Edison Electric INSTITUTE

Power by Association

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

Proposed Accounting Standards Update,
Leases (Topic 842) Targeted Improvements
File Reference No. 2020-700

Dear Ms. Salo:

The Edison Electric Institute (EEI) appreciates the opportunity to comment on Proposed Accounting Standards Update, *Leases (Topic 842) Targeted Improvements*, File Reference No. 2020-700 (the “Exposure Draft” or “Proposed ASU”).

EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for 220 million Americans and operate in all 50 states and the District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. In addition to our U.S. members, EEI has more than 65 international electric companies as International Members, and hundreds of industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

EEI strongly supports FASB’s initiative to evaluate newly adopted accounting standards, address concerns identified by large entities during the initial implementation of those standards, and consider improvements that could ease the adoption burden for smaller entities. With respect to Topic 842, we appreciated the opportunity for an industry representative to participate in the roundtable held on September 18, and we support the improvements proposed in the Exposure Draft that was issued shortly thereafter.

Specific Comments

Following are our responses to the questions posed in the Exposure Draft.

Issue 1: Sales-type leases with variable lease payments—lessor only

EEI would like to express our members' sincere appreciation for the proposed amendments to Topic 842 under Issue 1, which are consistent with the agenda request we submitted earlier this year. We are gratified that the Board "agreed that recognizing a loss at lease commencement for lease contracts that a lessor expects to be profitable overall results in reporting outcomes that do not reflect the economics of the transaction" and has voted in favor of "a practical solution resulting in financial reporting outcomes that more faithfully represent the economics of the transaction." (Exposure Draft Paragraph BC10)

We strongly support the proposed amendments to the lessor accounting for sales-type leases with predominantly variable lease payments to require lessors to classify such leases as operating leases. We provide below our specific responses to Questions 1 through 4 in the Exposure Draft.

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

We believe the proposed amendments are operable as they are narrow in their application and would simplify a lessor's accounting for a lease with lease payments that are predominantly variable and do not depend on a reference index or a rate ("predominantly variable payments") both at commencement and over the term of the lease. The amendments do not create implications for other aspects of Topic 842 or introduce a more complex model that is inconsistent with previous underlying decisions on lease measurement.

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?

A lessor should be required to classify and account for a sales-type lease with predominantly variable lease payments as an operating lease. Such classification and accounting should be required because it more faithfully represents the underlying economics of the lease arrangement than that under the current guidance by eliminating the recording of a day-one loss and derecognition of the lessor's owned asset.

Further, the proposed change preserves the underlying fundamental decision in Topic 842 generally to exclude variable payments in the measurement of lease assets and liabilities and results in greater convergence with IFRS 16. Our members compete with companies in the renewable energy sector that report under IFRS, and this approach would eliminate competitive arbitrage due to accounting differences. Finally, as a requirement rather than an option, the benefit of more representationally faithful reporting would be applied consistently across all lessor entities.

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.

We are in favor of "predominant" as the threshold for determining when a lessor should classify a lease with variable payments as an operating lease given the Board's clarification in paragraph B12 of the Exposure Draft that the term "predominant" is expected to mean "majority." An evaluation of whether variable payments are expected to be greater than the fixed lease payments in impacted arrangements of the electric energy industry (e.g., the purchase and sale of energy from renewable generation facilities, including facilities paired with battery storage systems) is more appropriate than an evaluation under an alternative threshold such as "substantially all." In particular, we believe that "substantially all" is such a high threshold that a majority of lease arrangements with significant variable payments potentially may still result in sales-type lease classification with associated recognition of artificial day-one losses, and thus would not solve the practical issue at hand.

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

The current accounting model under Topic 842 results in recording an artificial day-one loss for profitable transactions and creates a severe disconnect between the accounting and the economic substance of transactions containing a lease with predominantly variable payments, both at commencement and over the term of the lease. This anomalous result is not intuitive to investors, has led to changes in substantive economic terms of arrangements to avoid sales-type lease classification, and is likely to lead to new non-GAAP measures as preparers attempt to explain to investors the disconnect between the accounting and economics of these transactions. The proposed amendments better align reported financial results with the underlying economics of such arrangements and provide users financial information that is understandable and substantially more representationally faithful than the current model.

