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

File Reference No. 2018-260

Re: Proposed Accounting Standards Update, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*

Dear Ms. Cospers:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Leases (Topic 842): Narrow-Scope Improvements for Lessors*.

We support the Board's efforts to amend certain aspects of ASU 2016-02, *Leases (Topic 842)*, to reduce the costs and complexity of implementing the standard. For example, we generally support the Board's proposed amendments for lessors that would reduce ambiguity and clarify the Board's intentions on certain matters.

In particular, we support the Board's proposals that address how an entity may account for certain lessor costs paid directly by lessees. However, as noted in Appendixes A and B of this letter, we are concerned that the proposed ASU leaves open certain questions that the Board should address before issuing a final ASU to ensure consistent application in practice.

Appendix A contains our responses to the proposed ASU's questions for respondents. Appendix B discusses additional but related questions that have arisen about how entities should account for sales taxes that are a lessee cost.

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: Kristin Bauer
Robert Uhl

Appendix A

Deloitte & Touche LLP

Responses to Proposed ASU's Questions for Respondents

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 support the Board's proposed amendment to ASU 2016-02 that would provide an accounting policy election for lessors to exclude from lease revenue sales taxes and other similar taxes assessed by a governmental authority and collected by the lessor from a lessee. We believe that allowing a lessor relief from evaluating whether these taxes are a cost of the lessor or of the lessee, which is similar to the relief provided for contracts within the scope of ASC 606, would reduce the burden on lessors while not significantly reducing decision-useful information to financial statement users. While we expect that entities will often align their elections under both ASC 606 and ASC 842, we support the amendment as proposed (i.e., delinked from ASC 606) such that consistent elections between standards would not be required.

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

We support the proposed accounting policy election as written. In addition, we suggest that the Board add further discussion to the Background Information and Basis for Conclusions to describe the Board's journey of developing guidance on the accounting policy election. We understand that the Emerging Issues Task Force (EITF) debated the topic in EITF Issue No. 06-3, "How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)," which formed the basis of the guidance on the topic in ASC 606. We believe that this guidance then formed the basis for defining the scope of the accounting policy election under proposed ASC 842-10-15-39A. If so, we believe that the Board's intention was to carry forward the scope and interpretation from Issue 06-3 and that it would therefore be helpful to link the proposed requirements back to the legacy guidance on which they are based. Specifically, Issue 06-3 indicates that the scope of the Issue includes all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer. In addition, Issue 06-3 excluded taxes assessed on an entity's total gross receipts or *imposed during the inventory procurement process* from the scope of the accounting policy election, while the proposed guidance would exclude taxes assessed on a lessor's total gross receipts or *on the lessor as owner of the underlying asset* from the scope of the accounting policy election. We believe that the requested clarification above would give future users of the proposed guidance a better understanding of the scope of the accounting policy election, including the intentional similarity of the exclusions.

Finally, we understand that some preparers may request relief from evaluating whether property taxes are a cost of the lessor or of the lessee under the view that this determination features the same complexities as the sales tax determination. To the extent that the FASB receives such requests and decides to provide the requested relief,

the basis should be modified accordingly.

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.*

From our perspective, we do not believe that the proposal would result in a reduction of decision-useful information since the net effect of recording the taxes would be zero in the income statement.

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.*

We think that the accounting policy election should be applied consistently to all existing and new lease contracts from the date of adoption of a final ASU. The consistent application to all existing and new lease contracts would provide more decision-useful information, particularly because fewer variations in financial reporting would occur. We do not believe that requiring entities to restate prior periods would be justified, especially given the approaching effective date of ASU 2016-02 and the types of transition relief provided under ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. However, if an entity desires to restate prior periods, it should not be prohibited from doing so since comparable information is generally more decision-useful.

Further, we think that when a final ASU is issued, the new guidance should make clear whether an entity's amendment of comparable periods to align them with this accounting policy election (if applicable) is required, permitted, or prohibited when the entity elects the recently afforded transition option (i.e., the ability to present comparative reporting periods in accordance with ASC 840).

