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November 13, 2017

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

File Reference No. 2017-310

Re: Proposed Accounting Standards Update, *Technical Corrections and Improvements to Recently Issued Standards – Accounting Standards Update No. 2016-02, Leases (Topic 842)*

Dear Ms. Cospers:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Technical Corrections and Improvements to Recently Issued Standards – Accounting Standards Update No. 2016-02, Leases (Topic 842)*.

We support the Board's efforts to clarify and improve the guidance in the new leases standard (ASC 842) to reduce potential diversity in practice and the initial and ongoing costs of applying this guidance. The proposed amendments will help ensure that entities implement the new requirements consistently and efficiently, as the Board intended.

The appendixes below contain our responses to the proposed ASU's questions for respondents, suggest certain modifications to the proposed guidance, and highlight additional technical corrections to ASC 842 for the Board's consideration.

* * * * *

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact James Barker at (203) 761-3550.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix A
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

***Question 1:** Would the amendments in this proposed Update clarify the guidance in Topic 842 or provide a better link between paragraphs within Topic 842 or between the guidance in Topic 842 and other Topics? If not, please explain which proposed amendment(s) you disagree with and why.*

Yes. However, as noted in Appendix B, we believe that additional improvements can be made to the guidance in connection with Issues 4, 8, 11, 13, and 15.

***Question 2:** Will any of the proposed amendments result in substantive changes to the application of Topic 842 that would require transition provisions or an effective date for the final amendments other than those noted in the Summary section "When Would the Amendments Be Effective?" If so, please describe.*

We do not believe that any of the proposed amendments would result in such changes.

***Question 3:** Should other changes that are directly or indirectly related to the proposed amendments be made? Please note that the Board will conduct Codification improvements projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvements project.*

We believe that certain other changes should be made and have outlined our recommendations related to such changes in Appendixes B and C below.

Appendix B Deloitte & Touche LLP Suggested Modifications to the Proposed Guidance

Below we have outlined suggested modifications to the proposed guidance in connection with Issues 4, 8, 11, 13 and 15 in the proposed ASU. Added text is underlined, and deleted text is ~~struck out~~. (We have no comments on the proposed guidance in connection with the proposed ASU's other Issues.)

Issue #4: Lessor Reassessment of Lease Term and Purchase Option

We believe that although the modified language achieves the Board's desired objectives, it should be adjusted slightly to eliminate any perceived conflict between the first and second sentences of ASC 842-10-35-3. Accordingly, we suggest that the FASB consider the following changes to that paragraph:

Except as noted in the next sentence, a **lessor** shall not reassess the lease term or a lessee option to purchase the underlying asset unless the lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8. When a lessee exercises an option to extend the lease or purchase the underlying asset that the lessor previously determined the lessee was not reasonably certain to exercise or exercises an option to terminate the lease that the lessor previously determined the lessee was reasonably certain not to exercise, the lessor shall account for the exercise of that option in the same manner as a **lease modification**.

Issue #8: Transition Guidance for Amounts Previously Recognized in Business Combinations

We believe that the proposed amendment may be confusing for constituents because of the relationship between ASC 842-10-65-1(h)(3) and ASC 842-10-65-1(w). The guidance in (h)(3) implies that a lessor would charge to equity any favorable or unfavorable terms of an operating lease (under ASC 840) acquired as part of a business combination if the lease is determined to be a sales-type or direct financing lease under ASC 842. However, we believe that any favorable or unfavorable terms are likely to be included and offset in the net investment in the lease under ASC 842-10-65-1(w)(2). Accordingly, we suggest that the FASB consider the following changes to the proposed guidance in ASC 842-10-65-1(h)(3) and ASC 842-10-65-1(w)(1):

65-1(h)

If an entity has previously recognized an asset or a liability in accordance with Topic 805 on business combinations relating to favorable or unfavorable terms of an operating lease acquired as part of a business combination, the entity shall do all of the following:

3. See (w) for ~~Make a corresponding adjustment to equity if assets or liabilities arise from~~ leases that are classified as **sales-type leases** or **direct financing leases** in accordance with Topic 842 for which the entity is a lessor. ~~Also see (w).~~

65-1(w)

For each lease classified as a direct financing or a sales-type lease in accordance with this Topic, the objective is to account for the lease, beginning on the later of the

beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease, as if it had always been accounted for as a direct financing lease or a sales-type lease in accordance with this Topic. Consequently, a lessor shall do all of the following:

1. Derecognize the carrying amount of the underlying asset as well as any asset or a liability previously recognized in accordance with Topic 805 on business combinations related to favorable or unfavorable terms of a Topic 840 operating lease acquired as part of a business combination at the later of the beginning of the earliest comparative period presented in the financial statements and the commencement date of the lease.

