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Technical Director
File Reference No: 2020-700
FASB
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Submitted via email to: director@fasb.org

Re: Proposed Accounting Standards Update-Leases (Topic 842): Targeted Improvements

The Virginia Society of CPAs (VSCPA) Accounting & Auditing Advisory Committee (Committee) has reviewed the *Proposed Accounting Standards Update-Leases (Topic 842): Targeted Improvements,* issued by the Financial Accounting Standards Board (FASB). The VSCPA is a leading professional association dedicated to enhancing the success of all CPAs and their profession by communicating information and vision, promoting professionalism, and advocating members' interests. The VSCPA membership consists of more than 13,000 individual members who actively work in public accounting, private industry, government and education. The Committee appreciates the work the FASB has undertaken on this effort and the opportunity to respond to this Proposed Accounting Standards Update.

The Committee offers the following comments:

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?

> Yes, the proposed amendments are operable. Accounting for leases as operating as opposed to sales-type will reduce cost and complexity of applying the standard.

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?

> Yes, a lessor should 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. Under the current standard accounting for these transactions as sales type results in an initial loss recognition that may not appropriately represent the economics of the contract.

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.

> Predominant is both appropriate and operable as a threshold. The terminology used should address the issue being solutioned. In this matter the terminology used to define the threshold should be the point at which the variable lease components that do not depend on a reference index or rate would result in a loss recognition at lease commencement if accounted for as a sales type lease and if otherwise will be profitable throughout the contract. Regardless of the terminology, companies will need to develop policies and procedures in order to consistently apply the threshold.

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

Yes, the proposed amendment would improve decision-useful information for users of financial statements. An initial loss recognition on a profitable contract does not appropriately represent the economics over the lease term. Accounting for these leases as operating will allow the revenue and cost recognition to be better aligned resulting in greater transparency to users of financial statements.

<u>Issue 2: Option to Remeasure Lease Liability — Lessee Only</u>

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

The proposed amendments are operable. If a preparer issues financial statements in accordance with both generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the preparer already has systems and processes in place to remeasure the lease liability due to a change in a reference index or a rate. Therefore, providing an 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 would not be cost or time prohibitive on preparers.

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?

Yes. An option to remeasure lease liability solely for a change in a reference or a rate on which payments are based will provide a lessee with an opportunity to streamline and align their reporting under US GAAP and IFRS. However, for entities that report only under the US GAAP, this option may result in an additional analysis prepared for audit purposes to prove whether their current policy results in a material difference when compared to remeasured lease liabilities due to a change in a reference index or a rate on which payments are based.

Question 7: Should a lessee be required to make an entity-wide accounting policy election to remeasure lease liabilities solely for a chance 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?

Yes, a requirement to elect an entity-wide accounting policy can potentially result in cost and time savings as the entity will eliminate its need to adjust the lease liability amounts for the difference in their US GAAP policies versus their IFRS policies. An entity-wide policy will provide consistency of application, accounting, and reporting both internally and externally.

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

The proposed amendment may provide improved information for users of financial statements as the remeasured lease liability will reflect the current economic conditions.

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

There is a chance that the comparability of information may be significantly affected by the option to remeasure lease liabilities, if an entity elects to apply the option prospectively. However, if the comparability is significantly affected, the entity would disclose additional information in the footnotes to its financial statements.

<u>Issue 3: Modifications Reducing the Scope of a Lease Contract</u>

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

Yes, the proposed amendments are operable. Lease modification generally is a laborious process both with remeasurement of the right-of-use assets and lease liabilities as well as with the reclassification of the lease. In all cases where Issue 3 could apply, the proposed amendments would reduce the burden of lease modification on both lessees and lessors when remaining assets are economically unaffected. If the lease modification does not add any significant value to the users of the lease financial data, then the value of the modification itself is dubious.

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

In many cases, the proposed amendments would not only reduce the labor burden on lessees and lessors, but also improve how leases are classified. If a component of a lease is terminated early but does not affect the economics of the remaining lease component(s), then it seems that reclassification of the lease may even be misleading to the users of the financial statements.

For example, if a sales-type lease with several hundred assets has an early termination of a couple immaterial assets that do not economically affect the overall lease, then continued classification as a sales-type lease is more appropriate than reclassifying to an operating lease on the lessor's books just because the lessor now does not meet the thresholds to classify as sales-type. These proposed amendments will allow lessees and lessors to be more consistent with lease classification and accounting when the overall impact of a reduction in scope is not economically significant. Likewise, they are consistent with most other generally accepted accounting principles regarding materiality.

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?

These proposed amendments are appropriate considering how the labor burden of Topic 842 can be reduced while still maintaining or improving the usefulness of the related information. The TOPIC 842 AND TOPIC 840: *ACCOUNTING FOR LEASE CONCESSIONS RELATED TO THE EFFECTS OF THE COVID-19 PANDEMIC FASB* Staff Q&A highlighted the benefits of considering materiality when applying ASC 842 lease modification guidance and how the usefulness of the underlying information is not compromised when the lease cash flows themselves do not change materially, whether in timing or in amounts. A possible future amendment to consider would be the application of this type of guidance on the basis of materiality when applying ASC 842 lease modification guidance even after the COVID-19 pandemic.

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?

The transition methodology under 842-10-65-1(c) is reasonable. It requires retrospective application which inherently increases the time and effort required for transition; however, the option to apply 842-10-65-1(c)(2), a cumulative effect adjustment, seems reasonable for nonpublic companies and other organizations yet to adopt the standard. The only way to ease the burden of the adoption of Topic 842 more would be to allow prospective application, but this method could potentially compromise comparability for organizations that issue comparative statements and is not substantially different than application of 842-10-65-1(c).

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?

The decision to apply retrospectively or prospectively should fall on the organizations themselves, in contemplation of the users of the financial statements. In some cases, retrospective application would be useful to the point of being almost necessary in cases where significant leases have changed classification or have aggregated a large difference between contractually determined base rent and index-based rent. In many other cases, retrospective application would be unnecessarily burdensome and provide no material value to the users of the financial data. For those entities, a prospective approach would be beneficial.

Again, the Committee appreciates the opportunity to respond to this Exposure Draft. Please direct any questions or concerns to VSCPA Vice President, Advocacy Emily Walker, CAE, at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

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Chair, VSCPA Accounting & Auditing Advisory Committee
2020–2021

2020–2021 VSCPA Accounting & Auditing Advisory Committee:
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