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

File Reference No. 2020-700 – Comments on Leases (Topic 842) Targeted Improvements

Dear Ms. Salo:

For over a decade, LeaseAccelerator has been helping organizations manage their lease accounting and end-to-end lease lifecycle with our Software-as-a-Service platform. Today, we manage over $200 billion of operating and finance leases covering over 700,000 real estate and equipment leases generating 8 billion lease accounting journal entries each year.

On behalf of LeaseAccelerator, I am writing regarding the Financial Accounting Standards Board's (FASB) proposed Accounting Standards Update (ASU) Leases (Topic 842) Targeted Improvements. We support the FASB's efforts in connection with the post-implementation review (PIR) of Topic 842 and the continued outreach to various stakeholder organizations to address issues that may have arisen since the adoption of Topic 842 by public business entities. However, we have concerns with the proposal, including the following:

Issue 2: Option to Remeasure Lease Liability—Lessee Only (FASB text italicized)

Topic 842 prohibits a lessee from remeasuring its lease liability solely for a change in a reference index or a rate upon which some or all of the variable lease payments are based. Rather, any change in future payments resulting from changes in a reference index or a rate is accounted for as a variable lease cost. Those variable lease costs are recognized in the period in which the obligation for those payments is incurred. Certain stakeholders expressed that because IFRS 16, Leases, requires a lessee to remeasure the lease liability in subsequent periods when a change to the lease payments resulting from a change in a reference index or a rate takes effect, precluding lessees from similar remeasurement of lease liabilities under Topic 842 has resulted in increased costs for dual reporting entities. In developing Topic 842, the Board recognized that remeasuring the lease liability provides the most updated information about a lessee's future cash obligations. Notwithstanding, the Board decided to prohibit that remeasurement because stakeholders' feedback indicated that the benefits of remeasuring a lease liability solely for changes in a reference index or a rate did not justify the costs associated with requiring that remeasurement. 3 Many preparers that issue financial statements in accordance with both generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) have noted that the differences in the requirements in Topic 842 and IFRS 16 create ongoing costs and complexity primarily because preparers are required to maintain separate lease payment analyses and schedules for GAAP and IFRS Standards reporting purposes. Those stakeholders also noted that the Board had recognized that remeasurement provides the most updated information and, therefore, requested that the Board amend the existing requirements in Topic 842 to permit (but not require) lessees

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to remeasure lease liabilities for changes in a reference index or a rate affecting future lease payments at the date that those changes take effect, consistent with the requirement in IFRS 16. The amendments in this proposed Update would address stakeholders' concerns by providing lessees with the option to make an entity-wide accounting policy election to remeasure lease liabilities for changes in a reference index or a rate affecting future lease payments at the date that those changes take effect. By making this proposed amendment optional (rather than mandatory), each entity would be able to select the option that is most cost-effective for its particular circumstances. However, that option could affect the comparability of information for users of financial statements. An entity electing the option to remeasure lease liabilities for changes in a reference index or a rate affecting future lease payments would be required to disclose that fact.

Question 5: Are the proposed amendments operable? Why or why not?

Answer 5: The proposed amendments are operable in theory, however there will not be a consensus of how entities required to report under the standard will utilize the two options, and there will likely be meaningful divergence in practice should the amendments be approved. One will likely see a big-GAAP little-GAAP type distinction, a distinction between public entities and private entities, a distinction between users of proper lease accounting software tools as compared to those using spreadsheets for lease accounting, and dual reporting private entities (reporting under both ASC 842 and IFRS 16).

Distinction between public entities and private entities – most public entities have adopted ASC 842 and have been toiling under the standard for the better part of two years while most private entities will begin the adoption of ASC 842 in about a year or more from the present date.

Public entities - We believe it would be <u>highly unlikely</u> that public entities who have established policies, controls and governance around the “period cost” component of variable expenses linked to a reference index or rate would change such in place accounting policy. Furthermore, how would ASC Topic 250, Accounting Changes and Error Corrections be applied to this change from one generally accepted accounting principle to another generally accepted accounting principle? Would consistent application require that the change be made retrospectively and potentially require restatement of prior period financial results? What disclosures would be required for this type of change? Would a preferability assessment be required? Would a SEC registrant be required to file a preferability letter from its independent accountant with the Commission?

