FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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On Friday, September 18, 2020, the FASB hosted two public roundtable sessions as part of its post-implementation review process to gather views on five broad topics related to Topic 842, Leases. The Board also received input on various other lease related topics. Board members and the FASB staff heard the perspectives of a diverse set of stakeholders representing 21 organizations including financial statement users, public entity preparers, private entity preparers, industry representatives, and practitioners.

Topic 1: Lessee Application of Rate Implicit in the Lease

Participants discussed whether additional or amended guidance is needed to apply the guidance in Topic 842 on a lessee's use of the discount rate implicit in the lease (hereinafter, referred to as the implicit rate). Participants shared their views on three potential alternatives:

1. No change to Topic 842
2. Eliminate the requirement for lessees to consider the implicit rate in Topic 842
3. Provide an option in Topic 842 for lessees to use the implicit rate (with a default to the incremental borrowing rate (IBR)).

Participants were invited to share additional alternatives. Participants also discussed the "readily determinable" threshold as it relates to determining whether the implicit rate should be used by lessees and how that threshold is applied in practice.

Morning Session

All participants commenting on the topic supported making no changes to the guidance in Topic 842 on a lessee's use of the implicit rate. Practitioner participants indicated that no pervasive practice issues related to the usage of the implicit rate by lessees currently exist. Those participants also advocated against an alternative to eliminate a lessee's ability to use the implicit rate, stating that this rate, when readily determinable, most accurately reflects the economics of the transaction. Participants highlighted a subset of transactions, including related party leases and synthetic leases, for which the implicit rate is readily determinable and should be used. A practitioner noted that although lessees usually do not know the lessors' estimate of the residual value or the initial direct costs (key inputs in the implicit rate calculation), when those inputs are known or deemed immaterial, practice considers the implicit rate readily determinable and it is used by lessees.

Practitioners cautioned against providing an option to use the implicit rate with a default to IBR, expressing that optionality may diminish comparability. A participant representing public entity preparers observed that an option would create divergence from IFRS and would not be useful for entities that report under both GAAP and IFRS Standards. However, that participant did not oppose an option, recognizing that it could be helpful for certain entities.

One user supported no change to Topic 842, stating that the current guidance provides a faithful representation of the economics of a lease, comparability, and consistency with IFRS Standards.

Both practitioners and preparers noted that practice consistently interprets and applies the readily determinable threshold. Broadly, participants rejected the view that the implicit rate is readily determinable when there is publicly available information for all significant inputs of the rate and it is reasonable to expect that the lessor would have used those inputs in its calculation. A practitioner noted that using an estimation in determining the rate implicit in the lease generally is inappropriate because lessees usually do not know the inputs that the lessor uses.

Afternoon Session

All but one participant (a practitioner) supported no changes to the guidance in Topic 842 on a lessee's use of the implicit rate. Those participants stated that the application of the implicit rate is not a pervasive issue. Most practitioners indicated that a lessee's assessment of whether the implicit rate is readily determinable is similar to the assessment performed under Topic 840, Leases, for determining whether that rate is "known." Additionally, two practitioners stated that preparers generally are not requesting to estimate the required inputs for determining the implicit rate. Two preparers (a large private entity preparer and a large public entity preparer) noted a preference for no changes to Topic 842, noting that changes could disrupt established processes and controls.

One practitioner advocated for an option to use the implicit rate if that rate can be reliably estimated, such as (a) when a lessee can estimate the expected unguaranteed residual value of the leased asset and it is reasonable to expect that the lessor also used that estimate or (b) when the lessor's inputs are unknown but can be determined to be immaterial. This participant noted that the implicit rate more closely reflects the economics of the transaction and that using the implicit rate, rather than the IBR, may result in materially different lease liabilities. Notwithstanding, that participant did not object to retaining the existing requirements in Topic 842.

Topic 2: Lessee Application of the Incremental Borrowing Rate

Participants discussed a lessee's application of the discount rate guidance on the IBR and the difficulties encountered in estimating that rate, particularly during the implementation of Topic 842. Participants shared their views on two potential alternatives:

1. Provide no changes to Topic 842
2. Provide an option that would allow all lessees (public and nonpublic entities) to use a specific rate instead of IBR.

