Mike Monahan
Senior Director, Accounting Policy

February 5, 2018

Mr. Russ Golden
Chair
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference No. 2018-200 – Proposed Accounting Standards Update—*Leases (Topic 842): Targeted Improvements*

Dear Mr. Golden:

The American Council of Life Insurers ("ACLI")[1] appreciates the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or "Board") proposed Accounting Standards Update, *Leases (Topic 842), Targeted Improvements* (the "proposed ASU") that was issued for comment on January 5, 2018.

We want to commend the FASB for its responsiveness to stakeholders, and timely consideration of implementation issues related to ASU 2016-02, *Leases (Topic 842)* (the "Standard"). We appreciate the Board's efforts to clarify and reduce cost and complexity of implementation of the Standard. The proposed ASU would modify two aspects of the Standard, including 1) the introduction of an additional optional transition method, which would allow companies to recognize a cumulative-effect adjustment through opening balance of retained earnings in the period of adoption, and retain the current accounting and disclosures under ASC 840 for the comparative periods presented in the year of adoption, and 2) the introduction of a practical expedient which would allow lessors, by class of underlying assets, to not separate nonlease components from the related lease components, similar to that provided to lessees.

We agree with the proposed amendment to offer the additional optional transition method and we believe that, if codified, it will achieve the Board's objective and significantly reduce the cost and complexity of implementing the standard. While we support the objective of the proposed additional practical expedient for lessors to not separate nonlease components from their related lease components, we have some concerns that the amendment, as drafted, is unnecessarily restrictive and will not fully achieve the Board's objective. We believe the practical expedient, as drafted, could only be utilized by a narrow subset of companies.

[1] The ACLI is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at www.acli.com.

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As drafted, a lessor can only apply the practical expedient if both of the following criteria are met:

a. The **timing and pattern of revenue recognition** for the lease component and nonlease components associated with that lease component are the **same.**
b. The **combined** single lease component is classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3.

Our concern lies in the use of the specific phrase "the same". In addition, as is noted in BC24 of the proposed ASU, it appears the expectation is that companies will assess whether a lease meets the first criteria (timing and pattern of revenue recognition) based on qualitative characteristics, as opposed to quantitative analysis, to determine whether it qualifies for the practical expedient. This creates a high hurdle, meaning that any difference, no matter how immaterial, in the timing or pattern of revenue recognition, would preclude a lessor from applying this practical expedient. While we agree with the Board's objective of maintaining consistency of wording and concepts across various standards (e.g. – ASC 606 and ASC 842), and we applaud the Board's effort to accomplish this objective, we want to offer a recommended enhancement to the proposed criteria for the practical expedient, as outlined below.

Financial services companies often have extensive real estate investment portfolios, which consist of real estate investment properties and related lease contracts. As is typical within the real estate lease market, there is an expectation that a landlord provides certain services unrelated to the lease (e.g. – inside and outside common area maintenance, or "CAM"). Certain CAM services, such as snow plowing and outdoor grounds maintenance, will vary throughout the year based on weather and other factors, and therefore, by their nature this revenue is not earned ratably over time (i.e. – in most circumstances this would not share the same timing and pattern of revenue recognition as straight-line rent). However, in many instances, these services will make up an immaterial portion of the consideration in the contract. These services typically must be offered by the lessor for the lessor to remain competitive in the respective market. However, based on the words used in the proposed ASU, these lessors will be precluded from utilizing the practical expedient, and will still be required to incur significant costs to apply the complex requirements of the separation and allocation guidance in the Standard to a portion of revenue than is immaterial to the overall contract. We do not believe that the costs will justify the benefits of applying criterion 1.

Therefore, to reduce the restrictiveness of the criteria, we would propose adding a third criteria, effectively splitting the first criterion so that, if the nonlease portion of the revenue either meets the first criteria outlined in the proposed ASU (timing and pattern of revenue recognition), **or** is not significant in the context of the contract as a whole, then the lessor would not be required to separate the nonlease components from the related lease components, with the second classification criterion in the proposed ASU unchanged. We present below proposed wording updates which incorporate our recommendation:

> **842-10-15-42A.** As a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset, choose to not separate nonlease components from lease components and, instead, to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:
>
> a. Either, the timing and pattern of revenue recognition for the lease component and nonlease components associated with that lease component are substantially similar, ***or*** the nonlease component associated with the contract is not significant within the context of the overall consideration in the contract, and
> b. The combined single lease component is classified as an operating lease in accordance with paragraphs 842-10-25-2 through 25-3.