Private entities – We believe that private entities should follow the same rules as the publicly held entities and avoid the perception of big-GAAP and little-GAAP. Given the proposal as drafted, if small domestic single standard entities (ASC 842 only) are offered an option, we believe they would choose not to remeasure and expense as a period cost the variable expenses linked to a reference index or rate, as this option is simpler to maintain than remeasurement of both the lease liability and the right of use asset (including deferred and prepaid items as well as changes to the amortization of the ROU asset).

Distinction between users of proper lease accounting software tools as compared to spreadsheet users – The vast majority of publicly traded entities have implemented a lease accounting software tool to manage the process of lease accounting, to provide monthly journal entries and to provide periodic reports including reports to support financial statement footnote disclosures and the preparation of the lease accounting components included in the statement of cash flows. Due to the complexity of ASC 842 and the proper preventative and detective controls around lease accounting and disclosures that are required, the only way for an entity to properly discharge its fiduciary responsibility in this area is to utilize lease accounting software. As most privately-held entities are now commencing their journey into compliance with the lease accounting standard, they too are learning the complexities of the standard and the need for proper lease accounting software, even with small lease portfolios of say 25 leases, requiring more than spreadsheets. With lease accounting journal entries required for each month end close, a spreadsheet file for each lease and another spreadsheet to combine all leases to generate both management and disclosure information including weighted average calculations, it has become evident to most private entities that they too will need a lease accounting software tool beyond a mere spreadsheet. An accountant using spreadsheets to track lease accounting for a small portfolio would certainly not want to remeasure, as the effort to track both old and then new liability and asset balances compounds the already high workload, given that the lease accounting work for a small private entity is not a full time role and is typically thought of as the 5-9 job and not the 9-5 job. Once a private company has made the determination it needs a software tool beyond Excel, it will likely choose the remeasurement option to account for all lease modifications as remeasurements.

Dual reporting private entities – If a private entity has lease accounting reporting requirements under both IFRS 16 and ASC 842, under this scenario it is highly likely that the remeasurement option will be chosen under ASC 842. IFRS 16 has been in place for private entities for some time and has not been deferred as has been done under ASC 842, and these entities are required to remeasure reference index or rate changes under the IFRS standard. In our opinion, simply for ease of use, they would want to have the two standards comparable in this area.

Question 6: Should a lessee be provided with an option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based? Why or why not?

Answer 6: Providing an option would remove comparability, transparency, and clarity. We believe the best option would be to remeasure all payment changes.

Question 7: Should a lessee be required to make an entity-wide accounting policy election to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based? Why or why not? If not, at what level should that accounting policy election be required to be applied?

Answer 7: An entity-wide policy election would enhance comparability, transparency, and clarity and as such, we believe the best option would be to require an entity-wide election. We believe remeasuring lease liabilities for a change in a reference index or rate should be required of all reporting entities.

Question 8: Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

Answer 8: Providing options removes clarity and comparability and would make it more difficult for financial statement users to have true comparability. We do not want to see analysts and other users of financial statements doing "put and take" computations to get true comparable financial statements, comparable metrics, and ratios, as was often done under ASC 840.

Question 9: Would the comparability of information be significantly affected by the option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based?

Answer 9: Yes, for all the reasons stated above.

Issue 2 – Conclusion

We believe that Topic 842 should require all lessees to remeasure the lease liability for a change in a reference index or a rate upon which some or all the variable lease payments are based. This will provide for consistent application, a conceptually more accurate liability, allow greater clarity and transparency as well as comparability between entities as well as consistent application for dual reporting entities reporting under both ASC 842 and IFRS 16. To accurately account for remeasurements, a proper lease accounting system must be in place.

Issue 3: Modifications Reducing the Scope of a Lease Contract (FASB text italicized)

