

**January 6, 2020**

Mr. Shayne Kuhaneck  
Acting Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**RE: Agenda request to address application of sale and leaseback guidance in ASC 842**

Dear Mr. Kuhaneck:

We are submitting this letter to request clarification regarding application of the sale and leaseback guidance in ASC 842-40, *Leases: Sale and Leaseback Transactions*. Specifically this agenda request discusses the following two questions:

- Date at which leaseback classification should be determined for purposes of assessing whether the transaction qualifies as a sale under ASC 842-40.
- Date at which leaseback classification should be determined for purposes of accounting for the leaseback when the transaction initially does not qualify as a sale under ASC 842-40.

We have identified multiple views to each of the questions and believe that each of the views may be supportable under ASC 842. We therefore believe that the Board should consider clarifying the guidance in ASC 842 in order to reduce the diversity in practice that may result from varied interpretation of the existing guidance. The analysis of both questions is illustrated via the facts in the following example:

On January 1, 2020, Entity A sells a building to Entity B at its fair value of \$10 million and concurrently enters into a lease arrangement on the building for 20 years. January 1, 2020 is the “contractual commencement date.”

At the end of year 15 in the lease (i.e. December 31, 2034), Entity A has an option to repurchase the building for a fixed price. The repurchase option precludes sale accounting at the contractual commencement date. At the contractual commencement date, Entity A is not reasonably certain to exercise the repurchase option.

The leaseback also contains two 10-year renewal options. Rent for the first renewal period would be at the then-current market rate, and rent for the second renewal period would increase by five percent relative to the first renewal period. At the contractual commencement date, Entity A is not reasonably certain to exercise either renewal option.

At the contractual commencement date, the building’s remaining economic life is forty years.

At the contractual commencement date other than the fixed price repurchase option there are no other terms of the arrangement that would preclude the transaction from being accounted for as a sale-leaseback. If a classification assessment was performed at January 1, 2020, the lease would be classified as an operating lease by Entity A (e.g., the lease term of 20 years is not a major part of the building’s remaining useful life and the purchase option is not reasonably certain of exercise).

At the end of year thirteen (i.e. December 31, 2032), Entity A completes a significant acquisition. On that date, if Entity A was required to apply the guidance in ASC 842-10-25-1, 842-10-35-1 and

842-10-55-28, this event would qualify as a lease term and classification reassessment event, in which Entity A would determine that it is reasonably certain to exercise both of the 10-year renewal options in the lease (and continues to not be reasonably certain to exercise the purchase option). If a classification assessment was performed at December 31, 2032, the lease would be classified as a finance lease by Entity A and a sales-type lease by Entity B (however, there is no view below, or of which we are aware in practice currently, under which Entity B would perform a reassessment as of this date).

On December 31, 2034, the option to repurchase the building expires unexercised.

The contract has not been modified at any point from inception to that date.

**Note:** The “contractual commencement date” referred to under each view in this paper is the date that the leaseback commences legally, and is assumed to be the same date that the legal sale of the asset occurs (Example 2 of ASC 842-40-55 uses this term and this agenda request uses it consistent with its use in Example 2 in ASC 842-40-55).

**Question 1: Date at which leaseback classification should be determined for purposes of assessing whether the transaction qualifies as a sale under the sale-leaseback accounting guidance.**

**View A:** Lease classification as of the contractual commencement date should be used to determine whether a sale has occurred (that is, whether the sale-leaseback is or is not, in effect, a round-trip sale). The classification determination in ASC 842-40-25-2 is a one-time assessment.

**View B:** Lease classification as of the later of (1) the contractual commencement date and (2) the date the last lease classification reassessment event (ASC 842-10-25-1) occurs should be used to determine whether a sale has occurred.

**View C:** Lease classification as of the contractual commencement date should be used to determine whether a sale has occurred unless lease classification at contractual commencement date was determined to be a finance or sales-type lease, in which case lease classification should be assessed as of the last classification reassessment event (ASC 842-10-25-1).