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.*

On the basis of our outreach, we do not believe that many entities would opt for the alternative (if allowable) to estimate certain lessor costs paid directly by lessees when the uncertainty in the amount is not expected to be ultimately resolved. This might suggest that allowing an alternative is unnecessary and would create needless complexity. Conceptually, however, since these are lessor costs, if an entity wanted to estimate the amount paid directly by a lessee to properly reflect its own costs, it would seem unusual to prohibit such an effort. We think that the absence of any guidance in ASC 606 that explicitly prohibits such an estimation supports the conceptual view that an accounting policy election rather than a requirement may be more appropriate.

In addition, we recommend that the Board clarify whether the variable payments referenced in proposed ASC 842-10-15-40A are fully or partially related to the lease component. We assume that as currently written, the paragraph is intended to indicate that if a variable payment that is subject to the proposed requirement is even partially

related to a lease component, the entire cost should be accounted for under ASC 842 (i.e., the lessor should not estimate amounts paid directly by the lessee). We request that the Board confirm this scope assumption and incorporate it into the final ASU to ensure that the intent of the amendment is achieved, particularly if the guidance in the amendment remains a requirement.

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

We think that there are challenges related to applying the proposed guidance in ASC 842-10-15-40A that should be addressed before a final ASU is issued.

Although we acknowledge and support the effort to use a term included elsewhere in U.S. GAAP (i.e., "readily determinable"), we also recognize the difficulty of using the same term for various purposes. We understand that "readily determinable fair value"¹ is an ASC master glossary term used in ASC 321 and that "readily determinable" is a concept that an entity applies when determining the discount rate to be used under ASC 842. Therefore, while we do think that the term "**not** readily determinable" could be used in the context of the proposed guidance in ASC 842-10-15-40A, we believe that it is difficult to ensure consistency with the expected outcome unless there is greater clarity about the key tenets inherent in applying the term.

As currently drafted, we would interpret the key tenets of the term "readily determinable" to be (1) the existence of objective evidence of the costs paid or to be paid and (2) the availability of such evidence to the lessor. In addition, we observe that the Board indicates in paragraph BC18 of the proposed ASU that costs generally would not be readily determinable by a lessor when they are affected by lessee-specific factors. However, the Board does not sufficiently clarify when a payment is affected by lessee-specific factors. Accordingly, while significant estimation would not be required, an effort to identify the costs may be required.

Note that we do not necessarily believe that the information would have to be publicly available (which appears to be closer to the definition of "readily determinable fair value"); rather, it would merely have to be made available to the lessor, usually as a result of the lessor's ownership interest in the underlying asset. For example, assume that a lessee pays real estate taxes on behalf of the lessor directly to a taxing authority, but the taxing authority may be required to provide information about the real estate taxes to

¹ The ASC master glossary states that an "equity security has a readily determinable fair value if it meets any of the following conditions:

- a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year.
- b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
- c. The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions."

the lessor given the lessor's involvement with the property (i.e., as the legal owner). On the basis of our interpretation, we think that the real estate taxes are readily determinable. In contrast, consider a second example in which a lessee pays insurance costs directly to an insurance provider, as required by the lease. The lessor requires proof of insurance, which denotes the lessor as a primary beneficiary of the policy that is protecting the underlying asset. However, such proof of insurance excludes evidence of what the lessee paid for coverage specific to the lessor, and the insurance company is not required to make this information available to the lessor. On the basis of our interpretation, we think that the insurance costs are not readily determinable.

We request that the Board (1) confirm these or other key criteria that it expects entities to use when applying the term "not readily determinable" as intended in ASC 842-10-15-40A and (2) include such criteria in the final guidance. Further, we note that at the FASB's March 28, 2018, meeting, the Board acknowledged the complexity of assessing the degree of effort that would be required to obtain or otherwise determine the amounts paid directly by lessees for certain lessor costs. Accordingly, we believe that without additional amendments to clarify the Board's intent, the "not readily determinable" concept will not be consistently applied. For example, we are aware of a view in practice that a cost would not be readily determinable under the proposed guidance unless the amount was paid by the lessor and reimbursed by the lessee. This view is dramatically different from our initial interpretation as described above, which highlights the need for additional guidance from the FASB one way or the other.

