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Via email to director@fasb.org

Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Leases (Topic 842): Targeted Improvements* (File Reference No. 2018-200)

Dear Ms. Cospers:

We are pleased to provide comments on the Board's proposal to provide transition relief from comparative reporting upon the adoption of Topic 842 and a practical expedient for lessors to not separate nonlease components from the related lease components and instead, to account for those components as a single lease component.

We support the proposed improvements related to the transition relief. However, we have concerns about the operability of the practical expedient to be provided to lessors, and believe it could be modified slightly to provide more clarity about how to determine whether the pattern and timing of recognition are the same, especially when the arrangement includes variable consideration. Our concerns, along with responses to the Board's specific questions, are provided in Appendix A to this letter.

Appendix B identifies an issue under Topic 842 related to the reimbursable costs for lessors that may warrant further consideration by the Board. We believe an opportunity exists to further align Topic 842 with Topic 606, while at the same time providing practical relief to lessors.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Adam Brown at (214) 665-0673, Angela Newell at (214) 689-5669 or Jin Koo at (214) 243-2941.

Very truly yours,

BDO USA, LLP

Appendix A

ISSUE 1: Transition—Comparative Reporting at Adoption

Question 1: Would the proposed optional transition method to apply the new lease requirements through a cumulative-effect adjustment in the period of adoption reduce the costs and complexity associated with implementing Topic 842? If not, please explain why.

We agree that the proposed optional transition method would reduce cost and complexity when adopting and implementing Topic 842.

Question 2: Is the proposed transition method, as written in this proposed Update, operable? If not, please explain why.

We believe that the proposed optional transition method is operable as written in the proposed Update.

ISSUE 2: Separating Components of a Contract

Question 3: Would the practical expedient in this proposed Update for lessors to not separate nonlease components from the related lease components and, instead, to account for those components as a single lease component reduce the costs and complexity associated with applying Topic 842 by lessors? If not, please explain why.

We agree that the proposed practical expedient would reduce the costs and complexity of applying Topic 842. However, we believe the guidance could be improved in order to clarify in what instances the practical expedient may be elected. Refer to our response to Question 4 below.

Question 4: Is the proposed practical expedient, as written in this proposed Update, operable? If not, please explain why.

The proposed practical expedient permits lessors to not separate nonlease components from the related lease components if the timing and pattern of revenue recognition for the nonlease component and related lease component are the same and the combined single lease component would be classified as an operating lease. Our concern relates to the first criterion.

The proposed language in paragraph 842-10-15-42A(a) states only that the timing and pattern of recognition must be the same in order to apply the practical expedient. However, it is not clear how to apply this guidance when the consideration in the contract includes variable consideration. Specifically, the timing and pattern of recognition of variable consideration allocated to the nonlease component could differ under Topic 606 from the timing and pattern of recognition after first applying the allocation guidance in paragraphs 842-10-15-38 through 15-40.

We understand that the Board did not intend for differences in the pattern of recognition of variable consideration driven by differences between the recognition model in Topic 606 and the recognition model in Topic 842 to preclude a lessor from applying the proposed practical expedient to situations in which the timing and pattern of *transfer* of the lease and nonlease components are the same.

Therefore, we recommend that the Board revise the language in the proposal to focus on timing and pattern of transfer, rather than timing and pattern of revenue recognition as follows (additions underlined):

842-10-15-42A(a) “The timing and pattern of ~~revenue recognition~~ transfer for the lease component and nonlease components associated with that lease component are the same.”

We note that paragraph 606-10-25-31 indicates that the “The objective when measuring progress [of a performance obligation satisfied over time] is to depict an entity’s performance in transferring control of goods or services promised to a customer (that is, the satisfaction of an entity’s performance obligation).” Therefore, we believe that focusing the assessment on whether the timing and pattern of transfer of the lease and nonlease components is the same should result in consistent income recognition in most cases, without requiring a complex assessment of the specific accounting treatments of the lease and nonlease components on a separate basis. We also believe that a focus on transfer rather than revenue recognition would further the Board’s goal of reducing complexity, as articulated in paragraph BC24 (proposed changes underlined):

BC24: “In deciding on the requirements of the proposed practical expedient for lessors, the Board also considered that a lessor would not need to apply the separation and allocation guidance to determine whether it would qualify for the proposed practical expedient because that would have defeated the purpose of that practical expedient. For example, the lessor may be able to determine that a maintenance service is a performance obligation satisfied over time and that the measure of progress is time based (and therefore straight-line) without having to know the amount allocated to the maintenance performance obligation. In addition, because the proposed practical expedient would include a requirement that the combined single (lease) component must be classified as an operating lease, this must mean that the lease component, if separated from the nonlease components, also would be classified as an operating lease. Therefore, the pattern of ~~revenue recognition~~ transfer of the lease component also could be determined without having to know the amount allocated to that lease component.