**View D:** The reporting entity should assess lease classification when it determines the sale criteria in ASC 842-40-25-1 and 840-40-25-3 are met.

**Note:** *None of the above views assert that an entity should continuously reassess lease classification if the sale/purchase fails because of the classification criterion in ASC 842-40-25-2. They do not believe it was the Board’s intent, or reasonable, to expect entities to continuously monitor for changes that could change the lease classification (e.g. changes in the fair value of the asset, which could change the result of the lease payments test in ASC 842-40-25-2(d)) or to recognize a sale solely due to such changes or the passage of time from the contractual commencement date (i.e. if the remaining lease term falls below a major part of the remaining economic life of the asset).*

**View A:** Lease classification as of the contractual commencement date should be used to determine whether a sale has occurred (that is, whether the sale-leaseback is or is not, in effect, a round-trip sale). The classification determination in ASC 842-40-25-2 is a one-time assessment.

Under View A, lease classification as it would be assessed as of January 1, 2020 would determine whether a sale has occurred. Under this view, the parties always undertake a lease classification assessment as of the contractual commencement date, even when they may conclude first that a sale has not occurred for other reasons (in this example, the guidance on repurchase options in ASC 842-40).

Those that support using only the contractual commencement date for determining whether a sale occurs consider the stated intent of ASC 842-40-25-2, i.e. prohibition on finance/sales-type leaseback classification. As expressed in paragraph BC352(b) of the basis for conclusions to ASU 2016-02, ASC 842-40-25-2 reflects the Board's decision to prohibit what would in effect be 'round-trip' sales; that is, opportunities for both parties to recognize non-substantive, one-time income from the sale (seller-lessee) and sales-type lease (buyer-lessor) of the underlying asset. Under this view, changes in lease classification from materially *changed* economic circumstances, or simply the passage of time, should not affect how a reporting entity answers the question posed by paragraph BC352(b) of ASU 2016-02 about whether the transaction was in effect a round-trip sale.

Considering the example above, supporters of View A believe Entity A's business acquisition 13 years after the legal sale/contractual commencement date of the asset is irrelevant for determining whether the sale-leaseback was structured economically akin to a round-trip sale when it was negotiated and executed on January 1, 2020. Similarly, factors such as (1) the fair value of the building or estimates of the building's economic life, 13 years (December 31, 2032) or 15 years (December 31, 2034) after the transaction is legally concluded, and (2) changes in the ratio of lease term to remaining economic life from the passage of time since the contractual commencement date, are irrelevant in the context of determining whether the sale-leaseback was effectively a round-trip sale.

Therefore, supporters of View A believe that the sale criterion in ASC 842-40-25-2 is a one-time assessment that necessarily occurs at the contractual commencement date, and it is inconsistent with the Board's expressed intent in paragraph BC352(b) of ASU 2016-02 to consider the criterion in ASC 842-40-25-2 at a later date, divorced from the facts and circumstances the parties would have considered when negotiating and entering into the transaction.

In the example, View A would result in a sale upon expiration of the repurchase option since the classification of the lease at the contractual commencement date (operating) for both entities (A and B) would not be an impediment to sale/purchase under the sale-and-leaseback rules. Supporters of View A are not concerned that the lease may be classified for accounting purposes (under some of the views in Question 2 below) as a finance or sales-type lease upon lease recognition because they note that there is nothing in ASC 842 that presently prevents a leaseback from ever being classified as a finance/sales-type lease. This can occur for any leaseback if it is reassessed (lessee only) or modified (lessee and lessor).

In contrast, if the leaseback were classified as a finance lease by the seller-lessee (Entity A) or a sales-type lease by the buyer-lessor (Entity B) at the contractual commencement date (January 1, 2020), View A means that the transaction would continue to be accounted for as a failed sale/purchase (i.e., as a financing transaction) even after the repurchase option expires unexercised absent modifications to the agreement.