Participants also were invited to share additional alternatives.

Morning Session

Public entity preparers opposed amending the discount rate requirements in Topic 842 on the IBR for public entities. Although those participants highlighted that the development and implementation of processes to determine the IBR was challenging and costly, they stressed that processes for determining the IBR have been established and are repeatable. Many participants stated that amending the guidance relating to IBR would disrupt established practice for public entities.

A practitioner noted that nonpublic entities do not have advanced treasury functions and could struggle to establish processes to determine IBR. A practitioner and a participant representing public entity preparers noted that there is diversity among auditors even within the same firm regarding the processes or documentation necessary to sufficiently establish the IBR. However, because changes to the discount rate guidance potentially could add to that diversity, the practitioner opposed the FASB adding incremental guidance on how to determine the IBR. The participant representing public entity preparers was sympathetic to the challenges that nonpublic entities and smaller public entities may experience and supported providing an option allowing all lessees to use a specified rate. That participant noted that dual filers (preparers filing under both GAAP and IFRS Standards) would be unlikely to elect such an option because using a specified rate would diverge from IFRS Standards and create complexity for those filers.

Participants discussed whether the IBR should be replaced with a specified rate, such as an A or AA credit rate or a credit-adjusted risk-free rate. Practitioners generally disagreed with using a specific rate for leases classified as finance leases. A few practitioners expressed concern that using a specific rate for finance leases would change the amount of interest recognized in earnings. Additionally, a practitioner stated that finance leases are intended to be similar to debt and, therefore, should reflect an entity's borrowing cost. Several practitioners suggested that using a specific rate may be acceptable for operating leases.

The two users and certain preparers preferred a discount rate that economically reflects the lease transaction as opposed to specific rates. One preparer noted that using a specific rate for public entities with accessible credit ratings shifts the burden of determining the appropriateness of the rate from auditors and preparers to users. Additionally, a user indicated that the rate that reflects the economics most closely is more useful than an arbitrary, specified rate. A user observed that the risk-free rate is not a realistic reflection of the economics of the lease and penalizes nonpublic entities as it results in higher lease liabilities.

A private entity practitioner suggested that nonpublic entities be permitted to use the risk-free rate at the underlying class of asset level rather than at an entity-wide level. Given that using the risk-free rate instead of IBR may result in higher lease liabilities, that practitioner noted that some nonpublic entities may want to use their IBR to calculate liabilities for material leases (such as real estate leases) but prefer the simpler and more economical option to use the risk-free rate for smaller value leases (such as office equipment). Two other practitioners supported amending the guidance to allow for the risk-free rate to be used by nonpublic entities at the underlying class of asset level.

A FASB Board member asked whether adding a credit component to the risk-free rate would encourage more nonpublic entities to elect that expedient because it would lower their lease liabilities. Two practitioners supported adding a credit component and observed that adding a credit component to the risk-free rate would more accurately reflect the economics.

The FASB Chair noted the extensive publications issued by accounting firms on IBR and asked participants whether additional clarifying guidance on the IBR would be helpful and, if so, which aspects need to be addressed. One practitioner highlighted that some aspects of the guidance could be clarified (such as, what are the acceptable forms of collateral and whether amortizing rates or nonamortizing rates can be used) and stated that additional implementation examples may be helpful. However, most participants indicated that supplemental guidance is unnecessary. A participant representing public entity preparers was concerned that additional guidance may create diversity in how the rate is currently being determined. Most practitioners agreed and noted the costs of additional guidance may outweigh the benefits.

A private entity practitioner noted that disclosure of the weighted average discount rate is burdensome for nonpublic entities and proposed a qualitative disclosure or disclosure of a range of discount rates instead of the weighted average rate. Both user participants indicated that the weighted average rate disclosure is an important part of their analyses. One user stated that the weighted average rate is used to separate operating lease cost into interest and amortization to allow comparability with entities that file under IFRS. This participant asserted that if the weighted average rate disclosure were eliminated, users would have to use other, less precise estimates. Another user observed that the weighted average rate may be less useful to equity analysts, but that it is useful for fixed income analysts who focus on the balance sheet and cash flows.

