendments in this proposed ASU[1] is also helpful, and we request that this language be retained in the Basis for Conclusions of the final ASU.

Issue 2: Option to Remeasure Lease Liability—Lessee Only

We support the Board's decision to provide lessees the option to remeasure lease liabilities for changes in a reference index or a rate at the date those changes take effect. We recommend that the Board retain this option, as we agree that making this amendment optional enables each entity to select the method that is most cost-effective for its circumstances. We also believe that an entity-wide election is operable and would often be the level at which entities would choose to make such an election. However, some CCR members noted that allowing for an election by class of underlying asset could provide additional cost savings for certain entities that maintain separate lease portfolios by class of underlying asset and report only annually under IFRS.

For example, an entity may have separate portfolios of equipment leases and real estate leases. The equipment leases may be less standardized and require extensive manual work for financial reporting purposes. If this manual effort is carried out only annually for IFRS reporting, the requirement to remeasure all equipment lease liabilities on a quarterly basis under U.S. GAAP may increase costs and discourage the entity from taking advantage of an entity-wide election given the greater effort for what is often a less material portion of the assets leased. However, in this example, allowing for an election by class of underlying asset would enable the entity to reduce costs by remeasuring only its real estate leases, which may be more standardized and more automated. Therefore, we recommend that the Board allow for an election by class of underlying asset, noting that this type of option is already allowed in Topic 842 whereby lessors and lessees may elect to not separate lease and non-lease components by asset class. If the Board decides not to allow the election to be applied by class of underlying asset, we believe allowing for application at an entity-wide level would still provide cost savings for many entities.

We also recommend revising the proposed example in ASC 842-10-55-231A. The suggested edits below show the amount of the lease liability after remeasurement and clarify that remeasurement for a change in a reference index or a rate should occur when the change in the index or rate takes effect, which would need to be prior to payment for the payment amount to be correct in this example. We believe the following changes avoid potential confusion, as the Board's use of the word "remeasurement" when referring to the subsequent measurement of the lease liability after payment could be misinterpreted as referring to the remeasurement for a change in a reference index or a rate.

> 842-10-55-231A If Lessee has made the election in paragraph 842-20-35-4A to remeasure the lease liability to reflect changes to variable lease payments resulting from a change in an index or a rate, Lessee remeasures the lease liability at the beginning of Year 2 (the date at which the change in payments takes effect). That remeasurement would reflect the Consumer Price Index at the end of Year 1, which is the basis for the lease payment to be made on the first day of Year 2. After being remeasured ~~Lessee makes the lease payment at the beginning of Year 2, the lease liability is remeasured to reflect annual lease payments of $102,400~~ with a corresponding adjustment to the right-of-use asset, the lease liability is $639,681 (9 remaining annual lease payments of $102,400, discounted at the rate of 8 percent). ~~(8 remaining annual payments of~~

[1] Paragraph BC12 of the proposed ASU

~~$102,400, discounted at the rate of 8 percent is $588,456).~~ Lessee then makes its revised Year 2 payment of $102,400. In its quantitative disclosures for Year 2, Lessee will include $102,400 in its disclosure of operating lease cost. In its maturity analysis of its operating lease liability, Lessee will include $102,400 as the undiscounted cash flows from the lease (see paragraph 842-20-50-6).

Issue 3: Modifications Reducing the Scope of a Lease Contract

We support the Board's decision to exempt entities from applying modification accounting when accounting for lease components that are economically unaffected by a contract modification to terminate other lease components under the same lease agreement. We believe that this amendment will reduce cost and complexity and lead to financial reporting that better represents the economics of these arrangements. However, we do not agree with the requirement in paragraph 842-10-25-8B(c) to include payments made as a result of the modification, such as termination penalties, in the total payments for the remaining lease component(s) over the lease term when determining whether the total payments are substantially the same as those required by the contract before the effective date of the modification.

The modification of a contract to terminate rights to use underlying assets will typically require the payment of a negotiated termination penalty that, if included in the total payments for the remaining lease component(s) over the lease term, results in total payments that are not substantially the same as the total payments of those lease component(s) prior to termination. However, entities are willing to accept these termination penalties because paying a penalty to reduce the lease term is often less costly than completing the original lease term when the underlying asset is no longer needed in operations but not a casualty. Consequently, we do not believe that the payment of a termination penalty in these situations economically affects the remaining lease component(s) and, therefore, do not believe that such termination penalties should be treated differently than a negotiated payment to purchase the underlying asset or for a casualty loss. Instead, we recommend that the Board develop a principle by which preparers may apply judgment in determining whether the remaining lease component(s) are economically affected by payments made as a result of a contract modification. For instance, if the negotiated termination penalty is reasonable and customary, the termination penalty may be presumed to be related only to the terminated lease component(s).

We also note that in a partial termination scenario, it remains unclear how an entity should account for a termination penalty that was not included in total lease payments at lease commencement because the entity was not reasonably certain to exercise the option to terminate the lease. CCR believes that judgment is necessary to determine the lease component(s) to which the penalty relates, and, if the penalty relates only to the terminated component(s), the lessee should charge the penalty to income over the revised lease term, if any, of the terminated component(s) to better reflect the economics of the transaction. Although the proposed amendments do not directly state that the FASB intends this treatment, we note that ASC 842-10-25-8B states that an entity shall not "adjust its accounting for the remaining lease component(s)" when the termination of one or more separate lease components before the end of the lease term does not affect the remaining lease component(s). As such, CCR recommends that the FASB clarify that, when accounting for a termination penalty that was not previously included in total lease payments, an entity must use judgment to determine the lease component(s) to which the termination penalty relates.

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Transition Guidance

For Issues 1 and 3, we agree that entities that have adopted Topic 842 by the effective date of the final ASU should apply the proposed amendments either retrospectively or prospectively, as described in the proposed ASU. However, for Issue 2, we suggest that the Board also allow companies to adopt using a cumulative catch-up approach to improve the clarity of financial results for users.

Because retrospective application is operationally more difficult, we anticipate that many entities would elect a prospective approach when implementing the proposed amendments for Issue 2. However, prospective application may result in a number of adjustments over many years, as some indexes or rates change infrequently (e.g., every five years). Consequently, prospective application could create financial statement volatility over a significant period of time until all relevant indexes and/or rates have changed, increasing the complexity of adoption for preparers and reducing the clarity of financial results for users. By contrast, we believe that a cumulative catch-up approach is more easily interpreted by financial statement users and, therefore, may be preferred by some companies.

We are also concerned about the effective date for Issue 2. If the proposed amendment is adopted, lease system providers will need to change the current functionality of lease systems to allow entities the option to remeasure lease liabilities for changes in a reference index or a rate. We believe that entities using lease systems will generally wait to adopt until the lease system providers have implemented the change in functionality. In some cases, entities may be further delayed from adopting the proposed amendment if the new functionality requires existing lease systems to be upgraded. Therefore, we recommend that the Board clarify that entities may adopt the option to remeasure lease liabilities even after the effective date has passed. If the Board feels the need to require a deadline for adoption of the option, we recommend that any deadline take into account the time required for lease system providers to implement the new functionality, including any applicable systems upgrades required as a result of the change.

Conclusion

We appreciate the Board's effort to obtain input from stakeholders on this proposed ASU and stand ready to assist the Board in this effort.

Sincerely,

Prat Bhatt

Prat Bhatt
Chairman, Committee on Corporate Reporting
Financial Executives International