

New Jersey Society of Certified Public Accountants

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September 13, 2013

Via email to <u>director@fasb.org</u>

Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856-5116

RE: Leases (Topic 842) a revision of the 2010 proposed FASB Accounting Standards Update – Leases (Topic 850)
File Reference No. 2013-270

Dear Ms. Cosper:

The Accounting and Auditing Standards Interest Group of the New Jersey Society of Certified Public Accountants (NJSCPA) is pleased to offer its comments on the above referenced proposed standard. The NJSCPA represents over 15,000 certified public accountants and prospective CPAs. The comments herein represent those of some of the individuals of our Accounting and Auditing Standards Interest Group (Group) only and do not necessarily reflect the views of all members of the NJSCPA.

General Comments

We appreciate the Board's commitment to reducing diversity in the classification and accounting for leases, thereby promoting enhanced transparency. However, certain members of our Group expressed concerns over the complexity of this proposal, indicating that its implementation and continued compliance will increase, rather than reduce diversity in practice. If this proposal is adopted as is, we recommend that the Board define specific terminology used throughout the proposed standard, such as, but not limited to the list we have provided on the last page of this letter. We also request that the Board provide extensive implementation and illustrational examples throughout the proposal. Lastly, some Group members believe that the benefit of complying with the requirements outlined in this proposal do not justify the increased costs, and that enhanced disclosures would better serve to achieve the Board's goals for improving lease accounting. Accordingly, those Group members respectfully request that the Board reconsider that option.

Our responses to the following specific questions are derived from individuals representing both auditors and accountants in industry.

Question 1: Do you agree with the definition of a lease and the proposed requirements in paragraph 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease, is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Generally we agree with the Board's proposed definition of a lease, and that it is appropriate to evaluate whether an agreement contains an identified asset along with the right to control the use of that asset for a particular period of time in exchange for consideration. However we believe that the application of this definition in practice will be significantly difficult to apply consistently, and request that you consider the impact that the extensive use of judgment needed will have on both preparers of the financial statements and their auditors. The use of undefined terms and phrases (e.g. "substantially all") may only widen the degree of diversity in application. Therefore we request that the Board not only define certain terms and phrases, but provide additional illustrational examples of their application.

Some Group members believe that the proposed accounting for a lease may not truly reflect the economics of the transaction in circumstances, such as multiple-element service contracts containing embedded leases. Additionally, differing sized entities, operating in different industries and markets may have substantially different access or ability to observe prices for each component of a contract which could lead to diversity in accounting for the lease component in what could be similar contracts.

Question 2: Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why Not? If not, what alternative approach would you propose and why.

We agree with the Board's recommendation that a lessee's recognition, measurement and presentation of expenses and cash flows should follow different approaches (Type A or B) based upon the extent to which the lessee expects to consume the underlying benefits imbedded in the underlying asset during the lease term.

However, despite our support for the Type A and Type B classifications, the consumption-based principle is based upon a very ambiguous benchmark. The Board has indicated that the basic classification delineation is based on whether or not the lessee is expected to consume more than an "insignificant portion" of the economic benefits embedded in the underlying asset during the lease term. Without further explanation, illustration, and definition, we believe that this benchmark will be interpreted differently amongst preparers. For this reason, we request that the Board provide more explicit guidance for purposes of making more objective determinations relative to the consumption principle.

A few members of the Group believe that while a Type A lease may reflect the economic nature and consumption of the asset, the same may not be true for a Type B lease leading to no real

perceived value in determining the true assets of an organization. Additionally, these few Group members believe that a Type A lease creates a severe inefficiency in determining an organization's expenses, compared to its true cash obligations, and that regardless of the lease type, each method complicates, confuses and degrades its usefulness to the user of the financial statements in determining the lease assets and obligations of an entity.

Lastly, a few Group members disagree with the combination of the unwinding of the discount on the lease liability with the amortization of the right of use asset into a single expense.

Question 3: Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We agree with the Board's recommendation that a lessor's recognition, measurement and presentation of income and cash flows should follow different approaches based upon the extent to which the lessee expects to consume the underlying benefits embedded in the underlying asset during the lease term.

However, as described in our response to question 2, we are concerned with the very ambiguously defined benchmark used as the basic classification delineation for purposes of determining whether or not the lessee is expected to consume more than an "insignificant portion" of the economic benefits embedded in the underlying asset during the lease term. As previously stated, without further explanation, illustration, and definition, we believe that this benchmark will be interpreted differently amongst preparers. For this reason, we request that the Board provide more explicit guidance for purposes of making more objective determinations relative to the consumption principle.

Lastly, a few Group members do not believe that the initial recognition of the present value of lease payments and unwinding of the interest on the residual asset is reflective of true economic conditions.

Question 4: Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not what alternative approach would you propose and why?

