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Sir David Tweedie, Chair International Accounting Standards Board 30 Cannon Street London EC4M 6XH, United Kingdom Ms. Leslie F. Seidman, Acting Chair Financial Accounting Standards Board 401 Merrit 7 Norwalk, CT 06856-5116

Re: File Reference No. 1850-100 - Proposed Accounting Standards Update—Leases (Topic 840)

Dear Sir David and Chairman Seidman:

We appreciate the opportunity to comment on the Financial Accounting Standards Board's (FASB) and International Accounting Standards Board (IASB) Joint Exposure Draft document entitled *Leases*. The American Council of Life Insurers (ACLI) represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90 percent of the assets and premiums of the U.S. life insurance and annuity industry.

We acknowledge the desirability to simplify lease accounting, and support the FASB's and IASB's goal to improve the transparency, credibility and usefulness of leasing information, such that users of financial information can gain an understanding of an entity's leasing activities. We also appreciate that the Boards have listened to many of the concerns raised by constituents in the previous Preliminary Views document, however, we still have significant issues with the guidance as it is currently written. We have outlined our concerns in our answers to specific questions below.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)

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Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

We agree with the FASB's/IASB's conclusion that the estimates and calculations proposed for other leases is not necessary for short term leases, since they may result in an insignificant impact to the financial statements. We, however, do not believe that the scope of leases included in the population of short term leases, as defined in the ED, relieves the preparer from applying complex accounting to immaterial leases nor will it produce useful financial statement information for users, because the definition is too limiting.

We understand that some of the biggest criticism of the existing lease accounting model relates to longer term leases involving core operating assets. Many companies have a large number of small ticket, short duration, leases of assets such as copiers, fax machines, computers, etc, which would require substantial effort and cost in applying the recognition and measurement approach outlined in the exposure draft. Although the leases for these small ticket assets may exceed 1 year, we believe the costs of making the determinations, estimations and measurements of numerous immaterial leases in this proposed model may result in an insignificant impact to the financial statements while the cost and burden would most likely outweigh the benefits.

We request the FASB/IASB consider a modification to the definition of a short-term lease that would simplify the complex and burdensome requirements of the proposed lease accounting for these items. We would propose changing the duration criteria of a short-term lease from 1 year to 3 years; allowing existing operating lease accounting for short term leases similar to the proposed lessor accounting in the ED. The result would be a consistent lease accounting model for all non-core leased assets without applying overly complex measurement requirements that may have an insignificant impact on an entity's financial statements.

Ouestion 5: Scope exclusions

This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?

The sublease guidance results in a different measurement basis for lessees and lessors. The lessor measures a lease asset only on the basis of lease payments that can be measured reliably, while a lessee does not consider measurement reliability when it determines the liability to make lease payment. The Boards have acknowledged that the accounting for lessees and lessors could result in different measurements of assets and liabilities arising under a head lease and a sublease because of the different measurement basis and discount rate used by the lessor and lessee. This type of accounting does not reflect economic reality. In addition, it is unclear from the exposure draft how this differential in values should be reflected in the financial statements. We request the FASB/IASB to provide additional guidance on this topic.

Question 6: Contracts that contain service components and lease components

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We believe that more guidance is required on how and where the boundary of a lease should be drawn. Specifically, between service arrangements, outsourcing arrangements, licensing agreements and lease arrangements which may or may not identify a 'specific tangible asset' to be used.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We do not agree that the "the longest possible lease term more likely than not to occur" should be used for establishing assets and the corresponding obligation. We believe the balance sheet should represent the unconditional obligation to pay. The exposure draft methodology to calculate the lease term by trying to predict renewals 15 to 20 years in the future may not result in an accurate representation of the unconditional obligation, and could potentially overstate assets and liabilities, and thus misrepresent the true financial picture of the company to users of the financial statement. In addition, for entities that have large lease portfolios, it will be a monumental task to analyze on a lease by lease basis, the most likely lease term in addition to analyzing variable considerations (i.e. contingent rents, residual value guarantees, and term option penalties). It will also be time consuming and contentious to reach agreement with auditors on the decisions made by the preparer.

