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September 13, 2013

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

File Reference No. 2013-270

Dear Ms. Cosper:

McGladrey LLP is pleased to comment on the Proposed Accounting Standards Update, *Leases—Topic* 842 (the "proposed ASU").

We continue to support the joint efforts of the Financial Accounting Standards Board (FASB) and International Accounting Standards (IASB) (together, the Boards) to provide a single source of comprehensive guidance on leasing. We commend the Boards for what we consider to be substantial improvements from the August 2010 Exposure Draft on this project.

With respect to the proposed accounting for lessees, we are generally in agreement with the position that lease agreements give rise to rights and obligations that meet the definitions of assets and liabilities, respectively, in the FASB Concepts Statements. However, we believe that additional guidance is needed to avoid inconsistent application of the proposed approach. Our concerns are discussed in our responses to the specific questions raised in the proposed ASU.

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.

We agree with the proposed definition of a lease, as well as the proposed requirements for how an entity would determine whether an arrangement contains a lease.

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?

We agree that there are different types of leases, and that it is appropriate for the recognition, measurement, and presentation of expenses and cash flows for those leases to differ. We believe, however, that if the accounting is to differ based on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, guidance will be needed to define "insignificant." We believe that without such guidance, it is unlikely that consistent application of the proposed accounting will be achieved.

If the Boards elect not to define "insignificant," we recommend that more examples be provided that would allow preparers to draw inferences as to what the Boards' intended meaning is. We believe that preparers would benefit from examples that reflect instances in which the consumption of the economic benefits is both considered to be and not to be "more than insignificant". For example, we believe that a presentation of one example in which a conclusion is reached that the lease term is more than insignificant in comparison to the economic life of the asset because the lease term is 12% of the economic life, followed by an example in which a conclusion is reached that the lease term is not more than insignificant because it is 8% of the economic life of the underlying asset would be beneficial (if those percentages are consistent with the Boards' intent).

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?

Similar to our response to Question 2 above, we agree that, like lessees, lessors should apply different accounting approaches to different lease types. As noted above, however, we do not believe that consistent application of the proposed standard will be achieved without additional guidance or examples, and recommend inclusion of such guidance and/or examples.

We do support the removal of the leverage lease concept.

As discussed in our response to Question 7 below, we have additional comments related to transition for lessor accounting.

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?

As indicated in our responses to Questions 2 and 3, we are troubled by the vague wording of the requirements in paragraphs 842-10-25-5 through 25-8. In particular, in addition to the use of "insignificant" as it appears in paragraph 842-10-25-6, we question whether the vague wording of "major part" and "substantially all" in paragraph 842-10-25-7a and 7b, respectively, will be applied consistently by preparers and auditors.

Similarly, we question whether the use of the term "significant economic incentive" in paragraph 842-10-25-8 (relating to an option to purchase the underlying asset) will be applied consistently.

Furthermore, the practical expedient based on type of assets may be difficult to apply in certain situations such as long-term leases of land. If, for example, parties enter into a lease for 40 years, it is possible that

the present value of the lease payments would represent "substantially all" of the fair value of the land, thereby resulting in Type A classification. However, Type A classification in such an example would seem contradictory to the general principle of classifying leases based on the extent to which a lessee would consume the economic benefits of the underlying asset.

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 do agree with the lease term proposals and believe that they represent a significant improvement in this area over the 2010 Exposure Draft. However, as noted in our response to Question 4 above, we question whether the use of the term "significant economic incentive" (relating to an option to extend or terminate the lease) will be applied consistently.

As it relates to short-term leases, we believe that it would be helpful if the Board would expand guidance on how to evaluate month to month leases from both the lessor and lessee's perspectives.

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 generally agree with the proposals on the measurement of variable lease payments, however we believe that the costs associated with the re-assessment and subsequent adjustment for changes to the rate or index would outweigh the benefits and therefore consideration should be given to treating these changes in a manner similar to other variable lease payments and recognize them as expense in the period in which the change in the index to rate occurs.

We believe that preparers would benefit from additional guidance or examples related to "in-substance" fixed lease payments.

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?

We generally agree with the proposed transition requirements; however we believe that they could be further enhanced by allowing a simplified approach similar to what is being allowed for revenue recognition.

While we support the general concepts for lessor accounting that are included in the revised Exposure Draft, we believe that the transition provisions related to lessor accounting are particularly onerous and believe that the costs related to applying those provisions would exceed the benefit. For that reason, we recommend that the Boards consider allowing lessors, except in the case of leveraged leases, to continue to use existing lessor accounting for leases in existence at the time of adoption (essentially, permitting "grandfathering" existing leases from the lessor perspective).

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 general, we believe that the disclosures will provide more decision useful information for users of financial statements, and for that reason we generally support the proposed requirements. We note, however, that the proposed level of disclosures will be quite onerous for preparers, and might not be entirely necessary given the increased attention given to lease-related assets and liabilities on the statement of financial position. We also believe that the level of disclosure requirements may be particularly onerous for nonpublic entities. For these reasons, we recommend that the Boards reconsider whether all of the disclosures are necessary, especially for nonpublic entities.

Question 9: Nonpublic Entities (FASB Only)

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?

We generally support providing relief for nonpublic entities. However, we do not believe that the relief related to use of a risk-free rate should be allowed. We believe that allowing use of a risk-free rate would result in a measurement that does not reflect reality. Rather than allowing use of a risk-free rate, we recommend that the Board provide guidance on estimating an incremental rate to be used in situations in which an implicit rate is not known.

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 related party leases should not have different recognition and measurement requirements. The risk that the terms of related party arrangements are not the same as arms length transactions with third parties is not unique to leasing transactions. We believe that transparent disclosure of the terms will provide users with the relevant information to allow them to understand the arrangements, and determine what adjustments, if any would be appropriate for their specific purposes.

Question 11: (FASB Only)

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 agree that additional disclosures are not required.

McGladrey of Pullen, LCP

We appreciate this opportunity to provide feedback on the proposed guidance and would be pleased to respond to any questions the FASB or its staff may have concerning our comments. Please direct any questions to Rick Day (563.888.4017) or Richard Stuart (203.905.5027).

Sincerely,

McGladrey LLP