December 2, 2020

To: Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
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Via Email: director@fasb.org

From: Lexmark International

Re: File Reference No. 2020-700

Lexmark International ("Lexmark" or "the company") appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Leases (Topic 842): Targeted Improvements*. Lexmark is a privately-owned company in the technology industry that both sells and leases print devices and provides related services and supplies to its customers and lessees. The company has not yet adopted Topic 842 for its financial statements.

Lexmark generally supports the proposed amendments in the exposure draft and appreciates the Board's willingness to consider refinements to Topic 842 that will simplify and/or improve reporting under the standard. In addition to the proposed amendments, the company believes other improvements could be made to the accounting by lessors related to the allocation of variable payments and the sale of assets underlying an operating lease as discussed in Part II of this comment letter.

Part I: Responses to the Board's Questions

Issue 1: Sales-Type Leases with Variable Lease Payments – Lessor Only

Question 1: Are the amendments in this proposed Update operable? Why or why not?

Response to Question 1: Yes. Lexmark considers the proposed amendments to be operable and an improvement to the existing guidance of Topic 842. The assessment of the "predominant" threshold can leverage estimates already made as part of existing processes in many cases.

Question 2: Should a lessor be required to classify and account for a sales-type lease with predominantly variable lease payments that do not depend on a reference index or a rate as an operating lease? Why or why not?

Response to Question 2: Yes. Operating lease classification is a better reflection of the economics of an arrangement where the payments are predominantly variable. In addition, the proposed amendments will better align Topic 842 with IFRS 16 for lessors with dual reporting requirements. That being said, it is the company's view that more leases may still be classified as operating leases under IFRS 16 due to the requirement that the lessor transfer substantially all the risks and rewards incidental to ownership of the underlying asset for finance lease classification to occur under the international standard.

Question 3: Should "predominant" be the threshold for determining when a lessor should classify a lease with variable payments that do not depend on a reference index or a rate as an operating lease? Alternatively, would another threshold be more appropriate and operable (for example, "substantially all")? Please provide your rationale.

Response to Question 3: Yes. Lexmark supports the use of "predominant" as the threshold for determining when a lessor should classify a lease with variable payments as an operating lease. If the Board decides to change the threshold, the company suggests further alignment with IFRS 16 if possible.

Question 4: Would the proposed amendments provide improved decision-useful information for users of financial statements? Why or why not?

Response to Question 4: Yes. As stated previously, operating lease classification is a better reflection of the economics of an arrangement where the payments are predominantly variable. Lease arrangements with predominantly variable payments occur in the technology industry today and may occur more frequently in the future due to the lessee's desire to minimize lease liabilities and right-of-use assets reported on the balance sheet.

Issue 2: Option to Remeasure Lease Liability – Lessee Only

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

Response to Question 5: Yes. Entities that elect the option to remeasure liabilities solely for a change in a reference index or a rate on which payments are based are likely doing so under IFRS 16; therefore, the proposed amendments are operable. Please refer to the response to question 13 for considerations related to transition.

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?

Response to Question 6: The company supports providing lessees the option to remeasure lease liabilities solely for such changes to align with the reporting under IFRS 16. Entities that are already reporting under the international standard who have not yet adopted Topic 842 will likely benefit the most from the option to remeasure. The proposed amendment should be an accounting policy election and should not be mandated for lessee reporting under Topic 842.

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?

Response to Question 7: The company agrees that the election should be made collectively for all asset classes, rather than separately for each asset class, for the purpose of comparability.

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

Response to Question 8: Yes. Remeasuring lease liabilities solely for a change in a reference index or rate should result in improved reporting for entities that have a significant portfolio of such leases.

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?

Response to Question 9: The company does not know whether the comparability of information would be significantly affected by the proposed accounting policy election.

Issue 3: Modifications Reducing the Scope of a Lease Contract

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

Response to Question 10: The company considers the proposed amendments operable; however, the company questions whether termination penalties paid in full on the date of modification should be included in the assessment of the economics of the remaining lease components. The company also considers that certain clarifications regarding the proposed guidance would be helpful for preparers, particularly regarding termination penalties as the accounting for these under Topic 842 is not always intuitive. For example, it would be helpful to specifically address how a lessor of an operating lease subject to ASC 842-10-25-8C(a) would account for the termination penalty received and whether or not any accrued operating lease receivables related to the terminated lease components should be derecognized on the date of termination/modification. In addition, it would be helpful to specifically state in ASC 842-10-25-13(b) whether a termination penalty triggered by the modification should be included by the lessee (1) in the remeasurement of the lease liability and corresponding adjustment to the right-of-use asset for the remaining lease components or (2) as part of the derecognition of the terminated lease components or allocated between items (1) and (2).

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

Response to Question 11: Yes. The proposed amendments should provide better information to users of financial statements since fewer contracts with non-substantive changes will be subject to the full requirements of the lease modification accounting model.

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?

