GRANT THORNTON LLP
Grant Thornton Tower
171 N. Clark Street, Suite 200
Chicago, IL 60601-3370

D +1 312 856 0200
S linkd.in/grantthorntonus
twitter.com/grantthorntonus

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

Via Email to director@fasb.org

Re: File Reference No. 2020-700

Dear Ms. Salo:

Grant Thornton LLP appreciates the opportunity to comment on proposed Accounting Standards Update (ASU), *Leases (Topic 842): Targeted Improvements*.

We appreciate the Board's efforts to address ASC 842 implementation issues and believe that the proposed amendments are responsive to the three implementation issues described in the proposed ASU. We believe that the proposed amendments will lead to accounting outcomes that better reflect the economic substance of leasing activities and will reduce the costs and complexity of applying the guidance in ASC 842.

However, we have suggestions that we believe will improve the proposed guidance, and these are explained in our responses to certain questions in the proposed ASU, as follows.

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. We believe that the proposed amendments are operable, although we believe that it is important for the Board to gather and consider feedback on operability from financial statement preparers. We believe that the proposed guidance becomes more challenging to apply as the mix of fixed and variable consideration in a contract approaches parity. In other words, a lessor's ability to forecast variable consideration will carry greater weight in assessing whether the proposed guidance applies for contracts with both fixed and variable consideration. The Basis for Conclusions in ASU 2016-02 (in particular paragraph BC208) describes the challenge that lessors face in estimating usage-based variable consideration. Therefore, depending on feedback from financial statement preparers, the Board may consider amending the threshold for the level of variable consideration in the contract, as described in our response to Question 3.

One shortcoming of the proposed model is that it does not reflect the conversion of asset risk into credit risk despite the lessor having effectively transferred control of the underlying asset to the lessee. In the appendix to this letter we describe an alternative method that the Board could consider that would reflect this change in the type of risk without requiring recognition of a day one loss.

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. We believe that recognition of a loss upon commencement of a sales-type lease is generally not reflective of the lease's economic substance.

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 believe that "predominant" strikes a balance between operability and capturing a significant portion of contracts that contain a sales-type lease for which a day one loss would be recognized under the current guidance in ASC 842.

However, if, based on feedback gathered from financial statement preparers regarding operability as described in our response to Question 1, it is determined that a requirement to estimate variable consideration (particularly that based on lessee usage) for purposes of making an assessment of predominance is operationally burdensome with respect to contracts that contain a mix of fixed and variable consideration, we believe that a higher threshold such as "substantially all" should be considered. A higher threshold such as "substantially all" would capture many of the contracts for which recognition of a day one loss at lease commencement is an issue for the lessor, including those with payments that are entirely variable based on usage.

Issue 2: Option to Remeasure Lease Liability—Lessee Only

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

Yes. However, we are concerned that, as drafted, the proposed guidance might be applied differently than the corresponding guidance in IFRS 16, *Leases*.

Under IFRS 16, Example 14A illustrates the application of paragraph 42(b), which specifies that a lessee shall remeasure the lease liability when there is a change in future lease payments resulting from a change in an index or rate used to determine those payments. Paragraph 42(b) requires a lessee to remeasure the lease liability when the adjustment to the lease payments takes effect.

However, unlike the amended Example 25 Case A (as proposed) under ASC 842, Example 14A under IFRS 16 does not explicitly specify when the adjustment to the lease payments “takes effect.” It is our understanding that this lack of specificity has led to diversity in practice in the application of IFRS 16, such that some practitioners would remeasure the lease liability in a scenario similar to that described in Example 14A at the end of year two, while others would not, and would only remeasure the lease liability at the beginning of year three.

Since the objective of this amendment is to permit dual-reporting entities to consistently remeasure the lease liability for changes in lease payments based on an index or rate under U.S. GAAP and IFRS, we recommend that the amendments to Example 25 Case A in ASC 842 omit the parenthetical “the date at which the change in payments takes effect,” and otherwise align the amendments with Example 14A in IFRS 16.

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. We believe that providing this option to lessees under U.S. GAAP will help to align the subsequent measurement guidance under ASC 842 and IFRS 16, and will in many cases reflect a better estimate of future lease payments linked to an index or rate in the measurement of the lease liability.

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?

