



Ernst & Young LLP
One Manhattan West
New York, NY 10001-860

Tel: +1 212 773 3000
ey.com

Ms. Hillary H. Salo
Technical Director
File Reference No. 2022-ED500
Financial Accounting Standards Board
801 Main Avenue
P.O. Box 5116
Norwalk, CT 06856-5116

16 January 2023

Re: Proposed Accounting Standards Update, *Leases (Topic 842): Common Control Arrangements* (File Reference No. 2022-ED500)

Dear Ms. Salo:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), *Leases (Topic 842): Common Control Arrangements*, issued by the Financial Accounting Standards Board (FASB or Board). We also support the FASB's efforts to address feedback about Accounting Standards Codification (ASC) 842, *Leases*, in its post-implementation review process.

We believe the proposal to provide private companies and certain not-for-profit entities with a practical expedient to use the written terms of a common control arrangement, rather than the legally enforceable terms, to determine whether a lease exists and to classify and account for the lease would reduce the cost of implementing and applying ASC 842. However, we suggest clarifications to improve operability for preparers and recommend an entity that elects to use the practical expedient be required to make new disclosures to help users of the financial statements understand the arrangements.

While we commend the FASB for asking for feedback on the accounting for leasehold improvements in common control arrangements, we recommend certain clarifications that may enhance the operability of this portion of any final ASU.

* * * * *

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

Very truly yours,

Appendix – Responses to questions raised in the proposal

Issue 1: Terms and conditions to be considered

Question 1: Are the amendments in this proposed Update operable for private companies and not-for-profit entities that are not conduit bond obligors? If not, which proposed amendments pose operability or auditability concerns and why?

We believe the proposed amendments are generally operable for private companies and not-for-profit entities that are not conduit bond obligors. However, to improve the operability of the guidance, we recommend that the Board consider clarifying proposed paragraphs ASC 842-10-15-3A, 842-10-15-3C and 842-10-15-3C(a).

ASC 842-10-15-3A

In this paragraph, we recommend that the Board clarify whether lessees and lessors that elect to apply the practical expedient would also use the written terms and conditions to allocate consideration to lease and non-lease components rather than using the relative standalone price for lessees or relative standalone selling price for lessors, as currently required by ASC 842. This isn't clear because the proposal says the written terms would be used to "account" for a lease.

ASC 842-10-15-3C

In this paragraph, we recommend that the Board acknowledge that, if an ongoing arrangement that was previously determined to be a lease no longer meets the definition of a lease, any "profit or loss" upon derecognition of a lease-related asset and/or liability would generally be included as additional consideration in the accounting for the ongoing arrangement that is or will be accounted for under other US GAAP (e.g., ASC 606) rather than immediately recognized as profit or loss in the income statement.

ASC 842-10-15-3C(a)

We recommend that the Board clarify the last two sentences of this paragraph to better describe when the modification guidance in ASC 842 would and would not be applied by an entity that previously applied the practical expedient but is no longer under common control and can no longer apply the practical expedient.

We agree the modification guidance would not be applied when (1) the existing written terms and conditions of the lease are not modified and (2) those terms and conditions are legally enforceable. In this case, the only change would be that the parties are no longer under common control, which wouldn't require lease modification accounting.

However, we recommend that the paragraph could be clarified to say the modification guidance would be applied if a party to such an arrangement determines that the legally enforceable terms and conditions of the ongoing lease differ from the written terms used to account for the lease under the practical expedient, even when no changes to the lease are otherwise made.

In addition, we recommend that the Board consider removing the phrase “or modifying the lease” from proposed ASC 842-10-15-3C(a) because we believe that in all cases when a contract, containing a lease, is modified, entities would apply ASC 842’s existing lease modification guidance as of the date of the lease modification.

Question 2: Would the proposed amendments reduce costs without reducing the decision-useful information for investors and other allocators of capital? Please explain why or why not.

We believe the proposed amendments could reduce the cost of implementing and applying ASC 842 but could also reduce the decision-usefulness of information for investors and other allocators of capital. As such, we believe the Board should carefully consider financial statement users’ feedback. Below we provide our observations about the need for additional disclosure and a possible scope exception that financial statement users and the Board may want to consider.