Afternoon Session

Participants in the afternoon session also acknowledged the significant costs and complexities of establishing processes to determine the IBR. Most practitioners supported no changes to Topic 842 and cautioned that amending the guidance on the IBR may create additional costs for entities that have adopted Topic 842. Two preparer participants (a large private entity preparer and a large public entity preparer) also opposed changes to the guidance on the IBR.

Practitioners highlighted the practical challenges of providing the option to use a specified rate (other than the IBR) for operating leases only. Those participants stated that providing a specified rate that would apply only to operating leases would be difficult because the discount rate is required to determine the classification of a lease as operating or finance. A large private entity preparer commented that because nonpublic entities using the risk-free rate (in accordance with the practical expedient in Topic 842) already affects lease classification, using IBR could result in finance lease classification for leases that would be operating leases. That participant noted that his entity chose to use the IBR instead of the risk-free rate.

Two private entity practitioners supported an option that would allow all lessees to use a specified rate (other than the IBR) to reduce implementation costs for smaller entities that may lack robust treasury functions. One practitioner participant stated that entities lacking the necessary resources must outsource the calculation of the IBR to valuation specialists each period, resulting in a significant ongoing cost.

A practitioner proposed an option to use specified rates by class of assets. That proposal was supported by a private entity practitioner. A user expressed concern that optionality may create diversity in practice and reduce consistency. However, the user did not oppose using specified rates by class of underlying assets if the methodologies were applied consistently across nonpublic entities.

Overall, participants supported allowing nonpublic entities to elect the risk-free rate for classes of underlying assets as opposed to an entity-wide election. Participants referenced the morning session discussion and observed that using the risk-free rate results in higher lease liabilities. They suggested that nonpublic entities could benefit from having an option to apply the IBR to material leases and the risk-free rate to lower value leases. One private entity practitioner suggested amending the practical expedient to allow election on a lease-by-lease basis.

In response to the FASB Chair's question about whether additional clarifying guidance on the IBR would be helpful, two practitioners discouraged any amendments to the guidance and explained that more precise guidance may disrupt current practice.

Topic 3: Embedded Leases

Participants discussed challenges encountered with identifying leases in nonlease contracts (hereinafter referred to as embedded leases), such as service contracts. Participants also were asked whether current guidance should be amended to provide lessees with an option to exclude embedded leases that meet a certain threshold from the classification, recognition, and measurement requirements in Topic 842. Specifically, participants shared their views on three potential alternatives:

1. No change to Topic 842
2. Option to not apply Topic 842 based on a *qualitative* threshold
3. Option to not apply Topic 842 based on a *quantitative* threshold (low-value threshold similar to IFRS 16, *Leases*).

Participants were invited to identify additional alternatives.

Morning Session

Practitioners acknowledged that identifying and accounting for embedded leases is difficult and costly, but they generally opposed changes to Topic 842. Several practitioners noted that the guidance for identifying leases is converged with IFRS, and they were concerned that changes may diminish comparability. A participant representing public entity preparers and another preparer participant opposed changes to the guidance. Those participants highlighted that Topic 842 allows entities to combine lease and nonlease components, which reduces the costs associated with the application of Topic 842. Those participants also noted that capitalization policies and materiality often are sufficient to reduce some of the burden of identifying embedded leases and applying other Topic 842 guidance such as separation and allocation.

One practitioner noted that the potential alternatives would not reduce the costs of identifying leases. However, a private entity practitioner argued that applying the separation and allocation guidance after leases have been identified is still challenging.

None of the participants' comments supported the qualitative threshold alternative whereby a lessee would account for an entire contract in accordance with GAAP applicable for the nonlease component if the lease component met a certain threshold (for example, not significant). They noted that any qualitative threshold will require an entity to analyze whether a potential embedded lease would meet that threshold. Additionally, practitioners expressed concerns about operationalizing a qualitative threshold alternative. Those practitioners noted that applying that alternative might turn into a quantitative exercise, which could require additional processes and increase cost and complexity.

