

September 11, 2018

To: Technical Director  
Financial Accounting Standards Board  
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Via Email: [director@fasb.org](mailto:director@fasb.org)

From: Tim Chatting

Re: File Reference No. 2018-260

Thank you for the opportunity to comment on the Proposed Accounting Standards Update, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*. I am a preparer of financial statements for a privately owned company in the technology industry with annual revenue of approximately \$2 billion. My current role is focused on accounting policy and implementation of accounting standards updates. The views provided in this comment letter are my own and do not necessarily represent those of my employer.

I support the proposed amendments regarding sales taxes and lessor costs paid directly by lessees when then the amounts are not readily determinable by the lessor.

I do not support the proposed amendments regarding recognition of variable payments for contracts with lease and non-lease components. The amended guidance is too complex and is not operable in certain circumstances when a contract includes services performed throughout the life of the contract or at different times for the customer. While it is clear how the amended guidance would be applied to services performed upfront or near the end of the contract, it is less clear how the amended guidance would apply to a service that is performed continually throughout the contract when the ongoing services cannot be combined with the lease under the practical expedient. This is discussed further under the response to question 9.

It is my view that variable payments in contracts with lease and non-lease components should be accounted for in one of two ways: (1) allocated solely to the Topic 606 performance obligations in accordance with paragraphs 842-10-15-38 through 15-39 and 606-10-32-40 (criteria a and b satisfied) or (2) the variable payments are otherwise deemed to relate at least partially to the lease component and, therefore, revenue is recognized for each variable payment when the changes in facts and circumstances on which the variable payment is based occur and the allocation is performed at this time. This binary approach is the most practical way for preparers to navigate between Topic 842 and Topic 606 and is consistent with the Board's observation made in the basis for conclusions to Update 2016-02 that a lessor should not account for a single variable payment in accordance with two accounting models due to the complexity that would result. Any concerns regarding acceleration of revenue for services performed near the end of the contract under the second method could be alleviated through required disclosures for lessors.

Furthermore, if the Board were to reject the changes to paragraph 842-10-15-40 proposed by this exposure draft and the guidance in this paragraph remain unchanged, I believe clarification of the Board's intent regarding Case B of Example 14 is necessary to help preparers consistently apply Topic 842. This is discussed further under the response to question 10.

Responses to the Board's specific questions are provided below.

**Question 1:** Should a lessor's accounting for sales taxes and other similar taxes collected from lessees be aligned with Topic 606? If not, please explain why.

**Response to Question 1:** Yes. The same concerns exist for both topics. The effort involved in performing a jurisdiction-by-jurisdiction analysis is not justified since such taxes have no effect on net income when collected from the lessee or the customer.

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

**Response to Question 2:** Yes. I believe this is consistent with current practice for many preparers.

**Question 3:** Would the proposed accounting policy election result in a reduction of decision-useful information to users of a lessor's financial statements? If so, please explain why.

**Response to Question 3:** No. Such taxes have no effect on net income when collected from the lessee or the customer.

**Question 4:** Should a lessor's accounting policy election for sales taxes and other similar taxes collected from lessees be applied to new lease contracts only or to all existing and new lease contracts? Please explain your rationale.

**Response to Question 4:** I believe preparers should have an option at transition to apply its accounting policy for sales taxes and other similar taxes collected from lessees to new lease contracts only or to all lease contracts. This may help ease the burden of adoption for some preparers.

**Question 5:** Should a lessor be required to exclude certain lessor costs paid directly by lessees to third parties on behalf of a lessor as variable payments when the uncertainty in the amount is not expected to ultimately be resolved? If not, please explain why.

**Response to Question 5:** Yes. A lessor should be required to exclude lessor costs paid directly by lessees to third parties on behalf of a lessor as variable payments when the uncertainty in the amount is not expected to ultimately be resolved.

**Question 6:** Are the proposed amendments for the accounting for certain lessor costs operable? If not, please explain why.

**Response to Question 6:** Yes. The proposed amendments for certain lessor costs paid directly by lessees should help simplify application of Topic 842 for lessors.

**Question 7:** Would the proposed requirement for a lessor to not report certain lessor costs paid directly by a lessee to a third party on behalf of the lessor result in a reduction of decision-useful information to users of a lessor's financial statements? If so, please explain why.