We acknowledge that you considered this (as is outlined in BC25 of the proposed ASU) and rejected the concept of adding a magnitude criterion to the practical expedient in the proposed ASU. However, we want to address your concerns noted in BC25, as we believe our recommended update would greatly enhance the operability of the practical expedient.

a. If the overall criteria are drafted as noted above, we do not believe this would add additional complexity, and we believe it would broaden the scope of lessors who could utilize the practical expedient in situations where the nonlease components of the contracts are immaterial.
b. While we recognize the use of the predominance principle (e.g. – use of terms such as 'significant', 'substantially all', etc.) adds judgment to the criterion, we want to point out that there are various areas of GAAP literature that utilize this principle, particularly when determining the appropriate accounting model to apply to a balance or transaction (e.g. – consolidation guidance, insurance accounting guidance, and lease classification guidance). We believe that most companies have well established views and policies with regard to an appropriate threshold to use when this principle is used in accounting literature.

While we understand the concern raised in BC25, we believe that the reduction in cost and complexity achieved with this recommended update would significantly outweigh any additional complexities created by adding the additional criterion. In addition, we do not believe that adding this additional criterion and broadening the scope of the use of the practical expedient would impact decision-usefulness of the information presented in the financial statements, noting the underlying concept (as outlined in ASC 105-10-05-6) that the provisions of the codification need not be applied to immaterial items. Thus, this amendment would remain within the underlying concepts set forth in the US GAAP accounting framework.

In summary, we support the Board's objectives of reducing the costs and complexity of implementing the new lease accounting guidance, and we believe that the proposed ASU with our recommendations would make significant progress in achieving that objective. However, we believe that the proposed practical expedient for lessors, as written in the proposed ASU, is unnecessarily restrictive, and we hope that the Board considers our recommended updates to ensure that companies aren't required to apply the costly separation and allocation guidance to immaterial lease or nonlease components.

Additionally, as requested, please see our responses to your questions noted in the proposed ASU in Appendix A.

We want to acknowledge the considerable time and effort the FASB has spent on the leases project, and we appreciate the responsiveness and attention given to the challenges identified by respondents through the implementation of the new standard to date. We also appreciate the Board's leaning towards addressing issues associated with the interaction between *ASC 606, Revenue from Contracts with Customers* and *ASC 842, Leases*, including the consideration of the predominance principle. We thank you for the opportunity to provide our views on the proposed ASU and we would be happy to address any questions or concerns related to this comment letter the Board may have, at the Board's convenience.

Sincerely,

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Mike Monahan
Senior Director, Accounting Policy

Appendix A – Response to Questions

Question 1: Would the proposed optional transition method to apply the new lease requirements through a cumulative-effect adjustment in the period of adoption reduce the costs and complexity associated with implementing Topic 842? If not, please explain why.

Response: Yes.

Question 2: Is the proposed transition method, as written in this proposed Update, operable? If not, please explain why.

Response: Yes.

Question 3: Would the practical expedient in this proposed Update for lessors to not separate nonlease components from the related lease components and, instead, to account for those components as a single lease component reduce the costs and complexity associated with applying Topic 842 by lessors? If not, please explain why.

Response: Yes, the practical expedient, as drafted could reduce cost and complexity for some lessors, if it is appropriately modified as per our recommendation. As outlined in the main body of this letter, we believe the practical expedient is unnecessarily restrictive, and could lead to significant implementation efforts and costs that are not justified by the benefits. We have proposed some updates to ensure the practical expedient would meet the Board's objective to reduce the costs and complexity with applying Topic 842.

Question 4: Is the proposed practical expedient, as written in this proposed Update, operable? If not, please explain why.

Response: Yes. However, please see our response to Question #3 and the body of our letter for discussion of our views on proposed changes to the practical expedient to ensure it meets the Board's objectives.

Question 5: Would the information in the financial statements, including disclosures, provided by lessors electing the practical expedient in this proposed Update be decision useful? If not, please explain why.

Response: Yes. In addition, as outlined in the main body of this letter, we believe our recommended updates to the practical expedient in the proposed ASU would maintain the decision usefulness of the information in the financial statements for the reasons stated in the main body of the letter.