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September 12, 2018

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

RE: Proposed Accounting Standards Update, *Leases (Topic 842): Narrow-Scope Improvements for Lessors* (File Reference No. 2018-260)

Dear Technical Director:

We appreciate the opportunity to comment on the proposed ASU, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*.

Sales Taxes And Other Similar Taxes Collected From Lessees And Certain Lessor Costs Paid Directly By Lessees

While we have included targeted suggestions for improvement in our responses to the Questions for Respondents, we support both:

- The proposed accounting policy election for sales and other similar taxes; and
- The proposed requirement for lessors to account for lessor costs and related lessee payments on a net basis in the income statement when the lessee's payments of the lessor cost are made directly to a third party and the amount of the cost paid by the lessee is not readily determinable.

Increased consistency with Topic 606

Both proposals, as they are scoped in the proposed ASU, would increase convergence between the lessor accounting guidance in Topic 842 and the revenue guidance in Topic 606. We agree with the Board's statements in paragraph BC92 of ASU 2016-02 that "leasing is, fundamentally, a revenue-generating activity for lessors," and, therefore, "there should be cohesion between the revenue recognition (and related cost) guidance applicable to sellers of tangible goods and the guidance applicable to lessors of those same assets."¹

We encourage the Board to finalize these proposals with the objective of enhancing convergence between lessor accounting and revenue recognition accounting, which drove the nature, scope and breadth of so many of the lessor accounting decisions reached during the development of Topic 842. We believe convergence between lessor accounting and revenue recognition accounting is of long-term benefit to US GAAP and financial statement users (i.e. applying consistent principles in the accounting for similar transactions), and also benefits lessors that enter into leasing contracts that include non-lease components

¹ Similar statements are made in the introduction to ASU 2016-02, and the Basis for Conclusions to ASU 2018-11 (paragraph BC17).

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within the scope of Topic 606. For those lessors, having different accounting requirements for lease and non-lease components in the same contract creates unnecessary complexity.

Operational relief

We believe these proposals would simplify applying Topic 842 for many lessors and address operational issues raised without sacrificing core conceptual aspects of the standard. Specifically, we believe the proposals generally would address:

- the operational and information quality concerns raised by lessors about estimating lessor costs paid by the lessee directly to a third party when the lessor does not know, is not expected to know and cannot readily determine the amount the lessee paid;
- the operational concerns about determining the primary obligor for various ‘in-scope’ taxes in numerous taxing jurisdictions; and
- concerns that lessors entering into contracts with lease and non-lease components would have to account for similar items (e.g. sales and other similar taxes) in the same contract differently.

In addition, we believe the proposals address the conceptual inconsistency some stakeholders believe exists between the Board’s views in paragraph BC92 of ASU 2016-02 and the lessor accounting guidance in Topic 842 absent guidance of the nature in these two proposals.

Narrow scope still provides relief

We agree with the generally narrow scope of the proposals in view of the pending effective date of the leases standard. Expanded proposals may have unintended consequences and/or require additional due process that is not feasible to complete before the effective date. Therefore, unless the Board defers the effective date, we do not believe that it should reopen at this time core aspects of Topic 842, such as (1) identifying what are contract components or (2) the foundational guidance that a lessee’s payment of a lessor’s costs is not substantively different from the lessee making a larger or an additional payment (or variable payment) to the lessor.

We additionally believe a narrow scope for these proposals is appropriate to the extent that a broader scope could affect areas of existing convergence with IFRS 16. For example, items (1) and (2) in the preceding paragraph represent converged areas of the two leases standards on which the two Boards decided unanimously. We believe the FASB should retain areas of convergence that exist between the two standards for conceptual and practical reasons of operability for dual-reporting entities.

Finally, a more expansive scope for these proposals, again using items (1) and (2) as examples, may create new differences, rather than enhance convergence, between the lessor accounting guidance in Topic 842 and the revenue guidance in Topic 606.

Despite their generally narrow scope, as outlined in the preceding section, we believe the two proposals adequately address the concerns raised by stakeholders that gave rise to this narrow scope improvements project.

