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September 13, 2013

Technical Director
File Reference No. 2013-270
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Comments on Proposed Accounting Standards Update (Revised) Leases (Topic 842) a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)

Dear Members of the Board:

The Retail Industry Leaders Association ("RILA") and its Financial Leaders Council ("FLC") are pleased to respond to the *Proposed Accounting Standards Update (Revised) Leases (Topic 842) a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)*, issued on May 16, 2013 (the "Exposure Draft"). RILA is the trade association of the world's largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales and millions of American jobs.

With more than 100,000 stores, manufacturing facilities, and distribution facilities domestically and abroad, RILA and its FLC have been and continue to be keenly interested in this topic. RILA and its FLC provided comments on both the Discussion Paper entitled "Leases: Preliminary Views" (File Reference No. 1680-100) and the Proposed Accounting Standards Update: Leases (Topic 840) (File Reference No. 1850-100), and we appreciate the opportunity to again offer our views.

Because this topic is of paramount importance to the retail industry, we believe it is important to commend the Board and the IASB on the process that has been employed in attempting to develop a new leasing standard. While it has taken time, the thoughtful and thorough approach undertaken to date is appropriate. We also believe that the Boards' consideration of the costs and resulting benefits of any new standard is proper and should be the driving factor behind any final decision as to whether or to what extent the current lease accounting rules are changed. In this regard, we note that while some of the more burdensome aspects of the prior leasing proposals have been eliminated or reduced in the Exposure Draft, as a whole, the proposed standard continues to be overly complicated, costly, and burdensome with little or no offsetting benefit. For example, one of the Exposure Draft's proposed models would result in leases being accounted for inconsistently on the balance sheet and income statement. To address this inconsistency, the Exposure Draft proposes a new accounting concept for "Type B" leases which we have termed the reverse declining balance amortization approach. Because this amortization

concept does not currently exist in accounting, we anticipate that there could be significant implementation challenges and that additional guidance will be necessary. In addition, substantial costs are likely to be incurred as new systems would have to be designed to implement such an approach. This new concept also will not be easily understood by the user community. While we appreciate the Boards' objective of recognizing all leases on the balance sheet, we do not believe that the significant complexity of, and judgments required by, the Exposure Draft's proposed standard will make financial statements more comparable nor do we believe it will provide the user community with better or more relevant information.

The comment by a member of FASB's Investor Advisory Committee ("IAC") that "[w]e don't believe the proposal is an improvement to current [lease] accounting" bears out RILA's view. Rather than offer comments to specific provisions, the IAC has rejected the proposed standard entirely and, instead, recommended additional disclosures. While RILA believes some of the suggested additional disclosures would constitute forward-looking information which is not auditable and, we believe, beyond FASB's authority to require, the wholesale rejection of the proposal by the investor community should be determinative. Like the IAC, we continue to believe that the most appropriate way to provide any additional information would be through increased disclosure. As the IAC position makes clear, there is a thorough understanding of the current rules in the user community, neither the user community nor preparers support the proposed standard, and there appears to be consensus that additional disclosures are the best way to balance the benefits and burdens of providing additional information on leases.

To the extent increased disclosure alone is ultimately not viewed as sufficient, we believe a much more simplified model should be developed that would eliminate both the undue complexity and cost of the currently proposed model. For example, to the extent recognition on the balance sheet of all leases is determined to be essential, then perhaps a way to accomplish this result would be to capitalize as an asset and corresponding liability the total minimum rental payments which are already disclosed. The asset could be reduced on a straight-line basis as expense is recognized and the lease liability could be reduced as lease payments are made. Although the asset and liability balances would be overstated on the balance sheet, because they would be undiscounted, the discounted value of those lease commitments could be disclosed in the notes. Such a model would still result in leases being reflected on the balance sheet, provide additional information to the user community, and have dramatically lower implementation and ongoing costs.

While we continue to believe that wholesale change to current leasing rules is unnecessary, especially in light of the IAC rejection of the proposal and the substantial initial and ongoing costs that would be incurred, we offer below our comments on the Exposure Draft's proposed standard. Should the Boards move forward with that approach, our most overarching concern is that an appropriate effective date be provided. The effective date should take into account the significant effort and cost that would be involved in implementing the standard and the fact that systems and software to apply the new accounting guidance do not currently exist. Additionally,

[&]quot;FASB Investor Advisory Panel Adds to Criticism of Revised Leases Proposal," Bloomberg BNA Daily Tax Report, 169 DTR G-6 (August 30, 2013).

² Id

This is consistent with the fact that our members receive very few questions regarding our current lease disclosures from securities analysts and investors.

given the materiality of these related accounts, preparers will need to devote considerable time and resources developing, implementing, and maintaining internal controls compliant with Sarbanes-Oxley.

We thank you for the opportunity to comment on the Exposure Draft and offer our specific comments below.