In FASB Concept Statement No. 6, assets and liabilities are defined as probable future benefits or sacrifices, and we are concerned the methodology proposed in the exposure draft may result in the recognition of assets and liabilities inconsistent with this concept. We believe a more prudent approach and a more accurate representation of the unconditional obligation would be to record the right of use asset and corresponding obligation based on the minimum lease term, unless the renewal option rents are at such bargain levels that the option is certain to be renewed.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

We do not believe contingent rentals meet the definition of an unconditional obligation, since those rentals are dependent on a future event that may or may not occur. Such predictions may be more or less reliable, depending on the nature of the asset being leased and the entity's business environment. Therefore the specific facts and circumstances surrounding the lease contract must be considered to ascertain the existence of a lessee's financial liability or a lessor's financial asset related to contingent

1850-100 Comment Letter No. 476

rental agreements. We therefore propose that contingent rent be expensed as incurred by the lessee, and recognized in income at the time it is realizable. If the FASB/IASB, however, decides to require the lessee and lessor to consider contingent rental at the inception of the lease, we propose that the company is given the option of considering the facts and circumstances at inception of the lease for the of contingent rental and any term option penalty at lease inception and include these aspects of the lease only when it is probable that a liability and asset exist at the inception of the lease.

Question 16: Transition

- (a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

The guidance requires lessees and lessor to recognize and measure all leases as of the date of transition on a retrospective approach. This would require companies to evaluate leases (including many non-core leases that are short term in nature) which expired before the adoption date but existed in earlier periods to be presented in the company's comparative financial statement. We believe this may require a significant amount of resources to compile information for leases which are no longer in force, many of which are immaterial in nature.

Industry practice is that certain non-core leases such as copiers, fax machines, computers etc., are generally over a 3-year period. A prospective application for short-term leases entered into after a certain date would move all leases to the new model while not placing a burden on entities to compile and evaluate a great deal of information on leases that may be expiring within a few years or have expired during the transition period.

Question 18: Other Comments

Do you have any other comments on the proposals?

We believe the Boards should provide guidance on lease incentives and leverage lease transactions in the final draft. We also have concerns with the cost of implementing this guidance. We have outlined our concerns below.

Lease Incentives

This topic is not addressed within the exposure draft. We encourage the FASB/IASB to include explicit guidance in the final draft on how lease incentives should be treated. From the lessee's standpoint, we believe it should be treated the same as initial direct cost – reducing the right-of-use asset, however other interpretations may exist. For example, it may be viewed as a reimbursement from the lessor. Without explicit guidance, this could result in diversity in application.

Cost to implement

The implementation of certain aspects of the proposed model will require significant cost and effort, particularly system changes and procedures that will need to be put in place, and to monitor the likelihood of renewals and contingent rent at the lease inception and during subsequent periods. We cite some of the following issues with the requirement.

- We do not believe the amount of work required to review leases for significant changes at each reporting date will result in major adjustments to the financial statements. Therefore, we do not believe this should be required unless a significant change is probable. The significant cost and effort to reassess contingent rentals and options at each reporting date will be unduly burdensome, as will as bringing short-term leases and non-core assets on the books. Therefore, we do not believe this should be required unless the occurrence of the event is probable.
- There will be significant costs and efforts involved with implementing systems and processes to
 assess the likelihood of renewals and contingent rent at, and subsequent to, lease inception, and
 the cost to include short term and non-core assets on the books. As a result, we believe the cost of
 implementing new accounting systems as well as ongoing compliance costs required to comply with
 the proposed lease accounting model for non-core assets outweighs the benefits.

In conclusion, we believe that this lease methodology could substantially increase the volatility of the balance sheet and income statement. Moreover the front-ended expense does not equal the actual expense paid, which could contribute to a continual destabilizing of capital markets. We believe this will result in material increases in the cost of capital, reduction in its availability, or both.

ACLI appreciates the opportunity to comment to the Boards on this matter, and welcomes your feedback and questions.

Sincerely,

Mike Monahan

Director, Accounting Policy