If a lease contract providing a lessee with the right to use multiple assets (for example, a master lease agreement) is modified such that certain of those rights are terminated early, Topic 842 requires that an entity (both lessees and lessors) reconsider the classification and adjust the accounting for the remaining lease components in that contract. This modification accounting is required regardless of whether those remaining lease components are economically affected by the early termination. In practice, an early *termination could be executed either at or after the effective date of the modification (for example, because there is a notice period before a lessee can return the leased assets to the lessor). Stakeholders questioned the appropriateness of requiring modification accounting for the remaining lease components if the early termination of one or more separate lease components does not economically affect the remaining lease components in that contract. Multiple preparers raised concerns that reassessing classification and adjusting the accounting for lease components that are economically unaffected by the termination of other lease components are burdensome and cause unjustified cost and complexity. Specifically, this accounting requires that an entity reconsider inputs for classification and measurement purposes, such as the economic life and fair value of the underlying asset and the discount rate. Additionally, stakeholders highlighted that reassessment of classification of economically unaffected remaining lease components during the lease term could change lease classification (for example, lessors reclassifying a sales-type or direct financing lease to an operating lease) solely because of the passage of time. Those stakeholders asserted that those changes in classification could result in financial reporting that does not represent the economics of the arrangement. Consequently, stakeholders requested that the Board amend the leases guidance to exempt entities from applying modification accounting to the remaining lease components within a lease contract when other lease components within the contract are terminated and those terminations do not affect the economics of the remaining components. The amendments in this proposed Update would address stakeholders' concerns by exempting entities from applying modification accounting to the remaining lease components within a lease contract for transactions in which one or more lease components are terminated before the end of the lease term and that early termination does not economically affect the remaining lease components.*

Question 10: Are the proposed amendments operable? Why or why not?

Answer 10: The proposed amendments are operable in theory, however there will not be a consensus of how entities apply these proposed amendments as there currently is divergence in practice of how to account for multiple assets leased from the same lessor under a master or similar agreement.

If the various leased assets are accounted for as separate contracts under the standard, there is no reassessment and remeasurement of the remaining assets should the contract(s) for an asset or multiple assets be terminated early.

If the various assets are accounted for as one contract under the standard, an allocation of the payment consideration will need to be made, going back to lease inception, to determine if the reduction in the rental payment is commensurate with the asset(s) returned. This is a big challenge and in practice is hard to do. As such, the remeasurement approach is much more practical than trying to do a theoretical / hypothetical allocation. The lessor will generally not break down the lease payment by leased asset so the lessee will be required to use considerable judgement in this area. Furthermore, the asset type, useful life, asset fair value and rental payment may not be homogenous and as such, the early return of certain types of assets may trigger a change in classification.

Question 11: Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

Answer 11: We do not believe the proposed amendments will provide improved decision-making information for users of financial statements per the responses provided above**.**

Question 12: Are there other aspects of the modification accounting model in Topic 842 that could be improved without compromising the decision usefulness of the information provided?

Answer 12: The concept of a universal incremental borrowing rate (IBR), at both lease inception and at modification, should be considered. The suggestion is to use the same IBR across the entire portfolio for an entity, adjusted only for the length of term of the lease. A company with a strong balance sheet and a low IBR will book a larger lease liability for the same leased asset than an entity with a weaker balance sheet. The stronger company is in essence punished for its strength.

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The use of a universal IBR will also ease the effort entities must undertake in lease accounting, obtaining updating and documenting IBRs, reduce audit review effort and cost, and will clearly level the playing field for comparability, transparency, and clarity by financial statement users. If the Board chooses to go in this direction, this will unfortunately create another distinction between ASC 842 and IFRS 16.

Issue 3 – Conclusion

We believe that Topic 842 should require remeasurement and review of lease classification for a lease contract containing multiple assets that is accounted for as a single contract with the early return of an asset or assets. This will provide for consistent application and allow for greater clarity, comparability, and transparency under ASC 842.

Transition

Question 13: For entities that have not adopted Topic 842 by the effective date of a final Update of these proposed amendments, should the proposed amendments be applied at the date that an entity first applies Topic 842 using the same transition methodology in accordance with paragraph 842-10-65-1(c)? Why or why not?

Answer 13: Yes. We believe that the policy election should be made as of the Transition Date and carried forward and consistently applied to the entire portfolio from transition.

Question 14: For entities that have adopted Topic 842 by the effective date of a final Update of these proposed amendments, should the proposed amendments be applied either retrospectively or prospectively as described in this proposed Update? Why or why not?

Answer 14: Under ASC 250, these changes would be a change in accounting principle and would be a voluntary change and as such, the change should be applied retrospectively to the beginning of the earliest period presented.

We are also concerned that the proposed changes could result in incremental costs that, in our view, may not be justified by the perceived benefits. Given these concerns, we believe that the Board should strongly consider the impact before deciding whether to move forward with the proposed changes at this time.

If you have any questions regarding our comments, please contact me at lneuhaus@leaseaccelerator.com or at (917) 693-0188.

Sincerely,

Leonard Neuhaus

Leonard Neuhaus, CPA

Vice President, Lease Accounting

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