Issue 2: Option to Remeasure Lease Liability—Lessee Only

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

To the extent that the proposed amendments in Issue 2 can be applied at the option of the preparers of the financial statements, we support the proposed amendments and consider them operable. The optionality will afford preparers the opportunity to adopt the amendments if the benefits outweigh the costs to implement the requirement to remeasure a lease liability for changes in a reference index or a rate affecting future lease payments.

We also agree that the amendments will align application of Topic 842 and IFRS 16 for those preparers with reporting requirements under both US GAAP and IFRS accounting standards, which will create an inherent benefit to those preparers if they elect to apply the amendments. Accordingly, the proposed amendments are operable as each entity would be able to decide whether it wants to apply the proposed amendments based on its individual facts and circumstances.

As discussed more fully in our response to Question 6, we would not support this proposal as a requirement for all entities, which would significantly decrease its operability by requiring every entity that has already implemented Topic 842 to revise its systems, controls, accounting, and reporting for the benefit of a small group for which this proposal might be cost-beneficial.

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?

We support the proposed amendments only on the condition that the lessee is provided an option to remeasure lease liabilities solely for changes in a reference index or a rate on which payments are based. We strongly believe that the proposed amendments should be an option only and not required for all lessees. If the option is removed, we oppose the proposed amendments.

As originally contemplated in the development of Topic 842, the benefits of remeasuring lease liabilities related to changes in a reference index or a rate do not always outweigh the costs associated with implementing such changes. We continue to support those views but acknowledge that the divergence with IFRS 16 has caused additional complexity for those lessees required to comply with the requirements of both Topic 842 and IFRS 16. The proposed option will allow all lessees the ability to elect the most beneficial approach based on their individual facts and circumstances. This would provide alignment and relief for entities that report under both US GAAP and IFRS.

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?

We believe a lessee should be allowed to apply the proposed amendments at whichever level is most cost-effective and beneficial, similar to the Topic 842 practical expedient for lease and non-lease components, which allows lessees the choice to separate or combine such components by class of underlying asset.

In addition, we suggest the FASB consider permitting a lessee to apply the proposed amendments in a manner which may differ from its parent's consolidated financial statements. This is based on the fact that under certain circumstances it is acceptable for the accounting policies of a parent and one or more of its subsidiaries to differ in the parent's consolidated financial statements.

For example, as noted in AICPA Technical Practice Aids (TIS Section 1400.23), *Conforming Subsidiary's Inventory Pricing Method to Its Parent Company's Method*, there are no requirements for all subsidiaries of a reporting entity to value inventory under the same valuation method. As such, the parent and a subsidiary can use different valuation methods if it is practicable for each company to do so. Therefore, under this example, the subsidiary's financial statements will not be adjusted to conform with the parent's financial statements upon consolidation.

We believe most lessees that prepare financial statements under both U.S. GAAP and IFRS and that would elect to apply the proposed amendments would make an entity-wide accounting policy election because the option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based will converge Topic 842 and IFRS 16. Further, IFRS 16 currently does not allow such a policy election at a different level. However, similar to the inventory pricing method analogy discussed above, we suggest the Board consider giving lessees flexibility in making this accounting policy election across their operations. Otherwise, for an entity with domestic and international operations, it may be onerous and costly to apply the proposed amendments across all its domestic subsidiaries in a consistent manner.

That said, if such an election were permitted, a financial statement preparer should be required to disclose its election of the policy, at which level and to which subsidiaries the policy election has been applied, and to provide any other relevant disclosures to promote transparency that would assist users of the financial statements.

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

For those entities that report under both US GAAP and IFRS and choose to apply the proposed amendments, we believe the proposal would allow the lease liability balances reported in their financial statements to be better aligned. Other than this convergence between Topic 842 and IFRS 16, we believe the amendments will have limited effect on decision-useful information for users of the financial statements.

