PICPA
Pennsylvania Institute of Certified Public Accountants

September 13, 2013

Technical Director
Financial Accounting Standards Board
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Re: File Reference No. 2013-270: Proposed Accounting Standards Update, Leases (Topic 842): a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)

The Accounting and Auditing Procedures Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to comment on the proposed Accounting Standards Update (ASU) on Leases (Topic 842). The PICPA is a professional association of more than 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms, members serving in financial reporting positions, and accounting educators. Our comments follow.

1. Materiality considerations – The committee understands that the underlying intent of the proposed standard is to address abuses of the current accounting standards where transactions are structured to keep material liabilities off the balance sheet. The committee agrees that this is an important objective, however, it does not agree that many of the standard business leases (e.g., copy machines, etc.,) included within the proposed changes are causing these abuses. Meanwhile, the compliance costs associated with these high-volume, low-dollar leases could be significant. The committee requests that the Board remove these standard business leases from the scope of the proposed changes and focusing the proposed changes on potentially abusive circumstances. Additionally, as the cost is disproportionately higher for smaller organizations, we request an exemption for nonpublic entities for leases below a certain threshold. If no change in scope is permitted, we request that relief for nonpublic entities be provided through the use of a simpler model (i.e. without continual reassessments at each balance sheet date) and permitting prospective implementation of the standard. Further, the committee notes that the members of the FASB Investor Advisory Committee during its webcast on Aug. 27, 2013, questioned the decision usefulness of the amount of the liability that would be capitalized under the proposal. Instead, they placed value on enhancing disclosures rather than capitalizing the asset using the lessee's incremental borrowing rate. The committee does not believe that companies should be required to implement a costly standard that does not provide value to financial statement users.

2. Type A versus Type B leases

    a. The use of made up-terms seems contrived and adds unnecessary complexity to the proposed standard. The committee supports the use of more descriptive terms (e.g., financing lease, or capital lease).

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b. The use of two models (one for Type A and another for Type B) adds significant complexity to the guidance. An entity with multiple types of leases could have a significant compliance burden that would require new systems to track the different types of leases. Additionally, the disclosure requirements could be cumbersome for entities with both types of leases. The committee does not believe that the additional information provided would be worth the potential cost, especially given the lack of consensus as to what is needed (see the comment letter from Financial Executives International (FEI) dated May 22, 2013). If the financial statement users cannot agree on what should be presented in the financial statements, it is unclear why companies should be required to carry such potentially enormous compliance costs to provide the additional information. We recommend that a single model be developed to reduce complexity. If the final standard does not specify a single model, the committee requests an exemption for nonpublic entities from one of the models.

3. Reassessment of the lessee liability and lessor receivable – The committee believes that the requirements to reassess the lease liability and receivable at each balance date could add considerable time and effort to financial reporting. The committee requests that a less-cumbersome, less-costly model be developed and included in the final standard.

4. Fair value considerations – Paragraph 842-10-25-6 provides two criteria that if met would result in the lease of property to be classified as a Type A lease. The second requirement specifies that "the present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date." Fair value information is needed to make this assessment. This could add a significant burden to leasing entities that have to determine fair value of their properties each time a lease is executed. The committee requests a simplified approach that doesn't rely on fair value information. Additionally, given that real property is not typically depreciating in value, the committee requests that real property is automatically considered a Type A lease.

5. Related-party transactions – The committee was surprised that the FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on the legally enforceable terms and conditions of the lease, acknowledging that some related-party transactions are not documented and/or the terms and conditions are not at arm's length.

   Question 10 for respondents: The committee does not 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). The committee does not believe that the accounting treatment should vary bases on the existence of a legally enforceable agreement. The committee believes that the terms of the agreement should be accounted for based on their substance and that sufficient disclosures be required so financial statement users are aware of the nature of the transaction.

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6. Lease payments and terms – The committee notes that the definition of lease payments and lease term includes whether or not the lessee "has a significant economic incentive to exercise an option to purchase the asset, extend the lease, or terminate the lease." It is not clear how this definition is operational for the lessor. It is unclear, for example, how the lessor would be in a position to know whether the lessee has significant economic incentive to exercise options included within the lease. The committee requests guidance for the lessor that is not dependent on the lessee's perspective.

7. Expected residual value guarantees – Paragraph 842-20-30-3 d. of the exposure document requires the lessee to include the amounts expected to be paid under residual value guarantees in the amount of the lease payments. The determination of this amount may require the entity to assess the fair value of the asset. For situations in which the lessee agrees to make up any deficiency below a stated amount in the lessor's realization of the residual amount, the committee requests that a practical expedient be permitted, such as using the stated amount rather than an estimated amount of the deficiency.

8. Lessor accounting – The committee notes that the revenue recognition principles outlined in the proposed standard on leases are not consistent with those included in the new revenue recognition standard. As the new revenue recognition model is principles-based and can easily be applied to many industries, the committee does not support a separate revenue recognition model for lessors.

9. Private company considerations – Question 9 for respondents - The committee agrees that permitting a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability, and exempting a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability, will provide relief to nonpublic entities.

10. Formatting and due process – The committee appreciates the amount of effort that went into presenting the proposed changes in the FASB Accounting Standard Codification format, but believes that due process is hindered by the overwhelming format of the exposure document. Furthermore, the summary is too abbreviated to highlight the specific changes that need to be considered. The committee requests that future exposure documents include a section that restates the guidance without the cumbersome codification formatting.

We appreciate your consideration of our comments, and we are available to discuss any of these comments with you at your convenience.

Sincerely,

Richard E. Wortmann, CPA
Chairman, PICPA Accounting and Auditing Procedures Committee