One participant representing public entity preparers and one practitioner supported the alternative to add a quantitative threshold, similar to the low-value asset exemption provided under IFRS 16.[1] That practitioner noted that such a threshold would enhance convergence with IFRS 16. It also would result in contracts that are currently excluded on the basis of materiality being excluded in accordance with GAAP instead. Other practitioners preferred no changes to Topic 842 but did not oppose providing a quantitative threshold. Conversely, two practitioners and one public entity preparer were concerned that if a quantitative threshold was provided, smaller entities with large volumes of low-value asset exemptions may be able to avoid recognizing material lease obligations when aggregated. Two practitioners questioned the rationale for a quantitative threshold to exclude known, measurable liabilities from recognition. Participants who supported no changes to the guidance also questioned if the proposed quantitative threshold would provide relief because many entities have capitalization thresholds above the low-value asset exemption provided under IFRS 16. In response, a participant representing public entity preparers stated that not requiring Topic 842 to be applied to assets valued under the quantitative threshold would reduce the amount of known error resulting from excluding immaterial lease obligations from lease accounting. A practitioner noted that a quantitative threshold would need ongoing adjustment for inflation.

The FASB Chair asked participants if the definition of *lease* should be reconsidered to exclude contracts in which a customer cannot operate the underlying asset. Broadly, participants opposed the Board revising that definition. One practitioner noted that applying the definition of a lease under Topic 842 has not resulted in any unexpected outcomes in practice. A participant representing public entity preparers opposed changing the definition because it may disrupt those entities that have already adopted Topic 842. That participant also highlighted that a change to the definition would diverge from IFRS 16. A financial statement user indicated that the definition has generally worked in practice, although it sometimes includes arrangements that economically may not seem like leases.

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[1] IFRS 16 provides a low-value exemption from the requirement for a lessee to recognize a lease on its balance sheet. The basis for conclusions of that IFRS Standard describes the lease as low-value if the value of the underlying asset is less than $5,000 USD.

Afternoon Session

Similar to the morning session, practitioners acknowledged the cost and complexities associated with accounting for embedded leases.

Three participants, including two private entity practitioners and one user, supported the addition of a qualitative threshold to exclude certain embedded leases from the classification, recognition, and measurement requirements of Topic 842. The two private entity practitioners indicated that a qualitative threshold would reduce the ongoing costs and complexity of accounting for embedded leases. A user supported a qualitative threshold but emphasized that the threshold must be consistently applied. Other practitioners opposed changes to Topic 842, stating that the addition of a qualitative threshold will likely require judgment, which may lead to inconsistent application.

One private entity preparer discussed a service arrangement common in the construction industry and emphasized that the existing guidance for embedded leases results in poor financial reporting for those arrangements. That participant noted that a customer's recognition of lease liabilities for equipment used by a service provider (or a subcontractor hired by that service provider) that is not selected, operated, or insured by the customer results in inflated liabilities on the customer's balance sheet. That participant observed that the accounting result is not a faithful representation of the economics of that service arrangement. That participant noted that the cost and effort required to account for embedded leases is extensive and that the issue could become more pervasive as nonpublic entities begin implementing Topic 842. Therefore, the private entity preparer recommended that the Board develop an additional alternative to provide entities with relief from recognizing equipment leases for certain service arrangements.

Participants generally opposed the alternative to add an option for lessees to not apply Topic 842 based on a quantitative threshold. A user indicated that a numerical threshold may provide structuring opportunities. Practitioners reiterated concerns raised in the morning session that a quantitative threshold may exclude certain material obligations from recognition by entities with low materiality thresholds.

Participants in this session generally opposed revising the definition of a lease. Practitioners were concerned that amending that definition would require a fundamental reconsideration with respect to the principle of control and could compromise the Board's objective to recognize material obligations in the financial statements. One practitioner noted that a change to the definition may affect the conclusions reached on drilling rig and power plant contracts that are now being accounted for as leases. Another practitioner stated that the definition of a lease under Topic 842 is consistent with the transfer of control principle in Topic 606, Revenue from Contracts with Customers, and principles in the consolidation guidance. Additionally, a few practitioners noted that altering the definition would diverge from IFRS 16.