**View B: Lease classification as of the later of (1) the contractual commencement date and (2) the date the last lease classification reassessment event (ASC 842-10-25-1) occurs should be used to determine whether a sale has occurred.**

Supporters of View B believe that control of the underlying asset needs to transfer to the buyer at a point in time in order to recognize an accounting sale. They believe that classification reassessment events required by ASC 842-10-25-1 must be monitored throughout the period of the failed sale because lease classification has a direct influence on the control transfer evaluation and such evaluation should be based on current facts and circumstances. In the example provided, control of the building does not transfer at inception or at any point through December 31, 2034 because of the existence of the repurchase option. Starting on December 31, 2032, under View B, control also does not transfer for the seller-lessee (Entity A) because the lease term is reassessed and from that date represents a major part of the remaining economic life of the building, thus resulting in a finance lease. On December 31, 2034, the repurchase option expires unexercised and while one of the impediments to control transfer is removed, another still remains for the seller-lessee (Entity A) that precludes sale accounting. However, for the buyer-lessor (Entity B), no reassessment event has occurred up to and including December 31, 2034 because the sale-leaseback contract has not been modified. Therefore, the lease remains classified as operating, and a successful purchase occurs, for Entity B.

Supporters of View B believe the classification reassessment guidance in ASC 842 exists to ensure, within some reasonable cost-benefit constraints, that the accounting for a lease (particularly for lessees) reflects the best information currently available about the economics thereof (see paragraph BC242 of ASU 2016-02), including changed facts and/or circumstances. For example, the reassessment guidance serves to ensure significant changes in facts and circumstances are reflected in the measurement of the lease. Supporters of View B believe that so long as a sale, or lease, has not been recognized for other reasons, the parties to the sale-leaseback transaction should consider those same events or changes in circumstances as potentially changing whether a sale/purchase occurs or not in accordance with ASC 842-40-25-2. For example, if the seller-lessee has exercised a renewal option for the lease or constructed significant new leasehold improvements since the contractual commencement date, that fact should be considered in the accounting for the transaction, including in determining whether the transaction now is, or no longer is, akin to a round-trip sale.

Opponents of View B believe considering significant changes to facts and circumstances (e.g. Entity A's acquisition of another company 13 years after the sale-leaseback agreement was negotiated), or even modifications to the lease, is inconsistent with what the Board was trying to prevent with the finance/sales-type lease classification prohibition in ASC 842-40-25-2 (as expressed in paragraph BC352(b) of ASU 2016-02); they believe those changes have no relationship to determining whether the sale was, when initially negotiated and agreed, effectively a round-trip sale. They also note the non-symmetrical seller-lessee/buyer-lessor outcome that can result, and does result in the example provided, and believe that result is inconsistent with the Board's symmetrical intent for recognizing a sale/purchase expressed in paragraph BC371 of ASU 2016-02.

**View C: Lease classification as of the contractual commencement date should be used to determine whether a sale has occurred unless lease classification at contractual commencement date was determined to be a finance or sales-type lease, in which case lease classification should be assessed as of the last classification reassessment event (ASC 842-10-25-1).**

Supporters of View C believe changes in facts and circumstances, and modifications, should be permitted to cure *failed* sale-leaseback accounting that results from lease classification. Changed economics (see paragraph BC242 of ASU 2016-02) may indicate that the transaction is no longer, even if it once was, akin to a 'round-trip' sale.

In contrast, changed economics since contractual commencement (particularly long after) should not indicate the original transaction was effectively a ‘round-trip’ sale. View C supporters note that if a successful sale occurs, and the leaseback is later modified or the lease term/purchase option exercise is reassessed, the parties do not reverse sale accounting even if the lease becomes a finance or sales-type lease, so such changes in circumstances should not preclude sale/purchase accounting.

