

1850-100 Comment Letter No. 392 Reznick Group, P.C.

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Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

File Reference No. 1850-100

Re: Exposure Draft, Leases Topic (840), issued August 17, 2010

Dear Mr. Golden:

Reznick Group, P.C. appreciates the opportunity to comment on the exposure draft (ED), *Leases Topic* (840), issued by the FASB.

We support the overall objective of the Board in improving lease accounting. Although we have questions and clarifying comments with certain aspects of the ED's proposals, we believe that with further enhancements the Board can develop a clear and robust final standard on accounting for leases

Our responses to specific questions on which the Board is seeking comment are included in the Attachment to this letter.

If you have any questions concerning our comments or would like to discuss any of our responses or recommendations in more detail, please feel free to contact Michael Beck at (404) 847-7728.

Yours truly,

Regnick Group, P.C.

Ouestion 1: Lessees

- (a) Do you agree that a lessee should recognize 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?
- (b) Do you agree that a lessee should recognize amortization 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?

We agree that a lessee should recognize a right-of-use asset and a liability to make lease payments. However, we believe changes to the proposed lessee model are needed in order to establish a more practical approach for measuring the right-of-use asset and the lease obligation. We address this issue in our response to Question 8.

We agree with amortization of the right-of-use asset. We do not agree with recognizing interest on the liability to make lease payments. Given the nature of lease payments and the potential variability in the amounts that would be recorded as lease assets and payment obligation liabilities that could result from the proposed probability measurements and reassessments of both lease terms and lease payments, we believe that carving out interest as a separate expense component will cause a distortion of operating results, in general, and of leasing activities, in particular. Further, the resulting lease payment obligation will not reflect the actual lease obligation.

While we agree with the objective to reflect lease obligations on the balance sheet of lessees, lease obligations are not loans. They have no agreed-upon principal and interest components. The parties to a lease agree to payment and asset use terms. Once those terms are agreed to, the lessee is not able to avoid the future payments or the imputed future interest costs by prepaying the lease obligation. We believe the lease obligation is inseparable from the right-of use asset and is not an independent financing transaction.

Additionally, we believe that separating the lease payment to reflect an interest component does not achieve a better reporting of leasing expense. In fact, it results in a front loading of the expense. It also creates a disparity between the cash payments and the total lease-related expense. Imputing interest distorts the lease obligation and it will reflect neither the amount owed nor its fair value. Rather, the lease obligation will merely reflect a hypothetical present value of an assumed, but not fixed or determinable and quite possibly avoidable, stream of payments. We believe investors and other users would be better served with information that reflects the total lease obligation or asset without any interest adjustment.

Ouestion 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?

- (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?
- (c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

While we generally agree that lessee and lessor accounting should have symmetry, it is not clear to us that the results derived from application of the proposed lessor accounting would provide users of financial statements with sufficient benefits to justify the significant costs that lessors would incur to implement it. We recommend that the Board explore further how lessor accounting would affect various industries before making any changes in order to clarify how it would improve financial reporting of leases by lessors.

We do not support use of the derecognition approach. The ED already excludes sales from the lease accounting guidance and appears to allow a transaction that does not qualify as a sale to be accounted for in a manner similar to a sale. Further, in our view, recognition of gains and losses at inception of a lease is inconsistent with the concept of a lease, which is a contract to use an asset over a period of time. As a result, we think the revenues attributable to a lease should be recognized over the lease term based on satisfaction of the obligation to provide the use of the leased asset.

While we believe the performance obligation approach is more consistent with the overall concept of a lease, we have issues with the results derived from its use. Under the performance obligation approach, the right to receive lease payments and the performance obligation are presented together with the leased asset on the lessor's balance sheet. We believe presentation of two assets and a liability (the leased asset, right to receive lease payments, and the performance obligation) on a net basis is confusing and provides little benefit to a user that alternatively could be provided through informative disclosures.

The Board makes the argument that the right to receive lease payments is a separate asset from the leased asset that should be recognized. Yet the proposed presentation of netting this asset with the performance obligation and the leased asset is a strong indication that it is not a separate asset. We would argue that the right to receive lease payments is more of a right than a separate asset. We do not believe the right to receive lease payments could be sold separately from the leased asset. We also believe that any sale or other transfer of a leased asset would require that the lease rights accompany that transaction.