Topic 4: Lease Modifications

Participants discussed the cost and complexities associated with the application of the lease modification guidance (for both lessees and lessors).

Participants shared their views on the following items:

1. Certain reductions within the scope of a lease contract and the Board's recent decisions on that issue
2. Reassessment of lease classification upon a modification that does not create a separate contract, including updating assumptions
3. Accounting for termination penalties
4. Minor modifications.

Participants also were invited to share their views on any other aspects of lease modification accounting that may be improved without compromising the decision usefulness of the information

Morning Session

While the participants generally agreed that the lease modification guidance in Topic 842 is an improvement over the guidance in Topic 840, they supported the Board's objective to consider improvements to the modification model in Topic 842. Multiple participants (including a private entity practitioner) commented on balancing the costs and benefits of applying the modification guidance.

A participant representing public entity preparers discussed the practical challenges in applying the modification guidance. Specifically, that participant highlighted the cost and complexities associated with updating the fair value of a used asset (as opposed to a new asset) when reassessing classification at modification date. Additionally, that participant raised concern about the frequency of reclassifications under Topic 842 regardless of whether fundamental changes are made to a lease. That participant also commented on its experience with four lease accounting software systems and the inability of those systems to deal with certain aspects of modification accounting (such as lease prepayments).

All participants supported the Board's recent decision to amend Topic 842 for modifications that result in reductions within the scope of a lease contract. Because the Board is requesting feedback on additional improvements, two practitioners suggested that the Board consider a holistic approach to make comprehensive amendments to the modification guidance rather than piecemeal incremental changes. A participant representing public entity preparers supported a comprehensive review of the modification guidance but added that the issue currently being addressed (reductions in scope) is pervasive and, therefore, noted a preference for an expeditious piecemeal solution if holistic improvement would take longer.

In discussing other areas for improvement, multiple participants representing both preparers and practitioners noted that existing cost and complexity could be reduced by providing relief from modification accounting for "minor" modifications or modifications that do not fundamentally change the underlying economics of the original lease. The discussion revolved around potential relief from reassessing classification and updating assumptions, such as discount rate and an underlying asset's fair value, rather than remeasurement requirements.

In discussing how to determine whether a modification is minor or fundamental, one practitioner commented that Topic 840 included that notion and that the application of that guidance resulted in entities not having to reassess classification and update assumptions for insignificant changes but rather remeasure balance sheet amounts only. Topic 840 provides that except for lease renewals or lease term extensions, reassessing classification is performed only if a modification is made in a manner that would have resulted in a different classification of the lease had the changed terms been in effect at lease inception. Another practitioner discussed its experience with accounting for a minor modification (an insignificant change to payment terms) whereby the updated IBR at the modification date would have resulted in a material change to the lease liability. That participant agreed that while the legacy guidance was complex, it allowed entities to retain the lease classification and the assumptions if there was a modification that did not fundamentally change the original economics. A practitioner and a participant representing public entity preparers who supported relief from minor modifications emphasized the cost-benefit aspect of operationalizing that relief. The participant representing public entity preparers stated a preference for a quantitative (not qualitative) assessment to determine whether a modification is minor.

A practitioner noted that reducing a lease term seems different from renegotiating the original economics and, therefore, relief from reassessing classification and updating assumptions should be considered for reductions in lease terms as well. In discussing relief for reductions in lease term, another practitioner highlighted the alignment of modification guidance with the lessee reassessment guidance. That practitioner suggested that the Board consider similar relief from reassessing classification and updating assumptions within the lessee reassessment guidance.

Multiple participants (practitioners and a participant representing public entity preparers) noted that prospective accounting for termination penalties under Topic 842 may not necessarily reflect the underlying economics. Those participants preferred the termination penalty guidance for lessees in Topic 840. The participant representing public entity preparers added that systems can handle a point-in-time (rather than prospective) recognition. One practitioner, however, cautioned about the complexities associated with performing an economic analysis of penalties. That participant also noted that system complexities could arise if penalties are allocated and have different patterns of recognition. In considering a lessor's accounting for penalties, several practitioners noted that the Board should consider potential alignment with Topic 606.

