



July 15, 2021

Hillary Salo
Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: June 16, 2021 Proposed Accounting Standards Update, Leases (Topic 842) Discount Rate for Lessees That Are Not Public Business Entities [Project No. 2021-003]

Dear Ms. Salo:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

First and foremost, TIC appreciates the Board's outreach efforts through roundtables and the post-implementation review process to identify and address issues that have arisen with the application of Topic 842. TIC believes that the changes to the discount rate proposed in this exposure draft are an unequivocal positive development for non-public business entities as they provide more flexibility than the all or nothing approach to applying the risk-free rate practical expedient that is in the current standard. While TIC believes the overall exposure draft is positive, there are some aspects which we believe could be modified to further improve the usefulness of the practical expedient.

The following are TIC's detailed responses to each of the questions posed in the ED.

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

TIC believes that the practical expedient as drafted is operable.

Question 2: : Would the proposed amendments reduce costs of implementing the guidance or applying it on an ongoing basis? Why or why not?

TIC believes this change will encourage more entities to apply the risk-free rate expedient, which would reduce the costs of applying the standard on an ongoing basis. While we do believe that there may be some initial costs incurred associated with adopting the standard related to the transition method, these costs would be offset by the lower costs of ongoing application.

Question 3: *Should an entity that is not a public business entity be allowed to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level? Why or why not?*

TIC supports the ability of an entity to make the election at the asset class level rather than at the entity-wide level as we believe that it provides more flexibility for entities in applying the lease guidance. TIC also believes that this flexibility would be further enhanced by allowing entities to make this election on a lease-by-lease basis and suggests that the practical expedient be modified to allow for this level of election. The ability to choose on a lease-by-lease basis may also create a smaller recognition and measurement difference between public and private companies, while providing entities additional flexibility. For example, this potentially would be most relevant in situations where an entity has many leases in one asset class with only one of those leases being material. Allowing the application of the election on a lease-by-lease basis would allow the entity to use the risk-free rate on the smaller/ not material leases and choose to determine the incremental borrowing rate for the material lease included in that asset class.

Question 4: *Should an entity making the risk-free rate election be required to disclose that fact and to which asset classes it has elected to apply a risk-free rate?*

The disclosure of material accounting policy elections always should be provided to better inform users of financial statements; however, TIC does not believe that identification of the specific asset classes for which the risk-free rate has been used should be a required disclosure unless users of non-public business entity financial statements provide convincing feedback indicating that it would be relevant. We believe this would be consistent with the red-flag approach in the Private Company Decision Making Framework, and users who were interested in that level of information would have the option to contact management directly for additional details.

Accordingly, if the Board elects to modify the practical expedient to allow the application of the risk-free rate on a lease-by-lease basis as we have suggested in our response to Question 3 above, TIC suggests not requiring disclosure of the specific leases for which the practical expedient was applied.

Question 5: *Should an entity be required to disclose the weighted-average discount rate separately for leases for which a risk-free rate is used and all other leases (those that are measured using an incremental borrowing rate or the rate implicit in the lease)? For investors and other financial statement users, would a weighted-average discount rate that combines risk-free rates, incremental borrowing rates, and rates implicit in the lease into one measure provide decision- 4 useful information? If separate disclosures were made, how would those weighted-average rates be used and for what purpose (be specific, including what calculations would be done and when that information would influence decisions)? Please explain your reasoning.*

While TIC is not a user, we believe requiring disaggregated disclosures under Topic 842 is inconsistent with the Private Company Decision-Making Framework. While TIC acknowledges that many users of non-public entity financial statements will consider disclosures related to Topic 842 to be important, the Board has provided significant disclosure relief to non-public entities related to Topic 606, which TIC believes is a more broad decision relevant standard than Topic 842 for many users of non-public entity financial statements. As a result, we would not support requiring such a disclosure as we do not believe that it would influence or otherwise significantly benefit users of financial statements.

Question 5(a): *For preparers of financial statements, would requiring disclosure of the disaggregated weighted-average discount rates as described in Question 5 add cost relative to the current requirement to disclose one weighted-average discount rate? Please be specific and explain the nature and significance of that added cost.*

Any requirement for a weighted-average disclosure adds significant preparation and audit costs. For example, the weighted-average disclosures for Topic 718 (weighted average fair value, remaining contractual life, strike price, etc.) can be one of the more difficult disclosure areas to prepare and audit, which results in additional costs incurred by entities as well as practitioners. TIC also does not believe that such a disclosure would provide value to users given the additional costs.