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?

It would be difficult to isolate the degree of significance of the effect on the comparability of information due to the option to remeasure lease liabilities solely for a change in a reference index or a rate on which payments are based. It would depend on such factors as the number of an entity's lease arrangements that would be affected by the option to remeasure lease liabilities and the degree of change in the reference index or rate on which payments are based.

We note that there are already differences in the comparability of information about lease liabilities between entities, such as those related to practical expedient elections including short-term lease exemption, separation of lease components and non-lease components, land easements, as well as other assumptions that are based on individual entity policies.

As stated in the response to Question 8, entities that report under both US GAAP and IFRS would have better alignment of the lease liability balances they report when comparing those financial statements because the election of the option results in convergence between Topic 842 and IFRS 16 on this specific matter. As such, the comparability of information would be improved for an entity's reporting of lease arrangements for which it remeasures lease liabilities for a change in a reference index or a rate on which payments are based.

The key point of emphasis is that the accompanying disclosures should be transparent to users of the financial statements regarding which practical expedients and accounting policy elections an entity has made in applying Topic 842.

Issue 3: Modifications Reducing the Scope of a Lease Contract

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

The proposed amendments are operable as they could reduce the cost and complexity of applying the guidance in certain cases. However, for several aspects, we believe the operability could be improved.

First, because previous Topic 842 modification accounting guidance would apply to the early terminated components of a contract when the termination date is later than the effective date of the modification, in that case the proposed accounting would not reduce the cost and complexity of applying Topic 842 to a terminated contract. To further reduce the cost and complexity of modification accounting, we propose extending the ability to elect the practical expedient for short-term leases from ASC 842-20-25-2 so that it may be applied to the early terminated portion at the effective date of the modification. For companies that apply the practical expedient, this would continue to provide information on a similar basis to other lease contracts.

In addition, we understand that there would be no circumstances in which the guidance of ASC 842-10-25B could be applied where payments related to termination were made, except for purchase, or equivalent, of the early terminated component assets. Certain payments that might be incurred, such as fees to facilitate removal of the early terminated components, clearly relate only to those early terminated components; therefore we ask the Board to reconsider permitting application of ASC 842-10-25B where additional payments are made in relation to the termination that do not represent penalty payments.

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

We agree that avoiding changes in classification of current leases due to passage of time improves decision-useful information. We believe these amendments would not reduce the decision-usefulness in any instances.

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?

In certain cases, contract terms that do not impact the economics of a contract may require amendment to reference updated operational or regulatory factors. In line with the adjustments proposed in the exposure draft, ASC 842-10-15-6 could be updated to clarify that modifications to terms and conditions of a contract that have no economic impact do not require reassessment of lease classification or adjustment to accounting, which appears in line with the glossary definition of a lease modification.

We note that this question implies that the Board may propose additional amendments to the modification accounting model. While we do not necessarily oppose considering additional amendments, we urge the Board not to adopt future amendments that would change aspects of this Proposed ASU that are finalized before additional modification issues are addressed in order to avoid a series of unnecessary and confusing changes in the accounting for leases. If this potential exists, we suggest the Board consider addressing all aspects of the modification accounting model holistically in a single proposal.

Conclusion

EEI once again would like to express our gratitude for the Board's timely action to address the concerns underlying Issue 1. We urge the Board to finalize and adopt the amendments proposed under Issue 1 as soon as possible in order to ensure the Topic 842 accounting model provides useful, representationally faithful information to users of lessors' financial statements. We believe this approach, which is consistent with our agenda request, would be easy to implement and would simplify the accounting model consistent with the Board's overall objectives.

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EEI appreciates the opportunity to provide comments on the Exposure Draft. We would be pleased to discuss our comments and to provide any additional information you may find helpful. Please contact Randall Hartman, Director, Accounting, at 202-508-5494 or rhartman@eei.org.

Very truly yours,

/s/ Richard F. McMahon, Jr.

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