Two practitioners commented that if the Board makes changes to lease modification accounting, it should consider the effect on convergence with IFRS 16.

Afternoon Session

Similar to the morning session, while the participants generally agreed that the modification guidance in Topic 842 is an improvement over the legacy guidance, they supported the Board's objective to consider improvements to the modification model in Topic 842.

All participants supported the Board's recent decision to amend Topic 842 for modifications that result in reductions within the scope of a lease contract. A practitioner (who supports improvements to the modification model) noted the interaction of that issue with the issue of termination penalties and recommended that the Board not issue an Exposure Draft of its recent decisions to amend the modifications guidance. That participant recommended that the Board consider making holistic improvements to the model. Another practitioner noted that the Board could consider comprehensive improvement to the modification model rather than incremental improvements in a piecemeal manner but acknowledged that decision should be driven by the urgency of a discrete issue within the model. Another practitioner noted that an Exposure Draft could be a source of additional feedback on the issue from a broader group and recommended that the Board expose its recent decision.

In discussing other improvements, one practitioner who recommended that the Board not make piecemeal changes to modification model noted that relief could be provided for minor modifications. Another practitioner noted the complexities in applying the current modification model, including the reassessment of classification with updated assumptions and reallocation of consideration in the contract. That participant noted that relief from reassessing the classification should be explored for minor modifications as well as for reductions in lease term. Another practitioner who supported improvements to the model agreed that the Board could explore some relief for certain modifications that do not result in separate contracts and must be treated as new leases under current requirements. A private entity practitioner noted similar concerns about the modification model and supported any change that would reduce costs and complexity in applying the modification model. Practitioners highlighted the alignment of lease modification guidance with the lessee reassessment guidance, the contract modification guidance in Topic 606, and IFRS 16.

Participants representing public and private entity preparers discussed the challenges associated with applying the current modification model and asserted that reassessing the lease classification with updated assumptions is the most complex aspect of that guidance. A private entity preparer stated that updating the lease term for leases with renewal options at the modification date is a significant challenge because it requires extensive documentation of management judgment regarding the certainty of exercising a renewal or termination option in a lease. Additionally, that participant noted that updating the fair value of used assets during the lease term is complex and costly, and that they engage third-party valuation specialists to determine fair values.

Participants representing public and private entity preparers highlighted the complexities associated with the increasing frequency of lease reclassifications under Topic 842 from both lessees' and lessors' perspective. One public entity preparer emphasized that lease classification can continually change throughout the life of the lease based on the mechanics of the classification tests, regardless of whether there are fundamental changes to the economics of the lease, and noted that as a fundamental flaw in the model. Additionally, the preparer participants noted that reclassifications resulting from minor modifications create system complexities and cause confusion among users of the financial information. They stated that any simplification to that aspect would be a significant improvement.

In discussing whether a relief for minor modifications would address the issue of uneconomic reclassification outcomes, the two participants representing public and private entity preparers commented that reclassifications should be driven by the change in economics, and that consideration should be given to whether an event has fundamentally changed the original economics. A public entity preparer stated that having a quantitative minor threshold would be difficult to execute from a systems perspective. None of the preparer participants favored a minor threshold as an optimal solution.

One FASB Board member commented that while the Board had intended for reassessment of classifications for lease term extensions, it had not anticipated the high frequency of reclassifications resulting under Topic 842. That member raised two questions:

1. Should minor modifications require a remeasurement of assets or liabilities or should they be recognized through the income statement as changes to the cash flows occur?
2. Should a reclassification be performed only for fundamental changes?

That member concluded that further outreach with users would be necessary to understand their preferences.

A financial statement user noted that users generally would like to understand the effect of a modification on the balance sheet or income statement (timing of revenue or expense recognition).