Response to Question 12: It is the company's view that the lease modification accounting model should be applied in full only when changes to the contract are determined to be substantive. Adding a qualitative and/or quantitative screen to the assessment of all contractual changes may help preparers narrow the population for which lease modification accounting is applied. This could be based on the expected change in the future payments similar to an evaluation under ASC 470-50 to determine whether a change in terms underlying the debt of a borrower should be accounted for as an extinguishment (a difference of 10% or more) or a modification (a difference of less than 10%) of the existing debt. For changes that would not require lease modification accounting based on the screen test, lessees could account for any changes in the cash flows in the same way as when a contingency is resolved or as variable lease payments, depending on the circumstances, and lessors could account for any changes in the cash flows as variable lease payments.

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?

Response to Question 13: The company generally agrees with the proposed transition requirements for entities that have not adopted Topic 842; however, input from lease accounting software vendors may be necessary to determine the timing in which any functional updates would likely occur. For example, lessees with dual reporting requirements may not be able to take advantage of the election to remeasure lease liabilities solely for a change in a reference index or rate if the related functionality for IFRS 16 cannot be duplicated in the software for Topic 842 reporting in advance of the date Topic 842 is first applied.

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?

Response to Question 14: Preparers that have adopted Topic 842 should be permitted to apply the proposed amendments either retrospectively or prospectively, as described in this proposed Update, based on their specific circumstances. Each targeted improvement should be implemented based on an entity's assessment of the associated costs and benefits.

Part II: Additional Changes to Consider

It is Lexmark's view that other improvements could be made to the accounting guidance applied by lessors in addition to the amendments proposed in the exposure draft.

Allocation of variable payments by lessors

ASC 842-10-15-39 states that variable payments should be included in the contract consideration if the variable payments relate to "the lessor's efforts to transfer one or more goods or services that are not leases" or "an outcome from transferring one or more goods or services that are not leases" when the contract includes leased assets subject to Topic 842 and performance obligations subject to Topic 606. Paragraph 15-39 adds that variable payments meeting one of these conditions should be allocated solely to the related non-lease components "if doing so would be consistent with the transaction price allocation objective of paragraph 606-10-32-28." Variable payments that are not included in the contract consideration under paragraph 15-39 are deemed to relate solely or partially to the lease component and are allocated accordingly "[w]hen the changes in facts and circumstances on which the variable payment is based occur …" under ASC 842-10-15-40.

Application of these two paragraphs and the accompanying case examples in ASC 842-10-55-150 through 55-158, as currently written, can result in three possible accounting scenarios for a contract that includes a lease component under Topic 842, a service performance obligation under ASC 606, and variable payments:

1) The variable payments are included in the contract consideration and allocated entirely to the related service (Case C of Example 14).
2) The variable payments are included in the contract consideration but must be allocated to both the lease component and the service performance obligation in order to satisfy the ASC 606 transaction price allocation objective (Case B of Example 14).
3) The variable payments relate at least partially to the lease component and, therefore, are not included in the contract consideration. Instead, each variable payment is allocated to both the lease component and service performance obligation (or solely to the lease component if appropriate) in the period in which the change(s) in facts and circumstances on which the variable payment is based occur (Case A of Example 14).

It is the company's view that a failure to satisfy the transaction price allocation objective of ASC 606 when attempting to allocate the variable payments solely to non-lease component(s) (Case B) should or could trigger a reassessment of whether the variable payment amounts truly relate specifically to the non-lease component(s). This situation may be an indication that the variable payments, in substance, relate partially to the lease component(s) included in the contract. Lexmark believes that the economics underlying the second and third scenarios listed above may not justify the use of two different accounting models.

ASC 842-10-15-39 could be amended so that variable payments in contracts with lease and non-lease components be accounted for in one of two ways: (1) included in the contract consideration *and* allocated solely to the non-lease component(s) (in accordance with the conditions in paragraph 15-39 and the ASC 606 transaction price allocation objective) **or**, otherwise, (2) the variable payments are deemed to relate at least partially to the lease component and are allocated to the lease and non-lease components (or solely to the lease component if appropriate) in the period in which the conditions that trigger the variable payment occur in accordance with ASC 842-10-15-40. This would, in effect, eliminate the accounting scenario illustrated under Case B of Example 14. The company believes **an approach where the variable payments are deemed to relate at least partially to the lease component if they cannot be allocated solely to the non-lease component(s) is a more practical way for preparers to navigate between Topic 842 and Topic 606** and is consistent with paragraph BC163 of Update 2016-02, which states that "the Board decided that a lessor should not account for a single variable payment in accordance with two accounting models."

If the Board disagrees with the reasoning above on a conceptual basis, Lexmark still considers this an opportunity to simplify the accounting for lessors that should be considered by the Board. Reducing the number of accounting models, as discussed above, would help preparers that are trying to automate the accounting for contracts that have both lease and non-lease components and variable payments. This change may also benefit users of financial statements since diversity in practice may exist under Case B of Example 14 when a change in the estimated variable consideration occurs. If the timing of this proposed change is detrimental to public companies, perhaps the Board could consider this matter as an accounting alternative that could be elected by private companies.