Recognizing Variable Payments for Contracts with Lease and Nonlease Components

We believe revising paragraph 842-10-15-40 may help to clarify the Board’s intent in accounting for variable payments that are not part of the ‘consideration in the contract’ (i.e. because they do not relate

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solely to a non-lease component – see paragraph 842-10-15-39). However, we believe the proposed amendments could have unintended consequences. We describe those potential consequences, and provide suggested edits to address our concerns.

Issue 1 – Recognition of lease and non-lease components

We believe the words that we struck through in our suggested edits (which follow Issue 2) are not necessary to achieve the goal of the revisions to paragraph 842-10-15-40. More importantly, we believe the statement that “the lessor shall not recognize the lease and nonlease components...before the changes in facts and circumstances on which the variable payment is based occur...” is inconsistent with other guidance in Topic 842. Specifically, we believe other guidance in Topic 842 requires lessors to identify components at contract inception and to account for those components in many cases before changes in facts and circumstances occur that give rise to variable payments. Using Example 14—Case A of Subtopic 842-10 to illustrate, Lessor identifies the separate lease and non-lease components at contract inception and would begin to recognize operating lease income and non-lease maintenance revenue on the lease and non-lease components based on the fixed consideration in the contract before a productivity target would be met.

Issue 2 – Inability to specifically allocate variable payments that meet ASC 606-10-32-40 criteria

We believe proposed paragraph 842-10-15-40 could be read to prohibit a lessor from allocating variable payments to only one or some components of a contract because it would explicitly require allocation ‘on the same basis’ as the ‘consideration in the contract’. Lessors would not, therefore, be able to allocate variable payments (e.g. usage payments on leased equipment, or variable payments of property taxes or insurance) solely to a lease or non-lease component of the contract even if those variable payments would otherwise qualify for specific component allocation under paragraph 606-10-32-40. We do not believe it is the Board’s intent to prohibit specific component allocation of variable payments that meet the requirements in paragraph 606-10-32-40, as the remainder of the lessor allocation model is based on applying the Topic 606 transaction price allocation guidance (including the variable payments allocation guidance in paragraphs 606-10-32-39 through 32-41). We believe a prohibition would be an unnecessary exception to otherwise relying on the transaction price allocation guidance in Topic 606 to allocate between lease and non-lease components.

To address Issue 2, we suggest the Board consider adding to paragraph 842-10-15-40 the underlined text. We believe this revision would maintain consistency with Topic 606 with respect to lessor allocation between lease and non-lease components, and would appropriately permit variable payments to be specifically allocated when the requirements in paragraph 606-10-32-40 are met. We believe lessors are currently expecting to be able to specifically allocate variable payments that meet those requirements; therefore, a change in this regard would likely be unexpected and affect many lessors’ implementation plans for certain variable payments.

Suggested edits related to Issue 1 and Issue 2:

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 before the changes in facts and circumstances on which the variable payment is based occur

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(for example, when the lessee's sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and nonlease components of the contract on the same basis as the initial allocation of the consideration in the contract or the most recent modification not accounted for as a separate contract ²(unless the variable payment meets the criteria in paragraph 606-10-32-40 to be allocated to only one or some of the separate lease or non-lease components of the contract, in which case the payment shall be allocated in accordance with that paragraph). 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).

* * * * *

Our responses to the Questions for Respondents are included in the Appendix to this letter.

If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com, or Scott Muir at (212) 909-5073 or smuir@kpmg.com.

Sincerely,

Handwritten signature of KPMG LLP in black ink.

KPMG LLP

Appendix – Responses to 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.

Yes. Consistent with our comments in the cover letter, we support the Board’s efforts to enhance convergence between the lessor accounting guidance in Topic 842 and the revenue guidance in Topic 606 for conceptual and operational reasons.

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

Yes. We believe the proposed language would be operable. However, we believe there are potential improvements, derived principally from the Basis for Conclusions to the proposed ASU, that would clarify its application. Specifically, we believe *explicit reference in the Codification* to the fact that this election means treating all in-scope taxes as costs of the lessee, which would, therefore, result in net presentation in the income statement, would be clearer about the effect of the election in a leasing context than referring to excluding the in-scope taxes ‘from the consideration in the contract and from variable payments not included in the consideration in the contract’. In addition, we believe the proposed language is inaccurate because it is not the taxes that will be excluded from the consideration in the contract or from variable payments not included in the consideration in the contract, but rather the lessor’s related collections from the lessee. In the absence of a policy election, the in-scope taxes, if a lessor cost, would be presented as an expense while the related collections from the lessee would be presented as lease revenue in the income statement. We suggest these revisions (additions are underlined and deletions are struck through):

