



February 6, 2018

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

File Reference No. 2018-200

The Accounting Principles Committee of the Illinois CPA Society (“Committee”) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update (“ASU”), *Leases (Topic 842): Targeted Improvements*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

In general, the Committee is supportive of the Board’s proposed changes.

We have provided our responses to specific questions raised in the proposed ASU below.

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: We believe the proposed optional transition method will reduce the costs and complexity associated with implementing Topic 842.

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

Response: We believe the proposed transition method, as written, is operable.

Question 3: *Would the practical expedient in this proposed Update for lessors to not separate non-lease 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: Notwithstanding the issues noted below in our response to Question 4, we believe the proposed practical expedient will reduce the costs and complexity associated with applying Topic 842 by lessors.

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

Response: We believe that additional guidance is needed to explain how entities should assess whether the timing and pattern of revenue recognition for the lease component and non-lease components associated with the lease component are the same to ensure consistent application of the practical expedient.

We suggest that the Board add illustrative examples to the proposed guidance to help lessors apply the practical expedient.

In particular, we have concerns regarding application of the practical expedient to lease transactions that include variable payments, where the variable payments are included in the consideration in the contract based on the guidance in ASC 842-10-15-39. Pursuant to ASC 842-30-25-11, lessors account for variable lease payments “as income in the period in which the changes in facts and circumstances on which the variable lease payments are based occur.” Variable consideration associated with the non-lease component would be accounted for under ASC 606-10-30-5 through 30-14. This guidance requires an entity to “estimate the amount of variable consideration to which the entity will be entitled in exchange for transferring the promised goods or services,” subject to certain constraints. We are concerned about situations in which there may be a mismatch in the timing and pattern of revenue recognition for the variable consideration. For example, this might occur if the variable consideration relates to both the lease and non-lease components, as in the case of certain inflation-linked lease arrangements. Assuming both lease and non-lease components have variable consideration, would the practical expedient apply if the lease portion of the variable consideration was accounted for upon resolution of the contingency pursuant to 842-30-25-11, but the non-lease portion is estimated and recognized over the contract term? Similarly, would the practical expedient not apply if the non-lease component variable consideration was subject to the constraint in ASC 606-10-32-11 and 12?

We also have concerns regarding the application of the practical expedient to arrangements that include multiple non-lease components. As noted by the Board in the basis for conclusions, examples of non-lease components include “common area maintenance services in real estate or other activities that transfer a good or service to the lessee separate from the right to use the underlying asset” (paragraph BC13). Proposed ASC 842-10-15-42A(a) requires the timing and pattern of revenue recognition of the lease component and non-lease components associated with that lease component to be the same. It is unclear to us what is meant by “non-lease components associated with that lease component” and if a reporting entity must consider only non-lease components *directly* associated with the lease component. For instance, common area maintenance frequently is directly associated with the lease component in real estate arrangements for which determining standalone selling price is difficult. This compares to ancillary services which may be included in the customer arrangement to be purchased at the customer’s option at stated prices (e.g., housekeeping, laundry services, or personal services such as hair styling). These ancillary services are not directly associated with the lease component, are sold separately, and their pattern of recognition would not be the same as the lease component. If a reporting entity is required to consider all non-lease components associated with the lease component as noted in the basis for conclusions (“other activities that transfer a good or service to the lessee separate from the right to use the underlying asset...”) versus only those directly associated with the lease component for which there is no standalone selling price, a reporting entity would be challenged to conclude the timing and pattern of revenue recognition for *all* components within the arrangement are the same.

Furthermore, paragraph ASC 842-10-15-42A, as drafted, states a lessor may, as an accounting policy election, account for each separate lease component and the non-lease components associated with the lease component as a “single lease component” if the criteria are met. We note that in some transactions, such as the real estate example noted above, the predominant deliverable is the lease component; whereas, in other transactions, the lease component is not the predominant deliverable. For example, a company may provide “free” equipment to a customer in a customer contract if the customer agrees to order the company’s products to be used with the provided free equipment. These arrangements may or may not require minimum purchase commitments.

We believe the Board should consider allowing entities, when making the practical expedient accounting policy election available under paragraph ASC 842-10-15-41A, to make an additional election to either account for the combined unit of account under ASC 842 or ASC 606, depending upon the facts and circumstances of that arrangement. We believe that accounting for the combined component based on the predominant component could provide more decision useful information to financial statement users. However, we believe that implementation guidance would be needed to ensure consistent application, given the subjectivity inherent in determining predominance.

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: We defer to financial statement users to provide feedback regarding the decision usefulness of the information provided by lessors electing the proposed practical expedient.

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We appreciate the opportunity to provide our comments and observations on the proposed ASU and would be pleased to discuss them with the Board members or the FASB staff at your convenience.

Sincerely,

Ryan Brady, CPA

Chair, Accounting Principles Committee

Brian Kot, CPA

Vice Chair, Accounting Principles Committee

APPENDIX A
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2017-2018

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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Large: (national & regional)

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Jared Bourgeois, CPA
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Jason Eaves, CPA
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Thomas Masterson, CPA
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