Financial statement users may be concerned the proposed practical expedient would allow entities to use the written, rather than the legally enforceable, terms to achieve a desired financial reporting outcome. We also observe that the proposed practical expedient could limit and potentially distort information provided to investors about the economic impacts of an entity’s leasing activities. For example, a lessee that applies the practical expedient could document a lease term of one year for the lease of its primary manufacturing facility from its parent, which could distort the overall calculation of the weighted-average remaining lease term and the discount rate disclosed under ASC 842-20-50-4 for all leases.

We acknowledge that common control leasing arrangements are subject to the overall disclosure guidance in ASC 842-20-50 and 842-30-50 and the requirements in ASC 850, *Related Party Disclosures*. However, without additional guidance, there could be diversity in practice, which may result in useful information not being conveyed to financial statement users. One approach for the Board to consider is explicitly stating that the disclosure requirements in ASC 850-10-50-1 and 50-3 apply to material common control leases where the practical expedient is applied. Alternatively, any final guidance could require qualitative and quantitative information describing the nature of all material arrangements for which the practical expedient is applied, including the relevance of the leased assets to the entity’s ongoing operations and future cash flows.

We also recommend that the FASB consider scoping guidance for private companies in common control arrangements with public companies. We observe that, in this type of arrangement, the public company would be required to determine the legally enforceable terms and conditions of the arrangement, but the private company could elect the practical expedient to use the written terms, even though it would likely have access to the public company’s information. We encourage the Board to consider feedback from financial statement users to determine if, in this circumstance, the potential cost benefits justify the potential decrease in decision-useful information.

Question 3: Are the proposed transition methods appropriate? Please explain why or why not.

We agree that an entity that has not adopted ASC 842 by the issuance date of a final ASU should adopt the proposed amendments at the same time it adopts ASC 842, using the same transition method used for the initial adoption of ASC 842 (i.e., retrospective or modified retrospective). Using the same adoption methodology would likely be easier for entities and would result in financial statements that are easier to understand.

However, we recommend that the Board clarify how the proposed practical expedient would be applied when an entity elects the transition expedients in ASC 842-10-65-1(f) (i.e., the package of practical expedients) and 65-1(g) (i.e., the hindsight practical expedient). For example, the package of practical expedients allows entities to not reassess whether a contract is or contains a lease and not reassess lease classification. ASC 842-10-65 requires that these transition expedients, if elected, be applied to **all** leases. One solution would be for the FASB to amend 842-10-65-1(f) and 65-1(g) to exclude common control leases for which the proposed practical expedient is elected from the requirement to apply the transition practical expedients to **all** leases. This would reduce complexity in transition by clearly allowing an entity to elect the proposed practical expedient and the transition practical expedients.

We agree with providing entities that adopted ASC 842 before the issuance date of a final ASU with the option to apply the proposed amendments either prospectively or retrospectively as described in ASC 842-10-65-7(c). However, we observe that the proposed retrospective transition guidance in ASC 842-10-65-7(c)(2) does not address an arrangement that was previously a lease but is no longer a lease after applying the practical expedient.

Question 4: Should an entity be permitted to document any existing unwritten terms and conditions of an arrangement between entities under common control before the date on which the entity's first interim (if applicable) or annual financial statements are available to be issued in accordance with the proposed amendments? Please explain why or why not.

We view the Board's proposal to allow entities to document any existing unwritten terms and conditions of an arrangement between entities under common control before the date on which an entity's first interim or annual financial statements are available to be issued as a practical approach to reduce the cost and complexity of implementing ASC 842 (refer to paragraph 842-10-65-7(d)). However, we recommend that the Board clarify what it means by "existing unwritten terms and conditions" since the Board indicates in the Background Information, Basis for Conclusions, and Alternative Views section of the proposal (BC11) that private company stakeholders say the terms and conditions of these arrangements are often unwritten and lack sufficient detail. We believe it would be helpful for the Board to clarify how entities would determine the existing unwritten terms. For example, the Board could clarify whether it intends for entities to document terms and conditions that are consistent with known past or intended practice.

Issue 2: Accounting for leasehold improvements

Question 5: Are the proposed amendments operable for all entities? If not, which proposed amendments pose operability or auditability concerns and why?