842-10-15-39A A lessor may make an accounting policy election to account for ~~exclude from the consideration in the contract and from variable payments not included in the consideration in the contract~~ all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific lease revenue-producing transaction and collected by the lessor from a lessee (for example, sales, use, value added, and some excise taxes) as costs of the lessee (that is, as though the lessor is acting as an agent for the collection of the taxes). ~~Taxes assessed on a lessor’s total gross receipts or on the lessor as owner of the underlying asset shall be excluded from the scope of this election.~~ A lessor that makes this election shall present ~~exclude from the consideration in the contract and from variable payments not included in the consideration in the contract~~ all taxes within the scope of the election and all collections of those taxes from the lessee on a net basis in the lessor’s statement of comprehensive income, and shall comply with the disclosure requirements in paragraph 842-30-50-14. Taxes assessed on a lessor’s total gross receipts or on the lessor as owner of the underlying asset shall be excluded from the scope of this election.

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 believe this question is best addressed by financial statement users. However, we would not expect the effect to be substantially different from the effect of the Board’s decision to grant an equivalent policy election to entities under Topic 606. Financial statement users may be able to provide feedback about how they view the effect of the policy election under Topic 606 at this point.

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.

In general, we believe the proposed policy election should apply from the lessor’s date of initial application (e.g. the effective date, if electing the new transition option offered by ASU 2018-11) to all existing and new leases, which would be consistent with the Board’s transition guidance in ASU 2018-11 on the new lessor practical expedient not to separate lease and related non-lease components. We believe it would be preferable for the decision reached on this question (as well as the related one applicable to ‘certain lessor costs paid directly by lessees’ in Question 8) to follow the Board’s related decision for the new lessor practical expedient not to separate lease and related non-lease components. Applying the same transition approach as it relates to this question to all of these lessor elections (or accounting change in the case of certain lessor costs paid directly by lessees) likely would minimize confusion on the part of preparers and users. We believe it may be complex and/or confusing for preparers to adopt, and users to digest, a number of lessor accounting changes enacted during the final few months of the implementation period each with a different transition approach.

The preceding notwithstanding, it may be consistent with the Board’s stated intent to effectively permit lessors to “run-off” their existing leases² to permit those lessors with an existing accounting policy on gross or net presentation of sales or other similar taxes or items that will constitute lessor costs under Topic 842 to apply the proposed ASU’s guidance solely to 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.

Yes. As stated in our cover letter, we support this proposal because we believe it would further the Board’s stated objective of maximizing cohesion between lessor accounting under Topic 842 and the accounting for revenue contracts under Topic 606, would provide appropriate operational relief to lessors, and is scoped appropriately. With respect to cohesion with Topic 606, we believe that the proposal, as drafted, would result in lessors that apply Topic 842 and vendors that apply Topic 606 presenting lessor/vendor costs and lessee/customer payments thereof in a consistent manner.³

² See paragraph BC390 of ASU 2016-02.

³ See [FASB Memo No. 2, Reimbursement of Out-of-Pocket Expenses](#), for the June 26, 2018 Private Company Council (PCC) meeting and [TRG Agenda Paper No. 2, Gross versus Net Revenue: Amounts Billed to Customers](#).

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

Yes. We believe the proposal is operable. However, we are aware of questions some stakeholders have about when the proposed requirement would apply. To address those questions, and therefore provide clarity in a timely manner about how it intends for companies to apply the proposal in light of the pending effective date, the Board may wish to provide more explicit guidance. Specifically:

