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September 11, 2018

Via email to director@fasb.org

Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Leases (Topic 842): Narrow-Scope Improvements for Lessors (File Reference No. 2018-260)

Dear Ms. Cosper:

We are pleased to provide our comments on the Board's proposal to provide lessors with narrow-scope improvements to the application of the guidance in Topic 842, Leases. We support the Board's objective to reduce lessors' costs and complexity in transitioning to, and complying with, the new lease requirements. Our responses to the Board's specific questions, along with our suggestions, are provided in Appendix A to this letter.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Angela Newell at (214) 689-5669 or Thomas Faineteau at (214) 243-2924.

Very truly yours,

BDO USA, LLP

BDO USA, LLP

Appendix A

Sales Taxes and Other Similar Taxes Collected from Lessees

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.

We agree that a lessor's accounting for sales taxes and other similar taxes collected from lessees should be aligned with the accounting policy election in Topic 606 on revenue from contracts with customers (specifically, paragraph 606-10-32-2A). We believe lessors would benefit from a similar accounting policy election in Topic 842 because they otherwise would face the same operability issues as those that led to the issuance of the accounting policy election in paragraph 606-10-32-2A. We believe there would also be additional operability issues if the Board decided not to provide a similar accounting policy election in Topic 842 because, as described in paragraph BC10 of the Basis for Conclusions of the proposed Update, lease contracts often include nonlease components (within the scope of Topic 606).

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

We believe the proposed accounting policy election is operable. We also observe that the proposed amendments would not require an entity that elects the accounting policy election in proposed paragraph 842-10-15-39A to also elect the accounting policy election in paragraph 606-10-32-2A, and vice versa. We do not have any concerns with this flexibility and believe that most entities generally will make the same election for both accounting policies.

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.

We do not believe the proposed accounting policy election would result in any meaningful reduction of decision-useful information to users of a lessor's financial statements. We also observe that before issuing the similar practical expedient in paragraph 606-10-32-2A, the FASB staff performed outreach with financial statement users. Paragraph BC31 of the Basis for Conclusions of Accounting Standards Update 2016-12, *Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients*, notes that "[m]ost users reported that presentation of all sales (and other similar) taxes on a net basis (that is, excluded from both revenues and costs) would provide the most useful financial information."

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.

If a lessor were to apply the accounting policy election prospectively to new leases only, the information reported in a lessor's lease revenue may not be consistent between existing leases and new leases, depending on how they were reporting such items for existing leases before the new leases standard. Since this inconsistency in reporting would perpetuate for a number of years until existing leases expire or are modified, we believe that the proposed accounting policy election for sales taxes and other similar taxes collected from lessees should be applied to all existing and new leases.

Certain Lessor Costs Paid Directly by Lessees

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.

We agree that a lessor should be required to exclude certain lessor costs paid directly by lessees to third parties on behalf of a lessor as variable payments when the amount of lessor costs paid by the lessee is not readily determinable. In addition, while we agree with the location of the proposed amendment, we believe some entities that have lease components only may simply overlook the proposed amendment in Subtopic 842-10. Accordingly, we believe making conforming amendments to the guidance on recognition of variable lease payments in Subtopic 842-30 on lessor accounting would be beneficial.

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

We believe the proposed amendments would generally be operable considering the term "readily determinable" already exists in Topic 842, and existed in Topic 840, Leases, and therefore already was applied in practice. However, we believe the Board should further clarify the intended application of the proposed guidance for situations where a lessee is required to provide, or voluntarily provides, to the lessor the amounts that it paid on the lessor's behalf because some lessors may believe they can report those amounts as revenue in those situations. Our primary concern relates to the reliability of any amounts that a lessor would report as variable lease income; for example, when those lessor costs paid by the lessee to a third-party are impacted by lessee-specific factors (such as deductibles, whether the underlying asset is insured under an umbrella policy, etc.) or when the lessee's payment protects both the lessor's underlying asset and the lessee's assets (such as real estate insurance that protects both the lessor's building and the lessee's assets) but the lessee reports to the lessor the total amount paid rather than an allocated portion of the payment, which the lessor may not know. While we believe the intent of the proposed guidance is to require exclusion of those payments from variable payments when the amounts are not readily determinable, we believe it would be beneficial for the Board to clarify in proposed paragraph 842-10-15-40A or in the Basis for Conclusions that the proposed guidance would apply, and therefore a lessor would be precluded from reporting lessee-paid costs as revenue, even in situations where the lessee is required to, or does voluntarily, report amounts of lessor costs that it paid to third-parties.