We agree conceptually with the Board's recommendation that the consumption principle be applied differently depending on whether or not the underlying asset is considered "property" for purposes of classification. However, we believe that the Board has failed to provide objective guidance with regards to their established thresholds. Contrary to the percentage thresholds currently established under present Topic 840 with respect to capital lease treatment, the guidelines under this proposal are largely left to interpretation. If the Board's objective is to provide more transparency and consistency in the application of lease accounting, the lack of

objective guidance appears to undermine that effort. Differing judgments will undoubtedly produce different results amongst preparers when confronted with virtually identical fact patterns. As such, we request that the Board clarify the initial classification process by providing objective thresholds in order to eliminate ambiguity and promote uniformity in application.

A few Group members believe that the classification criteria of a lease, will inadvertently create diversity in practice, and in certain situations, not fully reflect the nature or intent of the arrangement. For example, a few Group members believe that in a Type A lease the exception for the lease term is compared to the total economic life of the asset whereas in a Type B lease the exception for the lease term is compared to the remaining economic life. This slight change in terminology may create vast differences between the two if a Type A lease becomes a Type B lease, and vice-a-versa.

A few other Group members do not agree with the criteria mentioned in paragraphs 842-10-25-06 through 25-8. As stated in the proposal, Type A leases generally relate to equipment and vehicles whereas Type B leases mostly represent land and building. These Group members believe the classification should end here and that no further classification should be made in relation to paragraph 842-10-25-6 and 7. It is also believed, that for presentation purposes, equipment, land, and buildings should not be commingled.

Question 5: Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We agree with the proposals on the lease term, with the exception of the criteria used in determining the reassessment of a lease term in instances where there are changes in relevant factors. While economic incentives may be a relevant factor in determining a lease extension, it is not the only criteria used when considering options for additional periods based upon the likelihood that such options would be exercised or foregone. Although the Board has apparently attempted to set a fairly high threshold for inclusion of cancelable optional periods, the proposed benchmark of "Significant Economic Incentive" is somewhat nebulous. The mere existence of some economic incentive may not be such a difficult hurdle; judging whether or not that incentive is considered "significant" is quite another matter. We agree that it is conceptually reasonable that optional periods that are "more-likely-than-not" to occur should be given due consideration. However, applying this principle in practice is not quite so simple a matter. Differing judgments relative to the probability of future events will undoubtedly produce different results amongst entities when confronted with virtually identical fact patterns. Further, conditions and circumstances that might exist as of the commencement date may not even faintly resemble conditions and circumstances in existence a short time into the lease term, let alone at the time options become exercisable. For these reasons, we request that the Board reconsider its recommendations with an eye towards simplicity rather than ambiguity.

Question 6: Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease

payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We partially agree with the Board's overall recommendations regarding variable lease payments. We agree with the Board's approach with respect to the manner in which lessors and lessees should re-measure lease receivables and lease liabilities, respectively, as revised indices or rates become known. This is consistent with present guidance and relatively simple to implement. We do not fully agree with the Board's recommendations relative to lease payments that are contingent on future events (e.g. sales volume). We note improvement in the form of the Board's recommended approach for both lessors and lessees regarding "in-substance fixed minimum" lease payments in instances where the minimum portion of variable payments can be reasonably predicted as of the commencement date. Further, we have no objection to the approach relative to lessees concerning the excess of such variable payments over a minimum portion, whereby the expense is recognized in the period during which the remaining portion of such variables become known. However, the Board's approach with respect to contingent payments relating to lessors could be construed as ambiguous.

We are concerned that the process of estimating future contingent receivables will be difficult to implement in practice and prone to widely diverging results. Designating this item as a component of the residual asset does not seem consistent with the customary perception of a residual asset value. We recognize that the Board's approach observes the concept of conservatism by virtue of the fact that any profit relating to the estimated contingent receivable is deferred until received. Nevertheless, we question whether the cost and effort associated with making the initial estimates and the calculations required in each succeeding period would outweigh any potential benefits associated with presenting and disclosing the resulting amounts. Therefore, we question whether such provisions would enhance the overall quality of financial reporting. We request that the Board reconsider the provisions relative to estimated contingent payments in order to stay within the spirit of simplicity and transparency that presumably underpins the ultimate goal of the proposal.

Question 7: Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

We support the Board's recommendations regarding how lessees and lessors would measure leases at the beginning of the earliest period presented, with the option of using either a modified retrospective approach or a full retrospective approach. The Board's proposed transition rules appear reasonable, especially considering the optional relief of employing a modified retrospective approach. Although the full retrospective approach may not be difficult to apply in situations where the number of leases involved is limited, the modified retrospective approach is a viable means of arriving at reasonable estimates in instances where a high volume of leases are involved, thereby mitigating the effort normally associated with extensive and cumbersome calculations.

Regardless of the approach taken, entities will still encounter significant difficulties and unnecessary burdens in transition, such as, for example, having to evaluate the same contract twice: once under this proposal and then again upon the adoption of the revenue recognition standard. This will likely create more diversity in practice and thereby reduce comparability.