- Paragraphs BC13, BC14 and BC17 suggest the Board intended to model the proposal after the ‘estimating gross revenue as a principal’ guidance in ASU 2016-08. The Board could further state whether it believes lessors should reach conclusions about what is readily determinable that are generally consistent with the conclusions a vendor that is a principal in a revenue arrangement would reach about whether an uncertainty is expected to ultimately be resolved.
- Statements made at the March 28, 2018 Board meeting expressed the view that lessors would generally be able to readily determine the amount of lessor costs for which they are the primary obligor. For example, at that meeting, FASB staff members observed that a lessor primarily obligated to a tax generally would be expected to have the ability and the right to obtain information about its tax liability, regardless of whether it or a lessee remitted the payment to the taxing authority, such that the tax and lessee payments of that tax would not be subject to the proposed requirement. This is in contrast to something like an insurance policy premium that is based on lessee-specific factors and to which the lessor has no right to obtain or access the premium information, which BC14 and BC18 of the proposed ASU indicate would not be readily determinable. If the Board agrees with the position expressed at the March 2018 Board meeting about costs for which the lessor is the primary obligor, which we believe is generally consistent with how to apply the ‘estimating gross revenue as a principal’ guidance in ASU 2016-08 (i.e. deciding when a payment uncertainty will not ultimately be resolved), additional guidance or discussion in the Basis for Conclusions of the final ASU to that effect would be useful. If that is the Board’s view, it would also provide a contrasting example to that of the insurance policy premium, more clearly delineating the boundaries of the proposed requirement than the proposed example illustrating lessor costs of property taxes and insurance reimbursed to the lessor by the lessee.
- The Board may wish to clarify to what, if any, extent the amount of effort involved to obtain the cost information affects the applicability of the proposed requirement. For example, if a lessor has the ability and the right to obtain information about the amount of a cost, but doing so would require significant effort (e.g. because of the volume of the company’s leases), does that affect whether the proposal would apply? If the Board believes the amount of effort to obtain the lessor cost information should factor into whether the proposed requirement applies, we believe the Board should revise the proposed guidance to either (1) use language other than ‘readily determinable’ to establish applicability of the requirement or (2) clarify that the requirement applies not only when the cost amount is not readily determinable, but also when obtaining the cost information would require significant effort (e.g. *undue cost or effort*, or similar). This is because we do not believe the level of effort required is a factor to be considered when evaluating whether something is readily determinable in other contexts (e.g. when deciding if an equity security has a readily determinable fair value). The Board should also de-link the proposal from the ‘estimating gross revenue as a principal’ guidance in ASU 2016-08 (e.g. in the Basis for Conclusions of the final ASU). This is because we do not believe a principal in a revenue transaction would conclude an uncertainty in the transaction price will not ultimately be resolved on the basis of the effort required to obtain the information available to resolve it. An effort consideration here, together with indications that the Board believes these two

requirements to be substantially the same, may confuse application of this requirement and/or the Topic 606 requirement that companies are already applying.

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 this question is best addressed by financial statement users.

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.

Please refer to our response to Question 4.

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.

Yes. The proposed amendments would clarify the intent of paragraph 842-10-15-40 and the inconsistency some stakeholders have interpreted between that paragraph and Example 14—Case A in Subtopic 842-10, which states in paragraph 842-10-55-152 that “Lessor...will recognize the income related to the variable payments and allocate that income between the lease and nonlease maintenance services (on the same basis as the initial allocation of the consideration in the contract), when and if earned.”

However, as described in our cover letter, we believe the proposed amendments may have the unintended consequence of confusing other aspects of the lessor accounting guidance. We believe our suggested revisions would resolve those concerns.

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.

Yes; we believe that the proposed amendments are understandable as written and that lessors could apply them.

However, as explained in our cover letter, we believe the proposed amendments could result in unintended consequences. Therefore, we respectfully ask the Board to consider our suggested revisions. We believe those revisions would resolve the issues we identified and, therefore, enhance operability of the guidance.

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 believe this question is best answered by lessor entities. However, we refer to our response to Question 4. We believe it would be appropriate for the Board to follow the same transition requirements for each of the amendments in this proposed ASU, aligned with the transition guidance it prescribed for early adopters in ASU 2018-11 for the lessor non-separation practical expedient.

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.

Because the amendments in the proposed ASU are intended to simplify implementation and application of Topic 842, lessors should be permitted to apply the proposed amendments as of the effective date of ASU 2016-02. We are not presently aware of reasons why a lessor would want or need additional time to implement these proposed simplifications to Topic 842, but because the mandatory effective date is close for many companies, we would not object to the Board addressing valid concerns by permitting adoption/election of one or more of the proposed amendments after the effective date of Topic 842.