TIC also suggests that the Board reach out to lease software providers to inquire if existing lease software has the ability to make disclosures as described in question 5. If existing lease software is not capable of making those calculations, TIC is concerned that entities would be required to use Excel based spreadsheets to make these calculations, which introduces an additional cost in preparing the spreadsheet as well as a greater potential for calculation errors than would be present in a software package which has been tested.

Question 6: *Considering the discussion in paragraph BC18 of this proposed Update, would replacing a risk-free rate in the election with another specified rate, such as a corporate bond rate, be operable? What effect would that replacement have on the cost of applying the amendments, if any?*

TIC agrees with the reasoning provided by the Board in BC18.

Question 7: *Should the rate implicit in the lease be required when it is readily determinable (for example, in certain related-party leases) for lessees applying the risk-free rate election? Why or why not?*

TIC believes the rate implicit in the lease should not be required even when it is readily determinable. As noted above, TIC advocates for entities being able to use the risk-free rate for all leases as a free choice. Our support for that position is based on several factors including:

- **Cost to apply is significant** - Based on the TIC’s experience, the determination of the rate implicit in the lease (effective yield considering lease payments and in certain instances, initial direct cost) is not well understood by private company preparers. As a result, preparers would need to either engage a third-party to provide this calculation or spend considerable time in determining the amount internally.
- **Related-party transactions are not always at arms-length** – Based on the client base that TIC members serve, related-party leases (including leases under common control) are not always structured at arms-length. Furthermore, related-party leases are much more common in the private company space. TIC questions the decision-useful information provided in a theoretical rate that is probably more appropriate when a transaction is negotiated at arms-length. While TIC acknowledges that appropriate disclosure surrounding related party transactions should be included in the financial statements, we believe the current disclosure requirements under Topic 850 are sufficient.
- **Appearance of inconsistency** – Including a requirement as contemplated in this question appears to be inconsistent with how the Board has recently dealt with related-party transactions. For example, the Board required using legally enforceable rights and obligations rather than the “substance” of the arrangement for purposes of recognition and measurement under Topic 842 and provided a scope exception for transactions under common control (including leasing arrangements) in Topic 810 (Consolidations)

Question 8: *Should an entity that has not yet adopted Topic 842 be required to adopt the proposed amendments at the same time it adopts Topic 842, using the existing transition provisions in paragraph 842-10-65-1? Why or why not?*

Question 9: *For an entity that has adopted Topic 842 before the issuance of a final Update, should the proposed amendments be effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with earlier application permitted? Why or why not?*

Question 10: *Should an entity that has adopted Topic 842 before the issuance of a final Update apply the proposed amendments on a modified retrospective basis through an adjustment to the lease liability and corresponding right-of-use asset for affected leases existing at the beginning of the year of adoption of a final Update? Why or why not?*

Our responses to questions 8-10 are interrelated and presented below.

TIC notes that beginning with ASU 2016-03 and continuing with other ASUs which include private company alternatives through ASU 2021-03 issued earlier this year, the Board has not included a

required effective date and also has included an unconditional one-time option for entities to adopt the alternative prospectively after its effective date without assessing preferability under Topic 250, Accounting Changes and Error Corrections. TIC strongly believes that the transition guidance for this exposure draft should include similar provisions in order to be consistent with previously issued private company alternatives as well as make the election more useful to entities.

For entities who have already adopted Topic 842, TIC suggests that they be allowed to continue recording leases as they had initially and if they choose to adopt this practical expedient to do so on a prospective basis. As currently written, entities would be required to recast previously issued financial statements, if they chose this alternative, which would result in additional costs with questionable benefit to users of financial statements. However, TIC does recognize that there may be some entities which would prefer retrospective adoption. As such, our suggestion is that entities be given the option to retrospectively apply the practical expedient instead of requiring them to do so.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Bryan Bodnar

Chair, On Behalf of the PCPS Technical Issues Committee