Question 8: Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Some Group members generally agree with the Board's disclosure requirements for lessors and lessees. However, we have some concerns relating to the level to which issues of judgments and assumptions pervade the overall theme of Topic 842; these are addressed in the responses to Questions 1 through 7 dealing with matters of scope, the accounting model, and measurement. Otherwise, the disclosure requirements appear reasonable and understandable as a whole.

As far as lessees are concerned, the Board's recommendation relative to the presentation of right-of-use assets and lease liabilities, separate and apart from all other assets and liabilities, on the statement of financial position is an appropriate step towards enhancing transparency. The additional requirement for breakdowns of both right-of-use assets and lease liabilities between Type A and Type B is consistent with the Board's focus on transparency. Further, disclosure of lease payment maturities and reconciliation thereof for lease liabilities as shown on the statement of financial position is reasonable and consistent with present guidance. The Board's recommendation to expand the scope of disclosures beyond the present guidance to now include a reconciliation of the beginning and ending balance of lease liabilities is once again a positive step towards enhanced transparency. Notwithstanding the fact that the Board is allowing this reconciliation to be optional for non-public entities, the effect of this relief is a bit tempered by virtue of the fact that it does not relieve the lessee from going through the effort associated with the research, judgments, calculations and accounting entries required to satisfy the recognition and measurement requirements otherwise stipulated under proposed Topic 842.

With regards to lessors, the basic requirements of the Board are fundamentally analogous to the present guidance, with slight variations. Presentation and disclosure of assets held for leases under Type B arrangements is relatively unchanged, the primary exception being that the lease payment maturity analysis called for under present guidance will no longer be required. It is doubtful that this will raise any objections amongst preparers. Furthermore, presentation and disclosure of lease receivables and residual assets under Type A arrangements is fairly similar to that for sales-type and direct finance leases under present guidance. One substantive exception is the fact that the lease payment maturity analysis called for under present guidance will no longer be required. Again, it is doubtful that this will raise any objections amongst preparers. A second significant exception is the Board's recommendation to expand the scope beyond the present guidance to now include additional disclosures regarding profit or loss recognized as of the

commencement date, the unwinding of interest on the lease receivable, and the accretion of interest on the gross residual asset. In parallel with the Board's recommendations regarding a lessee's reconciliation of lease liability activity for a period, this is once again a positive step towards enhanced transparency.

Notwithstanding the above, the major shift in the nature and extent of disclosures relative to both lessees and lessors concerns the new emphasis on the need for a narrative discussion of significant assumptions or judgments affecting lease vs. non-lease determinations, the allocation of consideration between lease and non-lease contract considerations, and lease classification as of the commencement date. Although these requirements appear reasonable in the spirit of enlightening readers and users of financial statements, proposed Topic 842 as presently constituted could be construed as a bit too open-ended in this regard. Therefore, it would be helpful if the Board would provide some useful examples relative to the nature and depth of the content deemed appropriate in this context.

We would like to mention that a few Group members believe that entities will find some of the disclosure requirements too complex and that they will add substantial costs in preparing financial statements.

Question 9 (FASB Only): Will the specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for uses of their financial statements? If not, what changes do you propose and why?

We do not believe that the relief provided within the proposal is substantial enough to mitigate the exponential costs of implementation for nonpublic entities. While we believe the use of the risk free rate is a step in the right direction, we recommend additional relief from some of the disclosures. We respectfully request that once the FASB has finished their deliberations of this proposal, we recommend that the FASB seek the assistance of the Private Company Council in determining what further nonpublic entity relief should be provided.

Question 10 (FASB Only): Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

We agree that it is not necessary to provide different recognition and measurement requirements for related party leases, and that if a leasing relationship between related parties exists, that relationship would first be evaluated under Topic 810, Variable Interest Entities. Furthermore, we agree, that in the absence of legally enforceable terms, only disclosure would need to be provided.

Question 11 (FASB Only): Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for relate party leases? If not, what additional disclosure requirements would you propose and why?

Please refer to our response in question 10.

Question 12 (IASB Only): Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

To the extent that the IASB issues the final standard based on the right-of-use model in the revised proposal, some Group members agree that a right-of-use asset should be within the scope of IAS 40, if the definition of investment property has been met. The removal of the option will result in greater consistency in the accounting for investment properties.

Lastly, while we recognize and appreciate the Board's focus on principles rather than bright lines, we believe that unless the Board defines the following terms and phrases used pervasively throughout the proposed standard, diversity in practice shall increase when this proposal becomes effective. Please consider defining and providing illustrational examples in the application of the following:

- More than significant
- Significant economic incentive
- Substantially all
- Throughout the term of the contract

Thank you for the opportunity to comment. We are available to discuss our comments at your convenience.

Respectfully submitted,
Rence Rampulla/ms

Renee Rampulla, CPA, CGMA, Leader

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