We are also concerned that a literal reading of Topic 606 and related TRG guidance might limit the usefulness of the practical expedient. Specifically, the FASB/IASB Joint Transition Resource Group (TRG) for Revenue Recognition paper “Stand-Ready Performance Obligations” (Agenda Ref 16) indicates in paragraph 15 that straight-line recognition for stand-ready obligations is not always appropriate. In situations in which certain of the common area maintenance services are seasonal, for example, an entity might conclude that straight-line attribution does not perfectly reflect the pattern of transfer to the lessee, and a strict application of the TRG guidance might result in a conclusion that the first criterion would not be met because the timing and pattern of revenue recognition (or transfer of benefit) for the service component under Topic 606 would not be the same as the timing and pattern of revenue recognition (or transfer of benefit) under Topic 842. We believe such a narrow application of the guidance was not the Board’s intention, and we believe that it would be unusual that a resulting attribution method would be materially different than straight line in most cases. Therefore, we recommend modifying the criterion in the proposed paragraph 842-10-15-42A(a) to indicate that the timing and pattern of revenue recognition be substantially the same.

We understand that certain industries have indicated a desire to account for the combined lease and nonlease component using the presentation and disclosure requirements of Topic 606 rather than Topic 842 because the nonlease component is the more prevalent component in the contract. Although we acknowledge the Board's concerns articulated in paragraph BC25 about added complexity, we believe that allowing a lessor to elect to account for the combined lease and nonlease component under another Topic (usually Topic 606) when the nonlease component is the predominant promise in the contract would result in more decision-useful information for users of the financial statements. In addition, we note that accounting for a combined item based on the more predominant item is consistent with the requirements of paragraph 606-10-55-65A related to sales- and usage-based royalties. Thus we would support such an election being included in the proposed Update.

Although we believe our proposed approach would simplify the analysis required to determine whether the proposed practical expedient is available in a particular situation, we still believe there will likely be questions in practice. In addition, we note that the separation and allocation guidance in paragraphs 842-10-15-38 through 15-40 is not well understood, and must still be applied in situations in which the pattern and timing of transfer are not the same for the lease and nonlease components, or if the lessor chooses not to apply the proposed practical expedient. Therefore, we also recommend that the Board include an example of the assessment to determine whether the practical expedient may be elected when variable consideration is present, which could be achieved by modifying Example 14 in Topic 842 (paragraphs 842-10-55-150 through 55-158). The revised example would illustrate:

- The reporting entity would first assess whether the timing and pattern of transfer for the lease and nonlease components are the same and whether a combined component would continue to result in operating lease treatment, and if so, whether it will elect the proposed practical expedient.
- If the reporting entity concludes that the timing and pattern is not the same, or if it elects not to apply the proposed practical expedient, then the contract's consideration would be allocated to the separate lease and nonlease components in accordance with paragraph 842-10-15-38, which incorporates the allocation guidance from the new revenue standard in Topic 606.
- Next, the reporting entity would apply the guidance in paragraph 842-10-15-40 to recognize the variable consideration for both the lease and nonlease component as income in the period that it occurs. Although the example already illustrates this concept, we believe this may not be plainly understood by practitioners for two reasons:
 - Some entities may interpret paragraph 842-10-15-40 to require attributing all of the variable consideration to the lease component, resulting in an income pattern for the lease that is other than straight-line.
 - Others may conclude that the variable consideration allocated to the nonlease income should be recognized solely pursuant to Topic 606, which would require estimating the variable consideration. That is, the entity may be confused by a requirement to allocate consideration to a nonlease component such as maintenance using the revenue framework as required in paragraph 842-10-15-38, yet deferring recognition of the variable consideration allocated to the nonlease component to the later of the period in which the uncertainty inherent

in the variable consideration is resolved or the services are delivered using the leasing framework under paragraph 842-10-15-40 and further illustrated in this example (Example 14 in Topic 842).

- Finally, each subsequent variable payment would still be allocated to the lease component and nonlease component using the same percentages as the initial allocation (e.g., 86% vs. 14% as contemplated in Example 14, Case A). However, the lessor would look to Topic 606 to recognize the nonlease component, as well as for presentation and disclosure requirements.

Question 5: Would the information in the financial statements, including disclosures, provided by lessors electing the practical expedient in this proposed Update be decision useful? If not, please explain why.

We generally believe that the information in the financial statements, including disclosures, would be decision useful.

Appendix B

Other suggested changes for lessors.

Example 12 in Topic 842 (paragraphs 842-10-55-141 through 55-145) is clear that real estate taxes and property insurance are not components of a lease, and that a lessee's payment of those amounts solely represents a reimbursement of the lessor's costs. Therefore, a lessor must include any payments of property insurance on its behalf by the lessee as additional consideration in the arrangement. In many commercial leases, in particular those for single-tenant properties, the lessee is responsible for obtaining property insurance, with the lessor as the named-insured. Consequently, the lessor has limited information related to the cost of the insurance, nor whether that cost is a reasonable, market-based price. Thus, in order to comply with the guidance in Topic 842, the lessor will be required to determine the lessee's cost of obtaining property insurance.

While we agree with the principle that property insurance are costs of the lessor and not a component of the lease arrangement, we do not believe that requiring the lessor to report gross revenues and insurance expense on its income statement in an amount that it neither knows nor has control over provides useful information to users of financial statements. Therefore, we recommend that the Board provide a practical expedient indicating that if a lessor cannot determine the value of insurance coverage obtained by its lessee on its behalf, that it may elect to disclose that fact in lieu of estimating the cost. We note that allowing the lessor to recognize lease income net of amounts paid directly by the lessee for insurance would be consistent with the accounting articulated in paragraph 38 of the basis for conclusions to ASU 2016-08, *Principal versus Agent Considerations*, in the situation in which an entity is a principal in a transaction but uncertainty in the transaction price is not expected to ultimately be resolved.