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Technical Director
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Dear Board Members and Staff:

I appreciate your invitation to comment and sincerely thank you for giving me this opportunity to comment on the exposure draft concerning leases. It is clear that much time has been spent on this proposed standard.

By way of background, I am a Chartered Accounting licensed in Canada (Province of Quebec) as well as a Certified Public Accountant (licensed in Illinois). This dual licensing gives me a unique perspective on the more rules based US GAAP approach as compared to the principle based approach under IFRS. I am currently the assistant controller in charge of reporting at Aeroterm, a property management company with over 8.5 million square feet of property at more than 30 airports in Canada and the United States. In addition, I lecture in the Graduate Diploma in Public Accountancy at McGill University in Montreal, Canada. All the opinions discussed are my own, and not that of my employer (Aeroterm) or McGill University.

While I appreciate the logic behind the proposed standard of eliminating off-balance sheet financing created by structured leases, I feel that the cost associated with the added complexity of the model, and the time involved to manage it, far out way the perceived benefits. Furthermore, I feel the use of a single model (as it applies to Lessees) eliminates the need for any professional judgment surrounding the facts at hand. This may well suit users and preparers of US GAAP who are more comfortable with a rule based system, but I feel it fails to achieve the main goal of all financial statements; to deliver relevant and reliable information to the users. As I mention frequently to my students, accounting is not a science with a "right" and a "wrong" answer. The true response to all accounting related decisions is "it depends...." By eliminating professional judgment from the decision making process, the proposed standard, not only degrades our profession, but degrades information available to the user.

I have addressed only the questions where I feel I can provide a relevant opinon.

Question 1: Lessees

(a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

The proposal to recognise a right-of use asset and liability to make lease payments makes sense; a contractual liability to make lease payments does exist, and conversely a contractual right to receive something exists. I.E. the use of a piece of equipment or a space in a building.

(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

The right of use assets should be amortized in a systematic approach, similar to other long lived assets with definite lives, and thus, yes I do agree with this treatment.

I do, however, disagree with the use of an effective interest rate method to remove the liability from the balance sheet. This assumption treats the liability as a financing loan. While certain leases that are entered into are, in substance, financing arrangements (IE long term leases of single tenant facilities, for instance), I feel that most leases that are small in amount and timing, are not in substance a financing loan. It would not be possible for a small tenant to "buy" and "finance" 1000 sq ft. for 3 years in an office building, for instance. Furthermore, this causes a mis-match of the expense streams of these nearly created assets and liability, as the right of use asset will likely be amortized by most companies on a straight line basis, where the recognition of interest expense will be higher in earlier years and lower in later years.

Based on the above, since it is the boards intentions to bring the assets and associated liabilities onto the balance sheet, I respectfully recommend that that both the right of use asset and the associated liability, be expensed in the income statement in the same fashion, thus ensuring that the assets and the corresponding liability on the balance will net to zero, and thus not inflate of deflate the balance sheet. Lastly, I believe the associated expense in reducing the liability should be amortization expense and not interest. Based on my experience, users do not like "fictious" interest caused by accounting entries as it skews the ability to calculate the company's weighted average cost of capital.

Question 2: Lessors

(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

Conceptually I agree with the duality approach of having the performance obligation approach and the derecognition approach and it distinguishes leases based on their perceived substance, as certain leases are nothing more than sales of a property with a financing component, and thus, at least conceptually the derecognition approach makes sense when the Lessor does not retain significant risks or benefits of the associated lease. However, practically, the derecognition approach removes from the balance sheet an assets that legally belongs to the lessor. IE, with the use of the derecognition approach, a lessor who owns 1 warehouse, and leases it out under a triple net scenario for the majority of it useful life would not show "Building" on its balance sheet. I feel that this would be misleading to users, especially users who may have a lien on such an asset (IE a bank). Therefore, for that reason, I believe all leases by the lessor should be treated using the performance obligation approach.