Put another way, View C supporters believe that there should not be “double jeopardy” as it pertains to the classification criterion in ASC 842-40-25-2 based on the Board’s rationale for the criterion (paragraph BC352(b) in ASU 2016-02), but believe changes in facts and circumstances, including changes to the terms and conditions of the transaction, should permit sale/purchase recognition to occur and financing accounting to end.

In the example, View C would result in a sale/purchase for both entities upon expiration of the repurchase option since the classification of the lease at the contractual commencement date (operating) would not be an impediment to sale under the sale-and-leaseback rules (i.e. there was nothing to cure with respect to lease classification). However, View C, like View B, could, in different circumstances from the example, result in different conclusions by the seller-lessee and buyer-lessor. This is because, View C might permit the seller-lessee to reassess a failed sale resulting from finance lease classification, but not the buyer-lessor. Those who oppose View B for its possible non-symmetrical outcomes have similar concerns about View C.

For example, if lease classification at the contractual commencement date had been a finance or sales-type lease, View C would result in a seller-lessee potentially curing a failed sale based on changes in facts and circumstances other than a modification; while a buyer-lessor would not be able to cure the failed sale/purchase (a lessor can only reassess lease classification upon a modification that is not accounted for as a separate contract). Accordingly, some opponents of View C note that it would be counter-intuitive that a buyer-lessor would not be able to cure a failed purchase absent a modification while a seller-lessee could, depending on the impact on lease classification, have an accounting sale based solely on changes in facts and circumstances that are within the seller-lessee’s control. Some opponents of View C note that this also could result in incentives for a seller-lessee to, for example, make a business decision directly impacting lease classification to obtain a specific accounting outcome for the sale-leaseback transaction.

#### **View D: The reporting entity should assess lease classification when it determines the sale criteria in ASC 842-40-25-1 and 840-40-25-3 are met.**

Those that support View D believe that since there is no lease until a sale occurs; there is likewise no lease commencement date until a sale occurs, and lease classification is assessed at lease commencement based on ASC 842-10-25-1. There is no requirement to assess lease classification at any date before the commencement date, which ASC 842-40-55-36 (Example 2 in Subtopic 842-40) says is the date the repurchase option expires.

*Example 2 — Accounting for Failed Sale and Leaseback Transaction, paragraph 842-40-55-36:*

*At the end of Year 5, the option to repurchase the asset expires, unexercised by Seller. The repurchase option was the only feature of the arrangement that precluded accounting for the transfer of the asset as a sale. Therefore, upon expiration of the repurchase option, Seller recognizes the sale of the asset by derecognizing the carrying amount of the financial liability of \$1,372,077, derecognizing the carrying amount of the underlying asset of \$1,371,429, and recognizing a gain of \$648. Buyer recognizes the purchase of the asset by derecognizing the carrying amount of its financial asset of*

*\$1,350,041 and recognizes the transferred asset at that same amount. **The date of sale also is the commencement date of the leaseback for accounting purposes. The lease term is 3 years (8 year contractual leaseback term — 5 years already passed at the commencement date)** (emphasis added). Therefore, Seller recognizes a lease liability at the present value of the 3 remaining contractual leaseback payments of \$200,000, discounted at Seller's incremental borrowing rate at the contractually stated commencement date of 4 percent, which is \$555,018, and a corresponding right-of-use asset of \$555,018. Seller uses the incremental borrowing rate as of the contractual commencement date because that rate more closely reflects the interest rate that would have been considered by Buyer in pricing the lease.*

Therefore, they believe that lease classification should be assessed as of the date the repurchase option in the example expires and therefore a sale occurs (that is, barring a conclusion that the leaseback is classified as a finance lease based on an assessment as of that date). In the example above, Entity A would assess lease classification at December 31, 2034 only, since that is the date, barring any other impediments (for example, finance leaseback classification based on the December 31, 2034 assessment), a sale would be recognized (the criteria in ASC 842-40-25-1 and 25-3 are met) and the leaseback would commence. View D supporters rely on the guidance in ASC 842-40-55-36 and take a view that in the example scenario where there is a clear impediment to sale accounting due to the repurchase option, Entity A may not assess classification at the contractual commencement date (i.e. there was no reason to assess classification since Entity A knows that the transaction is a failed sale/purchase given the existence of the repurchase option), and because there is no lease, Entity A does not monitor for classification reassessment events that may occur prior to recognition of an accounting sale.