We believe the proposed amendments are operable. However, we recommend clarifying ASC 842-20-35-12A(a) to include "the practical right to control" so that it is clear that the amortization requirements in ASC 842-20-35-12A also apply to arrangements where the lessee is applying the practical expedient to use the written terms and conditions of the arrangement (Issue 1).

We also recommend that the proposed additions to paragraph 842-20-35-12 be revised to refer to paragraph 842-20-35-12A instead of 842-10-35-12A.

Question 6: Would the proposed amendments provide clarity, reduce diversity, or both in the accounting for leasehold improvements associated with common control leases? Please explain why or why not.

In practice, lessees and lessors apply reasonable judgement to determine which entity controls and, therefore, recognizes an improvement to the leased asset. Based on a combination of relevant factors, in some circumstances lessors may recognize a leasehold improvement as an asset (e.g., when it makes substantive payments for the asset, the economic life of the improvement is substantially longer than the lease term, the improvement is useable by one or more parties other than the lessee). We believe the proposal in and of itself would not change existing factors used to determine which entity controls the improvement. However, an impact on lease term could affect some entities' judgments regarding who should recognize an improvement. For example, an entity may conclude improvements with an economic life significantly longer than a one-month lease term are lessor assets.

While the proposal provides guidance for improvements that are owned by the lessee and transferred to the lessor at the end of the lease, it could be improved by clarifying the accounting for improvements owned and recognized by the lessor but paid for by the lessee. In this circumstance, the proposed ASU is unclear as to how the lessee and lessor would account for such costs. For example, the final guidance could be clarified to articulate whether the lessee and lessor would recognize such costs as a dividend paid/received or as additional lease related cost/income.

Question 7: Would the proposed amendments result in information that is more decision useful for investors and other allocators of capital? Please explain why or why not.

We acknowledge that amortizing lessee-owned leasehold improvements associated with common control leases over the lease term (as currently required by ASC 842) may not reflect the economic substance of certain common control transactions. However, we defer to financial statement users to comment on whether the proposed amendments would provide them with decision-useful information.

Question 8: Do you agree with the proposed disclosure requirements? Please explain why or why not and whether any additional disclosures that should be required.

We support providing users with information about when the economic life of leasehold improvements associated with common control arrangements exceeds the related lease term. However, we recommend the Board clarify that the disclosure of remaining economic life and remaining lease term could be provided on a weighted-average basis (as applicable) by class of underlying asset.

Question 9: Are the proposed transition methods appropriate? Please explain why or why not.

We agree that an entity that has not adopted ASC 842 by the issuance date of a final ASU should adopt the proposed amendments at the same time it adopts ASC 842, using the same transition method used for the initial adoption of ASC 842 (i.e., retrospective or modified retrospective). We also agree with providing entities that adopted ASC 842 before the issuance date of a final ASU with the option to apply the proposed amendments either prospectively or retrospectively as described in ASC 842-10-65-8(c).

Effective date

Question 10: How much time do private companies and not-for-profit entities that are not conduit bond obligors anticipate needing to adopt the proposed amendments for Issue 2?

We believe preparers are in the better position to respond to this question.

Question 11: Should the effective date of the proposed amendments for Issue 2 be the same for all entities? Please explain why or why not.

We believe that the effective date for the proposed amendments for Issue 2 should be the same for all entities because they should have the information available to determine the appropriate amortization period. In addition, requiring the same effective date for all entities will provide financial statement users with comparable information.

Question 12: Should the proposed amendments for both Issue 1 and Issue 2 be effective for all entities during interim periods within the fiscal year of adoption of a final Update unless those entities have not yet applied Topic 842 in interim periods? Please explain why or why not.

We agree that the proposed amendments for both Issue 1 and Issue 2 should be effective for interim periods within the fiscal year of adoption of any final guidance for all entities that have adopted ASC since this will result in the most easily comparable financial statements.

Question 13: Should early application of the proposed amendments for both Issue 1 and Issue 2 be permitted? Please explain why or why not.

We believe that early adoption of the proposed amendments should be permitted. This would give entities the flexibility to adopt the guidance on a timeline that best allows them to achieve their financial reporting objectives and provides information that is most meaningful to financial statement users.