Topic 5: Lessee Allocation of Fixed and Variable Payments

Participants discussed the complexities and outcomes associated with the lessee allocation guidance when a lease contract includes (a) lease and nonlease components along with (b) fixed and variable payments. Participants discussed the following alternatives:

1. Amend lessee allocation guidance
2. Provide no changes to Topic 842.

Morning Session

Participants generally opposed changing the allocation guidance in Topic 842. Participants acknowledged the challenge of determining standalone selling prices but stated that most entities elect the practical expedient to combine lease and nonlease components and avoid the allocation process.

One participant representing public entity preparers supported no change to Topic 842 because repeatable processes have been implemented. That participant indicated that the practical expedient provides relief from the complexities of the allocation process. Additionally, that participant noted that demonstrating that payments in a contract represent the standalone price of a particular component would still pose a challenge. A different public entity preparer stated that it elects the practical expedient unless nonlease components are significant for a class of assets. When the nonlease components are significant, the entity performs an allocation of the consideration in the contract. That participant stated that the current allocation guidance with the practical expedient provides decision-useful information and did not recommend amending the guidance in Topic 842.

Practitioners stated that although there may be a conceptual basis to amend the allocation guidance for lessees in Topic 842 to align with the principles in Topic 606, they cautioned that making changes would significantly affect entities that have already adopted Topic 842.

Afternoon Session

Practitioners acknowledged the complexity of the lessee allocation guidance in Topic 842. They noted that many entities have elected the practical expedient to combine the lease and nonlease components to avoid the allocation process. Some practitioners were concerned that amending the guidance would interfere with processes that already have been implemented by public entities. However, practitioners agreed that there is a conceptual basis for amending the lessee guidance to align with Topic 606.

One practitioner emphasized the importance of preventing structuring opportunities if amendments to the allocation guidance are made. That participant expressed concern that entities may structure their contracts such that the fixed payments relate to the nonlease component and variable payments relate to the lease component. That structure may result in an entity excluding the lease obligation from recognition.

A private entity preparer whose entity does not elect the practical expedient emphasized the practical challenges of applying the allocation guidance and suggested that the allocation often does not reflect the underlying economics of the contract. This preparer stated that allocating costs, such as property taxes, to nonlease components is irrational and does not provide decision-useful information. Highlighting the counterintuitive results that the lessee allocation guidance may yield, a private entity practitioner expressed concern that some entities may not be complying with that guidance because it is not well understood. Both the private entity preparer and the private entity practitioner asserted that amending the lessee allocation guidance would simplify the allocation process and provide users with better information.

Additional Topics Discussed

Participants raised points on the following topics:

1. Accounting for leasehold improvements
2. Related-party leases
3. Transition for nonpublic entities
4. Lease concessions Q&A

5. Presentation of leases in the cash flow statement,

Morning Session

One participant representing public entity preparers described the operational challenge of extending the depreciable life of a leasehold improvement upon reassessing a lease term. This participant emphasized the complexity of the process from a systems perspective and suggested removing the requirement to reconsider the depreciable life of an existing leasehold improvement upon the extension of a lease term.

A private entity practitioner highlighted the challenges of applying the related-party guidance in Topic 842. The participant asserted that because the guidance uses the phrase *legally enforceable terms and conditions,* nonpublic entity preparers would incur additional costs obtaining legal opinions, particularly for contracts that are oral or implicit. That participant stated that the Board should clarify whether it intended for the application of the related-party guidance in Topic 842 to be based solely on written terms.

That private entity practitioner also emphasized the costs of adopting Topic 842 for nonpublic entities and requested clarity around certain transition matters. For example, whether the IBR for leases existing at transition date should be based on the entire lease term or the remaining lease term.

That participant also recommended an update to the Staff Q&A, *Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic,* to clarify its application under Topic 840.

A user participant informed the Board of diversity in practice relating to the presentation of lease activity within the operating section on the cash flow statement. That participant noted that some entities include the amortization of the right-of-use asset with depreciation and amortization in operating cash flows as a noncash adjustment, while other entities include the amortization in the changes in working capital. The participant also observed that there was diversity among entities in the interpretation of noncash changes in leases. The user explained that those differences in presentation require users to adjust to achieve comparability.