View D supporters believe the example transaction at January 1, 2020 is an in-substance financing transaction and is not intended or purported to be a sale/purchase and thus leaseback considerations relating to ASC 842's classification of the leaseback are not relevant. Only once control passes to the lessor (if at all) under ASC 842-40-25-1 and 25-3 the lease classification test under ASC 842 is performed to determine if the transfer at that date is in-substance a sale or a continued financing.

The first point in time classification becomes relevant is when the other impediment(s) – in the example above, the repurchase option – expires. Requiring entities in scenarios like the example to undertake a classification assessment at contractual commencement (View A), as well as to monitor for reassessment events and assess classification based thereon (possibly multiple times) (Views B/C) adds unnecessary complexity.

Those that oppose View D believe that the reference to “[t]he date of sale is the commencement date of the leaseback for accounting purposes” refers solely to recognition of the lease and not lease classification. They believe this is further supported by ASC 842-40-55-36, which states that:

- “The repurchase option was the *only* feature of the arrangement that precluded accounting for the transfer of the asset as a sale.”, which implies that lease classification was assessed at the contractual commencement date and was not problematic, and
- the “[t]he seller uses the incremental borrowing rate as of the contractual commencement date [...]”.

Additionally, some opponents of View D believe that the parties could choose to include a feature like a repurchase option in the arrangement with an expiration date set for the point in time when reassessment would be expected to flip to operating, rather than waiting until the end of the lease term to recognize a sale since at some point the lease term will be less than 75% of the remaining economic life of the asset or the fair value of the asset is expected to increase.



Opponents of View D also do not accept the idea that assessing lease classification at contractual commencement (View A), as part of the same analysis the parties conduct to conclude that the sale/purchase fails for another reason (which may not always be as simple as a single repurchase option) and to determine the financing accounting that will apply until sale/purchase accounting is achieved; or if they failed to assess lease classification at contractual commencement date, using the analysis and information that existed at contractual commencement date at December 31, 2034, is onerous or adds significant effort or complexity.

In the example, View D would result in a failed sale when the transaction is evaluated again upon expiration of the repurchase option. The transaction remains a failed sale/purchase for both the seller-lessee (Entity A) and the buyer-lessor (Entity B) at December 31, 2034 since the classification of the lease (finance/sales-type) is an impediment to a sale/purchase under the sale-and-leaseback guidance in ASC 842-40.

**Question 2: Date at which leaseback classification should be determined for purposes of accounting for the leaseback when the transaction initially does not qualify as a sale under ASC 842-40.**

**View A:** Lease classification as of the contractual commencement date should be used to recognize the leaseback when a successful sale-leaseback transaction occurs.

**View B:** Lease classification as of the later of the following should be used to recognize the leaseback in a successful sale-leaseback transaction: (a) the contractual commencement date, (b) the latest lease classification reassessment event (ASC 842-10-25-1).

**View C:** Lease classification as of the date when it determines the sale criteria in ASC 842-40-25-1 and 840-40-25-3 are met should be used to recognize the leaseback in a successful sale-leaseback transaction.

**View A: Lease classification as of the contractual commencement date should be used to recognize the leaseback when a successful sale-leaseback transaction occurs.**

View A supporters believe that the leaseback should be classified based on what the classification would have been at the contractual commencement date. First, they believe that the statement in ASC 842-40-55-36 that the incremental borrowing rate to be used to measure the lease at the recognition date (i.e. when the repurchase option expires) should be the rate determined as of the contractual commencement date is instructive. This statement indicates the contractual commencement date incremental borrowing rate should be used because that would more accurately reflect the economics of the transaction contemplated by the two parties when negotiated and agreed upon. Supporters of View A believe the lease classification similarly should reflect the economics of the lease when it was negotiated, rather than based on recognition date conditions that may be entirely different (and not predicted) from those at the contractual sale/commencement date.