We also note there could be situations where the amounts paid by the lessee on behalf of the lessor may be considered readily determinable (because the amounts paid are not impacted by lessee-specific factors) and yet the lessor may not be able to determine the ultimate amount paid by the lessee. For example, this could occur when a lessee has the right under the lease agreement to appeal or otherwise negotiate directly with a tax jurisdiction a lower property tax payment without the lessor's involvement or knowledge. In those situations, the property tax information available on the jurisdiction's website may not reflect such abatement or lower tax on a timely basis. We believe it would be beneficial to clarify how the proposed guidance would apply in those situations, including whether the lessor would be required to report such taxes as variable lease revenue and at what amount considering the uncertainty related to the actual amount paid by the lessee.

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.

We believe practice under Topic 840 is to generally exclude executory costs (such as property taxes and insurance) from variable lease revenue in net lease situations where the lessee is responsible for paying those executory costs directly to third-parties. In addition, based on our understanding of the proposed amendment, when the lessee pays lessor costs directly to third-parties, payments related to insurance generally would not be readily determinable because they are affected by lessee-specific factors, while payments related to property taxes (for example, real estate taxes) generally would be readily determinable (a point we believe should be acknowledged in the basis for conclusions). Accordingly, the proposed amendment may result in a change in reporting in a lessor's lease revenue, particularly for property taxes, and the Board therefore may consider performing additional outreach with users to determine whether this outcome would improve or reduce the decision-usefulness of information provided to them.

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.

As described in Question 7, we believe the proposed amendment could result in a change in reporting in a lessor's lease revenue particularly for property taxes. Accordingly, if the amendments are finalized as proposed, we believe that the amendments should apply to all existing and new lease contracts to maintain the consistency of information reported in a lessor's lease revenue.

Recognition of Variable Payments for Contracts with Lease and Nonlease Components

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

We agree that the amendments in the proposed Update would provide additional clarity about the intended application of paragraph 842-10-15-40. However, we believe the readability and operability of the proposed amendments could be improved by providing a two-step approach for accounting for the variable payments addressed in that paragraph (Step 1 – allocate, Step 2 - recognize). The amendments, as proposed, include some repetitiveness that we believe could be avoided. Specifically, we believe that:

- It is not necessary to first explicitly prohibit recognition of the variable payments before the changes in facts and circumstances on which the variable payments are based occur because recognition of the payments as income in profit or loss can occur only *after* a lessor knows the portion of the variable payments that is allocated to the lease and nonlease components.
- The timing of recognition of those variable payments as income in profit or loss would be addressed by the last sentence of the proposed amendments.

Our proposed changes from *original* paragraph 842-10-15-40 are shown in <u>underlined text</u> and ~~struck out text~~.

> **842-10-15-40** If the terms of a variable payment amount other than those in paragraph 842-10-15-35 relate to a lease component, even partially, the lessor shall <u>allocate</u> ~~recognize~~ those payments <u>to the lease and nonlease components</u> ~~as income in profit or loss in the period~~ when the changes in facts and circumstances on which the variable payment is based occur (for example, when the **lessee's** sales on which the amount of the variable

> payment depends occur). Variable payment amounts allocated to the lease component shall be recognized as income in profit or loss in accordance with this Topic, while variable payment amounts allocated to nonlease components shall be recognized in accordance with other Topics (for example, Topic 606 on revenue from contracts with customers).

However, if the Board decides to retain the structure of proposed paragraph 842-10-15-40, we suggest some minor edits to improve the readability of the first sentence in that proposed paragraph.

> **842-10-15-40** If the terms of a variable payment amount other than those in paragraph 842-10-15-35 relate to a lease component, even partially, the lessor shall not recognize ~~the lease and nonlease components related to~~ those payments as income in profit or loss before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depends occur) […]

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

See our response to Question 9.

Transition and Effective Date for Early Adopters

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.

We generally believe early adopters would not need any significant additional time to implement these proposed amendments because those are intended to simplify the application of the new lease standard and those who early adopted have already complied with the new standard. However, we defer to early adopters for additional feedback on this question.

We believe entities that early adopted ASU 2016-02 should also be provided with a transition method similar to that provided in Accounting Standards Update No. 2018-11, *Leases (Topic 842) – Targeted Improvements* (that is, to apply the proposed amendments either retrospectively or prospectively) so as to not penalize those entities that early adopted. We do not believe any additional disclosures beyond the standard requirements would be necessary upon transition.

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.

We believe it generally would be preferable for the effective dates of this proposed Update to align with the effective dates in ASU 2016-02. However, entities may need additional time to comply with the final amendments. This will depend on when the proposed Update is finalized compared to the effective dates in ASU 2016-02 and the extent to which preparers will need to update their processes, systems and controls as a result of the final standard for lessor improvements.