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15 July 2021

Proposed Accounting Standards Update, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities* (File Reference No. 2021-003)

Dear Ms. Salo:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities,* issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's efforts to address feedback about Accounting Standards Codification (ASC) 842, *Leases,* in its post-implementation review process. In this case, we believe the proposal to allow a lessee that is not a public business entity (PBE) to elect to use a risk-free rate as the discount rate for its leases by class of underlying asset, rather than for all leases, would reduce the cost of applying the standard for such a lessee. We also support the FASB's proposed clarification that lessees that are not PBEs should be required to use the rate implicit in the lease when it is readily determinable, even if they make the risk-free rate election.

However, we believe that questions about the decision usefulness of the information that would be required and the cost of applying the proposed amendments are best addressed by financial statement users and preparers, respectively. We encourage the Board to consider their feedback before finalizing or making changes to the proposed amendments.

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Our responses to the questions in the proposal are included in the Appendix.

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst + Young LLP

Appendix — Responses to questions raised in the proposal

> **Question 1:** Are the amendments in this proposed Update operable? Why or why not?
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> **Question 2:** Would the proposed amendments reduce costs of implementing the guidance or applying it on an ongoing basis? Why or why not?
>
> **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?

We believe the proposed amendments are operable and would reduce the cost of implementing and applying ASC 842 for lessees that are not PBEs. Therefore, we agree with the Board's decision to allow these lessees to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level.

We note that, under the proposed amendments, a non-PBE lessee would have the flexibility to use its incremental borrowing rate for big-ticket leases that it enters into infrequently (e.g., real estate) and the risk-free rate for leases of lower-priced assets or leases that it enters into more frequently (e.g., office equipment) so it does not have to incur the cost of calculating its incremental borrowing rate for them.

However, we encourage the Board to also consider feedback from financial statement preparers on whether the amendments are operable and would reduce the costs of implementing the guidance and applying it on an ongoing basis.

> **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?

We believe a lessee that makes the risk-free rate election should be required to disclose the class or classes of underlying assets for which it used the risk-free rate.

> **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-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.

We believe disclosure of the weighted-average discount rate for leases for which a risk-free rate is used separately from the weighted-average discount rate for all other leases would provide financial statement users with decision-useful information. That is, disclosure of an aggregate weighted-average discount rate for all leases may provide information that is less meaningful to a financial statement user who focuses on a lessee's cost of borrowing. However, we defer to financial statement users on which approach would provide better information.

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.

We defer to financial statement preparers on whether requiring disclosure of the disaggregated weighted-average discount rates as described in Question 5 would add cost relative to the current requirement to disclose one weighted-average discount rate. We understand that some systems may not currently track whether the rate is a risk-free rate, so this requirement may result in added costs to configure new or existing systems.

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?

We agree with the Board's decision to retain the use of a risk-free rate in the election. We believe replacing a risk-free rate with another specified rate, such as a corporate bond rate, would add cost and complexity to the election, especially for smaller entities. For example, these costs could include the cost of subscribing to a service that publishes average corporate bond rates of varying maturities, making adjustments to the selected rate(s) and having the adjusted rate(s) audited. We note that many entities don't currently need to subscribe to these services, and adjusting published average corporate bond rates for characteristics of the underlying bonds (e.g., prepayment/call features) to determine an appropriate corporate bond rate to use as the discount rate could add complexity.

However, we encourage the Board to consider feedback from preparers on the costs and benefits of replacing a risk-free rate in the election.

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?

We agree with the Board's proposed clarification that lessees applying the risk-free rate election should be required to use the rate implicit in the lease when it is readily determinable because we believe the rate implicit in the lease best reflects the economics of the transaction. We believe the rate implicit in the lease is not readily determinable for most lease contracts entered into with an unrelated lessor, so the proposed clarification would not affect the accounting for most leases. We believe the cost of determining the rate implicit in the lease when it is determinable (e.g., for certain related-party leases) would not be significant because the lessee would typically be able to obtain the auditable information directly from the lessor or another source.

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?

We agree that an entity that has not adopted ASC 842 by the issuance date of a final Update should adopt the proposed amendments at the same time it adopts ASC 842, using the transition provisions in paragraph 842-10-65-1. This would result in a single adoption of changes to lease accounting for these entities rather than one change for the existing guidance in ASC 842 and another for the amendments that would be included in a final Update. However, we encourage the Board to finalize the proposal as soon as possible to give entities sufficient time to include the proposed amendments in their implementation process.

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?

We agree that an entity that has adopted ASC 842 before the issuance date of a final Update should adopt the proposed amendments in fiscal years beginning after 15 December 2021 and interim periods within fiscal years beginning after 15 December 2022, with earlier application permitted. We believe this effective date would provide these entities with sufficient time to implement the proposed amendments and provide comparability with entities that have not adopted ASC 842 by the issuance date of a final Update.

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?

We agree that an entity that has adopted ASC 842 before the issuance date of a final Update should apply the proposed amendments on a modified retrospective basis for affected leases that existed at the beginning of the year of adoption of a final Update. We believe this would provide comparability between reporting periods and result in consistency among the leases within an asset class.

We also agree that the adjustment to the lease liability (using the discount rate and remaining lease term at the beginning of the fiscal year of adoption) should first offset the corresponding right-of-use asset, with any remaining amount of the adjustment recognized in opening retained earnings. We believe this approach is operable and would be similar to the accounting for lease reassessments and certain modifications under ASC 842.