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." An entity would determine whether a contract contains a lease by assessing whether:

- 1. Fulfillment of the contract depends on the use of an identified asset.
- 2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 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.

RILA generally agrees with the proposed lease definition, however, we believe that there could be situations where questions unnecessarily arise over whether an asset is an excluded intangible asset. To eliminate this concern, we believe it would be more appropriate to affirmatively limit the lease definition rather than define covered assets through exceptions. We believe limiting the definition to "tangible assets" or to "land and depreciable tangible assets" is preferable.

A significant majority of our members' leases contain both lease and service components for items such as common area maintenance, insurance, property taxes and other costs. Current GAAP requires separate accounting for these non-lease components as period costs, which we believe has a sound theoretical basis and has operated well. The proposed standard imposes a significant burden on lessees to obtain standalone prices for non-lease components that are not specified in the lease itself. We believe the effort required to obtain standalone prices for these non-lease components will be very arduous, time consuming, and expensive and, accordingly, believe that such costs should continue to be accounted for separately as period costs.

We appreciate the Exposure Draft's proposal that a company may, as an accounting policy, elect to not apply the lease accounting rules to short term leases. However, we believe that the Exposure Draft's definition of short term is too limited and will, in practice, provide little, if any, relief. Few leases are less than 12 months in length. We believe a more appropriate exclusion

would be for leases with a term of either 24 months, or 36 months, or less. Disclosure of these commitments would provide any necessary information and, in our view, would be sufficient.

Question 2: Lessee Accounting

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?

If the Exposure Draft model were required, our members would be in general agreement with this proposal, although we believe that it should be clarified. Paragraph 842-10-25-6 provides that the lease term is based on the "total economic life" of the underlying asset while Paragraph 842-10-25-7 references the "remaining economic life." The reference to "remaining economic life" in 842-10-25-7 could result in leases for similar property being accounted for differently depending upon when in the property's economic life the lease is entered. We do not believe that this result was intended and, accordingly, we recommend that a final standard instead provide a rebuttable presumption whereby all leases for land and/or buildings would default to what is now a Type B lease, unless there existed an independent and clear, objective reason why such classification was inappropriate. Alternatively, Paragraph 842-10-25-7a should reference the "total economic life" of the underlying asset or, in the further alternative, the exception in Paragraph 842-10-25-7a should be eliminated entirely and all leases of property should be considered a Type B lease unless the present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date.

Question 3: Lessor Accounting

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?

As our members are primarily lessees, we provide no comments on the lessor proposals.

Question 4: Classification of Leases

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?

If the dual model approach set forth in the Exposure Draft were ultimately adopted, we believe that accounting for Type B leases inconsistently on the balance sheet and income statement would be problematic. Under the current proposal, the liability on the balance sheet would be

discounted, while the expense on the income statement would be recognized on a straight-line basis. We recognize that this was an accommodation made to provide consistency of expense recognition for Type B leases at different points in their term, however, the reverse declining balance approach proposed for the balance sheet will create significant burdens for preparers and may lead to increased impairment charges for these types of leases. New systems would have to be developed to implement such an approach and, again, we see no corresponding benefit to this proposal.

Although we believe it is an unintended consequence, one extremely burdensome aspect of the Exposure Draft as currently drafted is the need for all leases of land and buildings to be reviewed to determine whether they are, in fact, Type B leases. Many of our members have thousands, some as many as 10,000, individual leases that would potentially qualify as Type B leases and would have to be reviewed to implement the current proposal. In addition, as discussed in our response to Question 2, we believe that under the current proposal store leases perceived as indistinguishable by financial statement users could be classified differently with some falling into the Type A model and most in the Type B model depending on when in the property's economic life the lease is entered. The added burden, together with the increased complexity, potential for confusion, and decreased comparability would be eliminated if our proposal set forth in response to Question 2 were adopted.

One clarifying suggestion we have relates to the naming conventions. Rather than classify leases as "Type A" or "Type B," terms that are new and meaningless outside of this context, we believe it would be preferable to define clearly the lease types in a final standard by distinguishing between "Other Tangible Assets" on the one hand and "Land and Buildings" on the other.

Question 5: Lease Term

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 are pleased that the Boards have proposed a lease-term definition more appropriate than the "longest possible term" proposal in the prior exposure draft, which RILA and the FLC viewed as inappropriate and one of the more challenging implementation aspects of the prior exposure draft. We believe, for the most part, the determination of the lease term will be consistent with the true contractual commitment. However, the reassessment requirements are overly burdensome and problematic for companies that renegotiate many leases each year or make significant leasehold improvements each year. The assessment of "significant economic factors" that could result in a reassessment requires significant judgments and estimates, which contributes to the burden and complexity of the proposed standard. For example, some of our members make significant leasehold improvements to hundreds of stores each year and some renegotiate as many as 2,000 store leases each year. Reassessment of each such lease will increase the cost to these companies substantially, with no offsetting benefit. In our view, the reassessment requirement should be simplified and recommend that reassessment occur only when there is an actual change to the lease, such as the exercise of an option period.