View A supporters further support their view by noting that ASC 842-40-55-37 suggests that lease classification in that example was assessed only at the contractual commencement date and, there is no mention that it was reassessed at the time the purchase option expires.

Finally, View A proponents believe a seller-lessee should not apply the lease term and purchase option reassessment guidance in ASC 842-10-35-1 to a failed sale because, from an accounting standpoint, the transaction is a financing for which a reporting entity applies other Topics in

accordance with ASC 842-40-25-5. That is, the transaction is not yet a lease and therefore a seller-lessee should not apply subsequent measurement guidance applicable to leases.

Those that oppose View A believe that it would be inappropriate to account for a lease as an operating lease when, at the lease commencement date (in this example, the date that the repurchase option expires unexercised), the lessee is reasonably certain to exercise renewal options extending over a major part of the underlying asset's remaining economic life or a purchase option over the underlying asset. They note that any successful sale-leaseback transaction would be accounted for by the seller-lessee as a finance lease at December 31, 2034 – i.e. having been reassessed at December 31, 2032 – and question the information usefulness of an outcome that does not similarly, in these circumstances, account for the same significant events and circumstances arising since the contractual commencement date.

**View B: Lease classification as of the later of the following should be used to recognize the leaseback in a successful sale-leaseback transaction:**

- a. the contractual commencement date**
- b. the latest lease classification reassessment event (ASC 842-10-25-1).**

View B supporters believe ASC 842-10-25-1 is clear about when lease classification is reassessed, and would base both entities' accounting for the leaseback, when it is recognized upon the expiration of the repurchase option, on what the classification would have been had lease accounting begun on the contractual commencement date. In this example, there would not be symmetry between the classification assessment dates of Entity A (seller-lessee) and Entity B (buyer-lessor); Entity A's assessment would be as of December 31, 2032, while Entity B's would be as of the contractual commencement date of January 1, 2020. This is because Entity A's acquisition would not be a classification reassessment event for Entity B. This difference for Entity A and Entity B would exist in any event if there had been a successful sale/purchase at the contractual commencement date; because the lease has not been modified, Entity B would not have reassessed lease classification despite the fact Entity A would have (due to the change in the lease term).

In rejecting View A, View B supporters think it is contrary to the lease accounting model to ignore classification reassessment events, which also affect measurement of the lease, when recognizing the lease on December 31, 2034. If lease accounting had been applied since contractual commencement, the classification of the lease for Entity A when initially recognized on December 31, 2034 would be its reassessed classification as of December 31, 2032. By accounting for such events, when the impediment to sale accounting abates, the lease accounting that results from View B is reflective of what it would have been had lease accounting applied all along for both entities and reflects the measurement of the lease intended by the Boards when including reassessment requirements in ASC 842.

View B supporters' basis for rejecting View A also leads them to reject View C. If the lease had been accounted for since the contractual commencement date, the parties would not reassess lease classification at December 31, 2034.

Opponents to View B believe a seller-lessee should not apply the lease term and purchase option reassessment guidance in ASC 842-10-35-1 to a failed sale because, from an accounting standpoint, the transaction is a financing for which a reporting entity applies other Topics in accordance with ASC 842-40-25-5. That is, the transaction is not yet a lease and therefore a seller-lessee should not apply subsequent measurement guidance applicable to leases. They believe that revisiting what various assumptions and judgments would have been at a point in time the entity was not monitoring for (assuming the entity, because there was no lease for



accounting purposes, was not performing hypothetical classification assessments, or monitoring for classification reassessment events) may be difficult or even impracticable.