**Response to Question 7:** No. The proposed amendments for certain lessor costs paid directly by lessees should not result in a reduction of decision-useful information.

**Question 8:** Should the proposed amendment in paragraph 842-10-15-40A to exclude certain lessor costs paid directly by lessees on behalf of a lessor as variable payments be applied to new lease contracts only or to all existing and new lease contracts? Please explain your rationale.

**Response to Question 8:** I believe preparers should have an option at transition to apply this guidance to new lease contracts only or to all lease contracts. This may help alleviate the burden of adoption for some preparers.

**Question 9:** Would the proposed amendments clarify the application of paragraph 842-10-15-40? If not, please explain why.

No. The proposed amendments seem to introduce a *later of* threshold (later of when the variable fee is earned under Topic 842 or control transfers to the customer under step 5 of Topic 606) for the purpose of recognizing revenue for Topic 606 performance obligations when the variable payments relate at least partially to the lease component. Although applying the later of threshold may be clear for services performed upfront or services performed near the end of the contract, it is less clear how the amended guidance would apply to a service that is performed continually throughout the contract ("ongoing services") when the ongoing services cannot be combined with the lease under the practical expedient. This may be the case if the lease is classified as a sales-type lease under Topic 842 due to the lease term covering a major part of the life of the underlying asset. Even if the ongoing services were a series of distinct services, certain pricing structures may preclude allocation of the variable payment to a specific period of service. In this situation, it seems that the proposed amended guidance would require the variable fee to be added to the transaction price and allocated when the variable fee is earned and the amount allocated to the ongoing services would be recognized using the measure of progress selected in step 5 of Topic 606, such as a straight-line method for the purpose of this response. This would appear to require the portion of the variable fee earned and allocated to the ongoing services to be recognized on a straight-line basis over the service period, including cumulative adjustments to revenue each time the allocation is updated, rather than recognizing the portion of the total

expected variable payments allocated to the ongoing services on a straight-line basis. If my understanding is correct, this pattern of revenue recognition would be different than either the recognition pattern of the variable rent under Topic 842 or a pure application of Topic 606 and may be confusing to users of financial statements.

If the understanding above is incorrect, then I presume that the Board intended for entities to recognize the *lower of* the portion of the variable fee earned and allocated to the ongoing services or the amount of the total estimated variable fee that would have been allocated to the ongoing services and recognized on a straight-line basis under Topic 606. This would require dual accounting for the same service and would be overly complex and burdensome for preparers with contracts that include sales-type leases, ongoing services, and variable payments.

Either way, the proposed amendments do not appear to improve the guidance for recognition of variable payments for contracts with lease components and non-lease components. The Board's intention with respect to the accounting for services performed continually throughout the contract should be clarified if the proposed changes are incorporated into the final guidance.

**Response to Question 9:**

**Question 10:** Are the proposed amendments for the accounting for certain variable payments for contracts with lease and non-lease components operable? If not, please explain why.

**Response to Question 10:**

No. The proposed amendments are overly complex and are not operable in certain circumstances when a contract includes services performed continually throughout the contract, as discussed under the previous question, or when multiple services are performed at different times for the customer.

It is my view that variable payments in contracts with lease and non-lease components should be accounted for in one of two ways: (1) allocated solely to the Topic 606 performance obligations in accordance with paragraphs 842-10-15-38 through 15-39 and 606-10-32-40 (criteria a and b satisfied) or (2) the variable payments are otherwise deemed to relate at least partially to the lease component and, therefore, revenue is recognized for the variable payment when the changes in facts and circumstances on which the variable payment is based occur and the allocation is performed at this time. I believe a binary approach is the most practical way for preparers to navigate between Topic 842 and Topic 606 and is consistent with the Board's observation made in the basis for conclusions to Update 2016-02 that a lessor should not account for a single variable payment in accordance with two accounting models due to the complexity that would result. Any concerns regarding acceleration of revenue for services performed near the end of the contract could be alleviated through required disclosures for lessors.

If the Board were to reject the changes to paragraph 842-10-15-40 proposed by this exposure draft and the guidance in this paragraph remain unchanged, I believe it is unclear whether lessors should apply paragraph 842-10-15-40 to the entire variable payment stream or only to the portion of the variable payment stream allocated to the lease component when the variable payments relate specifically to a performance obligation under Topic 606 but the result of allocating the variable payment stream solely to the non-lease component would be inconsistent with the allocation objective in paragraph 606-10-32-28. This situation is illustrated in Case B of Example 14 in paragraphs 842-10-55-153 through 55-156.