When we have shared our interpretation of "readily determinable" with preparers, one of the common concerns expressed has been the level of effort required to obtain information that may not be critical to financial statement users. In this regard, we would encourage the FASB to consider providing relief from the requirement to "determine" the amounts if such an exercise cannot be performed without undue cost and effort.

We also recommend that the Board clarify the point in time at which the lessor makes the assessment of whether the costs are not readily determinable. We assume that the proposed guidance in ASC 842-10-15-40A should be applied over the period of the contract (i.e., assessed each period) rather than only at lease commencement. That is, to the extent that costs paid by the lessee are or will become readily determinable, such costs should not be excluded from variable payments. However, given the lack of clarity in the proposed amendments, we expect that entities may question the appropriate accounting for costs that are not readily determinable at commencement of the lease but later become readily determinable.

In summary, we have significant concerns about the limited guidance offered on the readily determinable notion in the proposed ASU and encourage the Board to provide additional guidance on applying the concept, including the timing of assessment. Without additional guidance on this point, we would expect inconsistent treatment in practice.

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.*

From our perspective, we do not believe that the proposal would 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.*

We think that the proposed amendment should be applied consistently to all existing and new lease contracts from the date of adoption of a final ASU. The consistent application to all existing and new lease contracts would provide more decision-useful information, particularly because fewer variations in financial reporting would occur. We do not believe that requiring entities to restate prior periods would be justified, especially given the approaching effective date of ASU 2016-02 and the types of transition relief provided under ASU 2018-11. However, if an entity desires to restate prior periods, it should not be prohibited from doing so since comparable information is generally more decision-useful.

Further, we think that when a final ASU is issued, the new guidance should make clear whether an entity's amendment of comparable periods to align them with this requirement (if applicable) is required, permitted, or prohibited when the entity elects the recently afforded transition option (i.e., the ability to present comparative reporting periods in accordance with ASC 840).

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 support the Board's proposed amendment in ASC 842-10-15-40. The proposed amendment resolves the issue identified, which could have resulted in earlier recognition of revenue related to variable payments than under ASC 606.

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.*

We think that the proposed amendments are operable as written.

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 support the same transition approach as that provided under ASU 2018-11. That is, an entity that early adopted ASU 2016-02 before the issuance of ASU 2018-11 should be provided an election to apply the proposed amendments as of either (1) the lessor's first reporting period after the issuance of a final ASU or (2) the mandatory effective date of ASC 842 (i.e., January 1, 2019, for a calendar-year-end public entity).

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 agree that the effective date for this proposed ASU should be aligned with that of ASU 2016-02.

Appendix B Additional Comment

Comment — Accounting for Sales Taxes From a Lessee’s Perspective

Questions have arisen about how entities should account for sales taxes that are a lessee cost. Given the Board’s effort to address a lessor’s accounting for sales taxes and other similar taxes collected from lessees, we encourage the Board to consider the accounting for sales taxes from a lessee’s perspective.

Specifically, entities have asked whether sales taxes that are an obligation of the lessee and incurred at lease commencement should be capitalized as part of the right-of-use asset. Note that it is understood that sales taxes that the lessee is obligated to pay to the tax authority are not a “lease payment”; therefore, the exclusion of sales taxes from the lease liability is not in question. However, in discussions, questions have been raised about when an obligating event related to sales taxes occurs (i.e., at the execution of the contract, at the commencement of the lease, or on the billing date of the sales tax). We acknowledge that these questions were not raised in response to changes in the leases guidance but rather because this topic has received additional focus as a result of the issuance of ASU 2016-02.

It would appear that if a lessee becomes legally obligated to the tax authority at the commencement of the contract to pay a certain amount of sales taxes, the lessee would have a present obligation to pay the sales taxes regardless of whether they are payable up front or over the life of the contract. However, if the lessee is not legally obligated to make a payment until receipt of an invoice after lease commencement, it may be determined that the lessee is not subject to an obligating event that gives rise to a present obligation until receipt of the invoice. We believe that if the sales tax obligation is incurred at lease commencement, this cost could be capitalized in an asset as an initial direct cost or, by analogy to ASC 360, as a cost necessarily incurred to bring the asset to the condition and location necessary for its intended use.

We request that the Board consider the questions discussed in this comment and address the uncertainty in accounting application in a public forum.