Question 6: Variable Lease Payments

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 agree with the modification in the Exposure Draft to treat contingent rentals as a period expense. Such amounts do not represent a present obligation and, therefore, do not meet the definition of a liability.

For a similar reason, we do not believe it is appropriate to consider an index, such as the CPI, in measuring variable lease payments. Such indices are wholly outside of the control of the preparer and future changes in the indices are unknown and unknowable. Furthermore, the CPI index is intended to be a proxy for normal inflation and the financial statements do not generally incorporate expected inflation into asset or liability balances. Thus, we do not believe such an index factor meets the definition of a liability. Instead, we propose that only objective, knowable future increases be included in the measurement and that any changes to the lease payments due solely to an index factor be accounted for as a period cost when, and if, they occur, similar to true variable rents.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a 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?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

Perhaps the most important part of transition, but for which the Boards have not specifically sought comment, is the effective date of any final proposal. Any transition period and effective date will have to be sufficiently long given the fundamental changes proposed. A period of four to five years after a final pronouncement is released is warranted. We believe this is the case for four primary reasons:

1. Many public companies have tens, if not hundreds, of thousands of leases that would be affected by a new standard. And although most leases have already been gathered and analyzed for current reporting purposes, those leases would have to be reviewed again based on the new standard. In addition, all significant contracts not currently subject to the lease accounting rules would have to be located, gathered, and reviewed in order to

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The notable exception being post-retirement benefit obligations where medical cost inflation is included because it has grown at an "abnormally" high rate.

determine whether they contain a lease component. For companies with international operations, these contracts may also require translation.

- 2. Software to implement reporting for a leasing standard that contains entirely new concepts does not yet exist, and we understand that the third-party software developers are unlikely to invest resources until a final standard is released
- 3. Funds to implement a new standard also will have to be allocated through what are generally arduous budgetary processes for most large corporations. This budgetary process cannot even begin until a final standard is issued, third-party software is developed and its cost known. In addition, the budgetary process would also include any additional internally developed software that may be necessary and any additional accounting personnel that may be needed.
- 4. Internal control procedures would have to be developed, tested, and implemented. In addition, the impact of a new standard on income tax accounting would have to be identified and processes developed to provide necessary data to the tax department on a recurring basis.

In our view, an effective date of at least four to five years after a final pronouncement is released is essential.

We also believe that transition guidance that addresses the treatment of assets and liabilities recorded as a result of EITF-97-10 is necessary. Our members have recognized assets and liabilities as part of construction projects related to leased locations that they may not have a legal right to, or obligation for. Clarification of how these assets and liabilities should be treated in the transition is needed to ensure consistent treatment across companies.

We agree with the Exposure Draft's approach that permits, but does not require, a full retrospective approach.

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 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?

In our view, any additional information sought by the user community could be more appropriately provided through increased disclosure rather than wholesale change to the existing leasing model. However, if the Exposure Draft were adopted in its current form, it is counterintuitive that significant additional disclosures would also be required. The Exposure Draft's goal of reflecting all material leases on the balance sheet would be achieved so one would have expected the Exposure Draft to *decrease* required disclosures and not *increase* them. We believe that the increased disclosure contained in the Exposure Draft is a direct result of the

complexity of the proposed accounting model as it necessitates "reconciliations of amounts recognized on the statement of financial position" to demonstrate to the financial statement user how they were determined.

Furthermore, lease payments required to be made over the next five years and beyond are already disclosed in footnote disclosures as well as in the Contractual Obligations table required by the SEC for public companies. As an organization, RILA is concerned when disclosures continue to expand and do not provide relevant information or simply present redundant information. Thus, we question the benefit of the detailed reconciliations and narrative disclosures proposed if all material leases are reflected on the balance sheet, unless the current reporting model for leases were retained.

Question 9: Nonpublic Entities

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

- 1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
- 2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

Although several of our members are nonpublic companies, they generally follow the public company rules and do not believe that relief provisions are necessary. Moreover, private companies and public companies can be direct competitors and it does not seem appropriate that they would face entirely different burdens in order to comply with financial accounting rules and have non-comparable financial statements solely as a result of the decision to be publicly or privately held. To the extent there are any concessions made for non-public companies, we believe they should be applicable only to small companies.

Question 10 and 11: Related Party Leases

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?

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

We are in general agreement with these requirements.

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In conclusion, we believe that the Exposure Draft, as a whole, continues to be overly complicated, costly, and burdensome with little or no offsetting benefit. As the IAC position makes clear, there is a thorough understanding of the current rules in the user community, neither the user community nor preparers support the proposed standard, and there appears to be consensus that additional disclosures are the best way to balance the benefits and burdens of providing additional information on leases. We thank you for the opportunity to comment on this proposal.

Sincerely,

Sandra L. Kennedy

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President