It would be helpful if paragraph 842-10-55-156 could explain whether the guidance in 842-10-15-40 should be applied in Case B to (a) the entire variable payment stream (originally estimated to be \$21,000) on the basis that the variable payment relates partially to the lease component since a portion of the estimated variable payments was allocated to the lease component or (b) only 86.4% of the total variable payments allocated to the lease component (originally \$18,136) since the portion allocated to the maintenance is subject to Topic 606 rather than Topic 842. The accounting treatment under view A above would be consistent with paragraph BC163 of Update 2016-02, which states that "the Board decided that a lessor should not account for a single variable payment in accordance with two accounting models ..." and would seem to be a similar accounting result as Case A of Example 14 in spite of the fact that the contract consideration would include the variable consideration in Case B. However, it is not clear if view A is the appropriate accounting treatment based on the current explanation provided in paragraph 842-10-55-156.

Furthermore, if view B were the appropriate accounting treatment above, it would be helpful to explain how Subtopic 842-30 would be applied to this fact pattern. For example, would the total lease payments to be recognized on a straight-line basis be \$277,227 or \$259,091 (plus recognize \$18,136 of variable lease payments when and if earned)? Some preparers may view \$277,227 to be the lease payments for this purpose since the variable payments were determined to relate specifically to the maintenance service under the guidance in 842-10-15-39 and the amount allocated to the lease component is less than the total fixed consideration included in the contract. Other preparers may view \$259,091 to be the lease payments for this purpose since the total consideration (fixed and variable) was allocated between the lease and non-lease component in order to achieve a commercially reasonable allocation result and it is unclear how a downward adjustment to the expected variable payments would be handled for the lease component since “a lessor shall not remeasure the lease payments unless the lease is modified ...” under paragraph 842-10-35-6. This distinction would also affect the maturity analysis of lease payments that must be disclosed by lessors.

I have discussed the question above regarding Case B of Example 14 with two well-respected individuals from different accounting firms and received different responses regarding the appropriate treatment. Clarification of the Board’s intent regarding this case example, specifically whether a third accounting model should exist when the allocation objective of Topic 606 requires a relative stand-alone selling price allocation of the total consideration, would encourage consistent application of Topic 842 if the proposed amendments to paragraph 842-10-15-40 are ultimately rejected by the Board.

Lastly, if the proposed amendments to paragraph 842-10-15-40 are ultimately rejected by the Board, it is not clear how companies should handle the transition of existing contracts with lease components and non-lease components when the package of practical expedients is elected. It is my understanding that the Board did not intend for lessors to re-assess the transaction price and re-allocate consideration between lease and non-lease components when the package of practical expedients is elected; however, it is unclear whether and how paragraph 842-10-15-40 would be applied to existing contracts on the date the new standard becomes effective since Topic 840 does not preclude lessors from accounting for a variable payment under two accounting models. An illustrative example may be helpful in this regard and could be provided as part of the narrow-scope improvements to Topic 842 or included on the webpage for implementing new standards as supplemental information.

**Question 11:** How much time would be needed to implement the amendments in this proposed Update for an entity that early adopts Update 2016-02 before these proposed amendments are finalized? What transition method and transition disclosures should those entities be required to apply (provide)? Please explain your reasoning.

**Response to Question 11:** I believe that minimal time will be needed to implement the proposed amendments regarding sales taxes and lessor costs paid directly by lessees when then the amounts are not readily determinable by the lessor. I suspect that significant time may be needed to implement the proposed changes to recognition of variable payments for contracts with lease and non-lease components due to the increased complexity that is involved. Preparers that have recently configured or are in the process of configuring revenue recognition software may need to create new accounting models within their software in response to the proposed changes.

**Question 12:** Should the effective date for the amendments in this proposed Update be aligned with that of Update 2016-02? If not, please explain why.

**Response to Question 12:** Yes, except for the proposed changes to paragraph 842-10-15-40 due to the complexities and operability concerns noted in the responses to questions 9 and 10. More time would likely be needed to implement the proposed changes to paragraph 842-10-15-40 since these changes are more likely to affect the configuration of revenue recognition software.

Regards,  
Tim Chatting, CPA