Yes. Since the objective of this amendment is to allow an entity to align its policy under U.S. GAAP with the requirement under IFRS, and since the guidance under IFRS must be applied entity-wide, we believe that the policy election under U.S. GAAP should be made on an entity-wide basis.

Issue 3: Modifications Reducing the Scope of a Lease Contract

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

As drafted, it is unclear how termination penalties associated with terminated lease components should be accounted for under the guidance in ASC 842-10-25-8C. In order to prospectively account for the continuing lease component(s) in the same manner as before the partial termination, we believe that a termination penalty incurred in connection with a modification that satisfies the conditions in ASC 842-10-25-8B should be attributed entirely to the terminated lease component(s). We believe that the proposed guidance should be revised to make this clear.

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?

A fundamental challenge with applying the partial termination accounting model is reconciling the conclusion that a contract contains a single lease component with a determination that the lease has been partially terminated. As amended, Example 18 illustrates a scenario in which a contract that conveys the right to use office space contains a single lease component, and the contract is modified to reduce the leased square footage by one half.

In our experience, situations in which the scope of a lease is reduced, such as reductions in leased square footage of office space, suggest that prior to the reduction in scope the contract contained at least two lease components. In a scenario where a single lease component is partially terminated, we believe it is necessary for the parties to the contract to consider whether the identified asset has changed, or whether the contract continues to contain a lease component at all.

To illustrate, in Example 18, if the original 10,000 square feet of office space constituted the identified asset associated with a single lease component, then upon the partial termination described in the example, it appears that either (1) the identified asset has changed (it is no longer the particular 10,000 square feet of office space) or (2) the customer no longer has the right to control the use of the identified asset (that is, the original 10,000 square feet of office space, half of which the original lessee can no longer use).

We believe that this concept of a partial termination associated with a single lease component will continue to create challenges in applying the partial termination modification model and may require additional clarification in ASC 842. In the meantime, we suggest that the proposed amendment to Example 18 in ASC 842-10-55-177 be removed, and that Example 18 be revised to illustrate application of the proposed guidance in ASC 842-10-25-8A through 25-8C.

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?

Yes. We see no reason to provide an alternative implementation date and transition methodology for the proposed amendments for entities that have not yet adopted ASC 842.

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?

Yes. We believe that entities will benefit from the flexibility to either update their lease accounting for prior periods presented under ASC 842 or to apply the proposed amendments prospectively.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Ryan Brady, Partner (ryan.brady@us.gt.com) or Rahul Gupta, Partner (rahul.gupta@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP

Appendix

Alternative model for sales-type leases with a day one loss

We believe that continuing to recognize an underlying asset and depreciation expense (for assets presented as property, plant, and equipment) over the lease term does not reflect the economic substance of a sales-type lease transaction, because by entering into a sales-type lease, the lessor has effectively transferred control of the underlying asset and converted asset risk into credit risk associated with a financial asset.

Further, since the lessor has converted asset risk into credit risk when it executes a sales-type lease, we believe that the current expected credit loss (CECL) impairment model in ASC 326 is better suited to the economic substance of the lessor's asset in a sales-type lease than the nonfinancial asset impairment model in ASC 360.

We believe an alternative approach could reflect this conversion of risk from the lessor's perspective without requiring recognition of a day one loss. Rather than recognizing a loss upon derecognition of the underlying asset, the lessor could effectively defer the loss as a component of the net investment in the lease.

Specifically, for sales-type leases that would otherwise result in a day one loss, a lessor could reclassify the underlying asset to a financial asset, and subsequently apply a method similar to the units-of-revenue method defined in ASC 470-10, *Debt*, to allocate lease payments between amortization of the net investment in the lease and lease income over the lease term.

Since many lessors develop quantitative estimates to evaluate the expected profitability of a lease arrangement, as described in paragraph BC13 in the proposed ASU, we believe that in many cases a method similar to the units-of-revenue approach could be applied without incurring undue costs. The Board however can explore other methods of amortizing the net investment in the lease, or for operational simplicity could consider a straight-line amortization approach.

Such a model would accurately reflect the type of risk the lessor is exposed to via the lease arrangement and would require application of a credit-based impairment model, consistent with the lessor's economic risk exposure. In addition, such a model avoids the need for lessors to apply a threshold such as "predominant" in deciding which lessor accounting model is appropriate for each lease.