View B proponents acknowledge the perspective that the classification and other reassessment guidance should not apply during the failed sale/purchase period because there is not yet, for accounting purposes, a lease, but rejects that perspective. View B rejects this argument on the basis that it is clear that the parties in a failed sale-leaseback transaction are within the scope of ASC 842, even while there is a failed sale (i.e. they do not “leave” ASC 842, at least not entirely). For example, ASC 842 still instructs the parties to a failed sale-leaseback on how to determine the interest rates they use (ASC 842-40-30-6 and ASC 842-40-55-33), and entities undoubtedly look to Example 2 in Subtopic 842-40 for instruction on accounting for the failed sale-leaseback.

Supporters of View B, like View C supporters, also are not troubled by the fact that at December 31, 2034 the leaseback may initially be recognized as a finance lease. This is because there is no prohibition on a leaseback ever becoming a finance lease – i.e. in a successful sale-leaseback where a classification reassessment event occurs after the sale date, there is no prohibition on that lease being classified as a finance lease after a reassessment; sale/purchase accounting is not revisited in those cases.

But opponents of View B note that the Board intentionally aligned the sale-leaseback guidance between seller-lessees and buyer-lessors. That is, at the contractual commencement date, a seller-lessee and a buyer-lessor apply the same guidance in determining whether a sale has occurred. Accordingly, View B opponents question why seller-lessees would subsequently apply guidance that buyer-lessors are otherwise precluded from applying to the leaseback (i.e., the classification reassessment requirements in ASC 842-10-25-1 that arise from changes to the lease term or assessment of a purchase option) considering that the sale-leaseback guidance, by design, was intended to be symmetrical for seller-lessees and buyer-lessors (as indicated in BC371 of ASU 2016-02).

**View C: Lease classification as of the date of sale when it determines the sale criteria in ASC 842-40-25-1 and 840-40-25-3 are met should be used to recognize the leaseback in a successful sale-leaseback transaction.**

View C proponents note that under ASC 842-10-25-1, lease classification is assessed at the commencement date. View C proponents also refer to Example 2, paragraph 842-40-55-36 previously described that states that “[t]he date of sale also is the commencement date of the leaseback for accounting purposes.” Accordingly, View C proponents believe that for a reporting entity to account for the leaseback, lease classification should be assessed when the repurchase option expires since that is the commencement date of the leaseback for accounting purposes as explained in Example 2. They also note that there is no requirement to assess lease classification at any date before the commencement date, which ASC 842-40-55-36 (Example 2 in Subtopic 842-40) says is the date the repurchase option expires.

View C proponents believe that accounting for the leaseback using the lease classification when the repurchase option expires also is more reflective of the economic conditions and facts and circumstances at that date and therefore will provide more relevant information to users.

While View C may result in a lease classification of finance lease / sales-type lease as of the date of the accounting sale (assuming a view other than View D was followed for Question 1) and therefore may question whether there was an accounting sale to begin with, proponents of View C believe that this change in classification is the result of significant changes to facts and

circumstances and economic conditions that are not reflective of the terms and conditions when the sale and leaseback transaction was negotiated (i.e., it is not indicative of a round-trip sale).

Opponents of View C note that Example 2, paragraph 842-40-55-36 states that “[s]eller uses the incremental borrowing rate as of the contractual commencement date because that rate more closely reflects the interest rate that would have been considered by Buyer in pricing the lease.”

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We would be pleased to discuss any questions that you may have about this agenda request. If you have any questions, please contact any of the undersigned.

Sincerely,

Thomas Faineteau, Partner-National Assurance, BDO USA LLP

James Barker, Partner-National Office-Accounting & Reporting Services, Deloitte & Touche LLP

Mark Mahar, Partner and Mark Barton, Partner, Ernst & Young LLP-National Professional Practice

Rahul Gupta, Partner-National Professional Standards Group, Grant Thornton LLP

Scott Muir, Partner – Department of Professional Practice, KPMG LLP

Marc Jerusalem, Director – National Quality Organization, PricewaterhouseCoopers LLP