Issue #11: Transition Guidance for Modifications to Leases Previously Classified as Direct Financing or Sales-Type Leases Under Topic 840

While we agree that the proposed amendment would clarify the transition guidance for lessors on modifications beginning on the effective date, we propose that the Board slightly revise the wording in ASC 842-10-65-1(x)(4). Accordingly, we suggest that the FASB consider the following change:

Beginning on the effective date, if a lessor modifies the lease (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8), it shall account for the modified lease in accordance with paragraph 842-10-25-16 if the lease was ~~is~~ classified as a direct financing lease before the modification or paragraph 842-10-25-17 if the lease was ~~is~~ classified as a sales-type lease before the modification. A lessor shall not remeasure the net investment in the lease on or after the effective date unless the lease is modified (and the modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8).

Issue #13: Impairment of Net Investment in the Lease

We agree that for net investments in leases, the proposed amendment would clarify the application of the impairment guidance to lessors. However, the proposal should clarify that the cash flow assumption after the end of the lease term (i.e., the cash flows the lessor would expect to derive from the unguaranteed residual asset) should not include an adjustment to reflect credit risk. Accordingly, we suggest that the FASB consider the following change to the proposed guidance in ASC 842-30-35-3:

A lessor shall determine impairment related to the **net investment in the lease** and shall recognize any impairment in accordance with Topic 310 on receivables (as described in paragraphs 310-10-35-16 through 35-30). When determining the loss allowance for a net investment in the lease, a lessor shall take into consideration the collateral relating to the net investment in the lease. The collateral relating to the net investment in the lease represents the cash flows that the lessor would expect to receive (or derive) from the **lease receivable during the remaining lease term** and the **unguaranteed residual asset** ~~during and~~ following the end of the remaining **lease term**. The amount that the lessor expects to derive from the unguaranteed residual asset should be based on the expected value of the residual asset after the end of the lease term (excluding credit risk).

Issue #15: Effect of Initial Direct Costs on Rate Implicit in the Lease

We agree that the proposed amendment to the implementation guidance would clarify the

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effect that initial direct costs have on the determination of the rate implicit in the lease for lessor lease classification assessments. However, in our experience, this is a confusing concept for constituents. We therefore strongly recommend that the FASB modify the guidance in ASC 842-10-25-4 (not just the associated examples) to make it clear that the rate implicit in the lease may be different (if the fair value of the underlying asset differs from its carrying value) depending on whether the lease is being assessed for sales-type classification or direct financing classification.

Accordingly, we suggest that the FASB consider the following change to ASC 842-10-25-4:

A lessor shall assess the criteria in paragraphs 842-10-25-2(d) and 842-10-25-3(b)(1) using the rate implicit in the lease. For purposes of determining the rate implicit in the lease when assessing the criterion in paragraph 842-10-25-2(d), a lessor shall assume that no **initial direct costs** will be deferred if, at the commencement date, the fair value of the underlying asset is different from its carrying amount.

Appendix C

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Additional Proposed Technical Corrections

While the following technical corrections were not included in the proposed ASU at this time, we believe that the Board should consider adding them:

- *Amend ASC 842-10-15-40 to clarify the timing of the recognition of variable payments* – ASC 842-10-15-40 requires a lessor to recognize income that is associated with variable payments (and excluded from a contract’s consideration) when changes in facts and circumstances occur on which the variable payment is based. In addition, a lessor allocates such income between the lease and nonlease components on the same basis as the initial allocation of consideration in the contract (i.e., on the relative stand-alone selling price basis) upon recognition, as illustrated in ASC 842-10-55-151 and 152. That is, the income is recognized for the nonlease component when the variability is resolved, not necessarily when the service is performed. Without an adjustment, the timing of revenue recognition for the nonlease component may be different under ASC 606 and ASC 842. We believe that lessors should not recognize revenue sooner under ASC 842 than they would under ASC 606 and that the Board did not intend to allow accelerated revenue recognition under ASC 842. We therefore suggest that the FASB amend ASC 842-10-15-40 to include guidance that is similar to the recognition requirements for sales- or usage-based royalties in ASC 606-10-55-65 to preclude accelerated revenue recognition in such circumstances.
- *Clarify that fair value rent should be treated as an index or a rate* – We believe that it would be beneficial for the Board to add explicit guidance indicating that fair market rents should be treated as an index or a rate and that such guidance would help prevent diversity in practice that could develop as a result of different interpretations of ASC 842-10-35-4(b) regarding the resolution of contingencies.
- *Clarify the accounting for lease modifications during transition* – The transition guidance is clear that entities should apply ASC 842 to modifications on or after the effective date as well as to reassessments to measure the lease liability for any reason. However, the guidance is less clear regarding the framework for modifications and potential reassessments that occur during the transition period, substantially increasing the complexities related to transition because the modification and reassessment guidance in ASC 840 and ASC 842 differ significantly. We request that the Board consider clarifying which accounting approach or approaches are appropriate for lease modifications that occur during the transition period.
- *Clarify the ASC 842 interim disclosure requirements* – On the basis of discussions with the FASB staff, we understand that entities are not meant to apply all the disclosure requirements in ASC 842 on an interim basis. We believe that the FASB should modify the disclosure requirements to clarify this point.