Sale of assets underlying an operating lease

Assets underlying an operating lease may be subsequently sold by the lessor to a third party in order to accelerate the receipt of cash. Selected paragraphs from the derecognition guidance of ASC 360-10 are copied below.

40-2 Paragraph **840-20-40-5** states that if a sale to a third party of property subject to an operating lease (or of property that is leased by or intended to be leased by the third-party purchaser to another party) is not to be recorded as a sale because of the provisions of paragraph **840-20-40-3 through 40-4** , the transaction shall be accounted for as a borrowing.

Pending Content:
Transition Date: *(P) December 16, 2017; (N) December 16, 2019* | **Transition Guidance:** **606-10-65-1**
Paragraph **840-20-40-5** states that if a sale to a third party of property subject to an operating lease (or of property that is leased by or intended to be leased by the third-party purchaser to another party) is not to be recorded as a sale because the entity has not transferred control over the promised asset to the third party in accordance with paragraph **606-10-25-30** , the transaction shall be accounted for as a borrowing.

40-3A

Pending Content:
Transition Date: *(P) December 16, 2018; (N) December 16, 2021* | **Transition Guidance:** 842-10-65-1
An entity shall account for the derecognition of a nonfinancial asset, including an in substance nonfinancial asset and an asset subject to a lease, within the scope of this Topic in accordance with Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets, unless a scope exception from Subtopic 610-20 applies. For example, the derecognition of a nonfinancial asset in a **contract** with a **customer** shall be accounted for in accordance with Topic 606 on **revenue** from contracts with customers.

There appears to be an inconsistency between the updated guidance for ASC 360-10-40-2 in the codification (shown above) and the edits to this paragraph that were included in ASU 2016-02 (shown on the following page). ASC 840-20-40-5, which is superseded upon adoption of Topic 842, continues to be referenced in the latest version of the pending content for ASC 360-10-40-2 included in the Accounting Standards Codification. Furthermore, there is no pending content that references the transition guidance of Topic 842 included in paragraph ASC 360-10-40-2. Codification maintenance appears to be needed, which we assume is to incorporate the edits from ASU 2016-02 into ASC 360-10-40-2.

The excerpt below is from ASU 2016-02:

Derecognition

> Sale of Leased ~~Property~~Assets

360-10-40-2 ~~Paragraph 840-20-40-5 states that if a sale to a third party of property subject to an operating lease (or of property that is leased by or intended to be leased by the third-party purchaser to another party) is not to be recorded as a sale the entity has not transferred control over the promised asset to the third party in accordance with paragraph 606-10-25-30, the transaction shall be accounted for as a borrowing.~~ To determine when an asset subject to a lease shall be derecognized, an entity shall apply the following paragraphs in Topic 606 on **revenue** from **contracts** with **customers**:

a. Paragraphs 606-10-25-1 through 25-8 on the existence of a contract
b. Paragraph 606-10-25-30 on when an entity satisfies a **performance obligation** by transferring control of an asset.

Based on the changes included in ASU 2016-02, it appears that ASC 360-10-40-2 would continue to refer to Topic 606 to evaluate whether control has transferred and derecognition of the underlying assets is appropriate; however, specific instruction regarding how to account for the proceeds from a transaction that cannot be recognized as a sale would no longer exist within the derecognition guidance of ASC 360-10. When control does not transfer to a third party and the underlying assets cannot be derecognized by the lessor, it is unclear that the transaction will always be accounted for as a borrowing/financing under the application of Topic 606 or Subtopic 610-20 alone since the accounting can be affected by the reason why control did not transfer (e.g., repurchase provision, noncustomary restrictions on the buyer’s use of the assets, etc.) as well as the terms of the transaction (e.g., comparison of a repurchase price to the original price, is part of a sale-leaseback arrangement, etc.).

It is Lexmark’s view that accounting for the proceeds from a failed-sale transaction (when control of the assets underlying an existing operating lease does not transfer to the third party) as a borrowing is a proper reflection of the economics of such transactions in all cases consistent with historical guidance. When control of the underlying assets does not transfer to the third party, the receipt of proceeds is similar to the assignment of the operating lease payments to a third party without the underlying assets, which would be accounted for as a borrowing. Failed-sale transactions executed as part of sale-leaseback-sublease arrangements, as described in ASC 842-40-55-18 and 55-19, are also accounted for as a financing; however, it is not clear that the this guidance is intended to be applied (by analogy or otherwise) to all cases where assets subject to an existing operating lease are sold by the lessor to a third party and control does not transfer. It is Lexmark’s view that **maintaining or reinstating the language in ASC 360-10-40-2 that explicitly requires accounting for the sale of an asset subject to an operating lease “as a borrowing” when control of the asset does not transfer would simplify the analysis and should result in consistent reporting for similar transactions**.

Closing

Thank you for the opportunity to comment on the proposed changes to Topic 842. The company hopes the additional comments provided above will also be taken into consideration, which we believe will simplify application of Topic 842 for preparers and safeguard against diversity in practice. Please feel free to contact me if you have any questions.

Regards,

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