(b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

I do agree with the recognition of assets and liabilities under the performance obligation approach. However, I disagree with the income and expense treatment as proposed. Under the proposed method,

a lessor using the performance obligation approach will have amortization from its existing long lived asset (IE machinery, building etc.), interest revenue and lease income. The duality of the income stream suggests two lines of business. While it is possible, in certain situations, that a lessor is in substance a financing entity that should be recognizing interest income, the fact remains that most lessors are not in substance financing entities. Using the proposed model, more revenue will be recognized at the beginning of the lease as compared to the end of the lease. While this model may in fact better represent the usage pattern of the assets, this is a determination that should be left to professional judgment given the fact pattern at hand. Therefore, I respectfully suggest, the board leave room for professional interpretation (with accompanying note disclosure), that would allow an entity to recognize revenue over time in a manner that best reflects the fact pattern of their particular case/industry.

I believe the revenue and expense patter under the derecognition approach makes sense, as the lessor is essentially acting as a financing entity. However, as mentioned above, I disagree with the approach from a balance sheet perspective.

Question 3: Short-term leases

The 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 twelve 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 recognise lease payments in profit or loss over the lease term.
- (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 recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term

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?

I do agree with the proposed treatment for short-term leases. However, I don't think that this option should be available on a lease-by-lease basis. This "cherry-picking" method, could lead to potential earnings manipulation, especially in entities with high value short-term leases. Therefore, the availability of utilizing this section should be an accounting policy choice that applies to the entire reporting entity.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised. Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

I agree with the above, with one exception: A bargain purchase option. If the lease contains a purchase option, whereby the estimated purchase price is so far below the estimated FMV that it all but guarantees that the lease will purchase the asset at the end of the lease, then the lease contract should be treated as sale. I propose that the determination of a bargain purchase option be left open to professional judgment, with some guidelines.

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?

I respectfully disagree that the lease should be determined as the longest possible term that is more likely than not to occur. From an operational standpoint, it is often very difficult to determine if a leasee will renew 5 or 10 years in the future. Their business model may change (IE need more space / less space or equipment etc). The need to re-evaluate these assumptions each reporting period will add work not only for leasees and lessors, but also from an audit standpoint. Also, I don't see how this will provide additional useful information to the user. I would suggest that only the minimum lease term be utilized at initial measurement (with appropriate disclosure for lease renewals/terminations for material leases) unless the lease is structured in such a way that the renewal options are so favorable that it is unlikely that the leasee would not renew.

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 measured reliably? Why or why not?

I respectfully disagree that expected contingent rents and expected payments under term option etc. should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique. Contingent rentals are often very hard to predict, especially as many contingent rental contracts are for many years. The necessity to estimate these amounts and revalue them on an ongoing basis will increase substantially the amount of work involved in lease accounting, without, in my opinion give additional relevant information to the users. As such, I believe all contingent amounts should be recorded when earned. In order to give a relevant picture to users, the boards may want to consider additional disclosure surrounding contingent amounts; however, requiring on-going estimation of these will result in considerable costs, with minimal benefit.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

As mentioned above, I don't believe that contingent amount and unknown lease periods be included in the final version of the lease standard. That being said, I do agree that the assets and liabilities recognized on the balance sheet need to be reassessed on an on-going basis for any new information that has arisen that would materially alter the amounts being reported.

Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

Whilst I understand from an academic standpoint what the boards are trying to achieve, I believe that the costs of implementing the exposure draft in its current form outweigh the perceived benefit. Therefore, I recommend the boards re-consider some of the more time consuming sections of this exposure draft before the final standard is released.

Overall conclusion:

The spirit and goals of the exposure draft are well warranted. However, the boards need to weight the benefits users will receive from these new standards versus the cost of calculating, maintaining and reporting the applicable amounts. The current standard as it exists does not serve users; this is a fact to which I agree. However, the proposed standard levels too much work on financial statement preparers. A happy medium must be obtained.

Regards,

David Nayer, CA, CPA Montreal, Quebec, Canada November 24, 2010 As mentioned above, I don't believe that contingent amount and unknown lease periods be included in the final version of the lease standard. That being said, I do agree that the assets and liabilities recognized on the balance sheet need to be reassessed on an on-going basis for any new information that has arisen that would materially alter the amounts being reported.

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