Another issue we have with the argument that the right to receive lease payments should be recorded as a separate asset is that the right is not strong enough to result in derecognition of the leased asset. We believe the lessor only has one asset, not two. The right to receive lease payments is secondary to the leased asset. If the leased asset is not derecognized through a sales transaction, then it should remain on the books. It should not be replaced with other assets that relate to it, such as the right to receive lease payments. Following that logic, if the right to receive lease payments cannot be recorded in place of the leased asset, then we are not sure the lease obligation should be recognized as a separate liability. Such an obligation provides more

information about how the leased asset must be used and little information about the cash obligations of the lessor. In fact, the performance obligation is not expected to be settled using assets of the lessor other than the leased asset. We would expect this to be a significant issue in the real estate industry where lessors are in the business of leasing property for as their primary source of revenue and where their primary obligations would be to lenders and not to tenants. It is misleading to require reporting that reflects lessors as financial institutions. Unlike financial institutions, which are exposed to loss of the principal of their loan in the event of nonpayment, lessors can re-lease the asset. In many industries, one lessee can be replaced with another and one lease replaced with a new one.

We agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP.

Question 3: Short-term leases

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?

We agree with a simplified approach to short-term leases. However, we believe additional clarification is needed regarding the definition of "maximum possible lease term" in order to exclude renewals that are not specifically provided for in the lease agreement. It is common in residential rental real estate (primarily apartments) for most leases to have a lease term of 12 months. It is also common for a tenant, following the expiration of the initial lease term, to enter into a new 12 month lease or convert to a month-to-month lease. Such tenants may stay in the building for several years. We believe these types of leases should be included in the short-term lease definition. However, we are concerned that without additional guidance, such leases might be deemed to have a maximum possible lease term of more than 12 months even though no renewal or extension options exist under the lease agreement.

We also believe lessors of an apartment property, which are in the business of leasing all of their units, should not be required to measure each of the homogeneous units on a lease-by-lease basis under the simplified approach. An apartment building may have 200 units, all eligible as short-term leases except for a few units which might have 15-month or 18-month terms. We believe that a lessor that has a property with homogeneous residential units that offers those units for lease under lease terms that would qualify for the short-term lease option should be able to ignore the existence of a few longer term residential leases so long as substantially all of the leases of the homogeneous residential units qualify for the short-term option. This would allow the lessor relief from having to monitor or undertake more complex accounting for insignificant exceptions to the 12 months or less criteria when the property substantially qualifies for the short-term lease option. We believe separate measurements of one or two leases with nominally longer lease terms would not provide meaningful information and would not warrant the additional cost involved. Non-homogeneous units, such as commercial space or retail space located within the property, would be measured separately on a lease-by-lease basis.

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Generally we agree with the definition. However, we believe that once lessees are required to record leases obligations on their balance sheet, the definition will come under increased scrutiny and some may attempt to circumvent the definition. So we encourage the Board to focus more attention on the lease definitions. This focus should include taking care that agreements that are not leases, such as power purchase agreements, are not inadvertently caught in the definition because it is too broad.

The increase in solar panels and other green energy technology assets have created some controversy in the accounting industry over whether or not the related power purchase agreement is in fact a lease. The issue is centered on whether the contract conveys the right to control the use of the specified asset. Solar panels are often placed on the roof of an entity and the power sold to that entity through a power purchase agreement, usually based solely on the number of kilowatt hours generated. Maintenance easements are granted to the owner of the solar panels. Some argue that the physical location of the solar panels on the roof of the buyer/owner meets the definition of a lease since the owner of the building has the right to restrict access to the solar panels. This can result in a contract that meets the definition of a power purchase agreement in every other way being accounted for as a lease. Improved clarity in the definitions of a lease in the area regarding control over the use of a specified asset (paragraph B4 of the ED) would help users achieve consistent accounting and stem efforts to circumvent the issue by skirting the definition of a lease.

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?

We do not agree that a lessee or a lessor should determine a 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. Our primary objection is that the resulting measurements are too subjective and they can result in lessees recording liabilities that they can avoid and in lessors recording assets they do not control. Also, we believe the more likely than not criteria is too low

of a threshold and would lead to frequent changes in lease assets and liabilities. The subjective nature of using probabilities determined by management to determine the longest possible lease term that is more likely than not to occur likely would result in a measurement based to some significant degree on management's intent and not on objectively measureable inputs. We believe the current model is highly subjective, decreases comparability amongst companies and increase complexity in accounting for leases.

We prefer a model where the lease term reflects the non-cancellable lease term, with limited exceptions. Until an option to extend the lease is exercised, the lessee does not have an obligation to pay rentals during the optional renewal period. We would include renewals and extensions that are probable based on existence of either an economic incentive to exercise the option or a penalty which is imposed if the option is not exercised. The existence of optional lease extensions should be disclosed. If this model is considered too restrictive, then we believe the lease term should be based on reasonably assured criteria with a much higher threshold than the current 51%.

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 reliably measured? Why or why not?

We do not agree that contingent rentals specified in the lease should be based on an expected outcome technique. Such a technique is too complex for the subject matter and attempts to forecast the future. With the exception of lease payment increases based on a published index, we believe the base lease payments reflect the expected outcomes at the time of the lease. Most contingent payments reflect a provision for uncertain future events that are reasonably possible based on the nature of the leased item. We believe that the lease obligation should not reflect significant uncertainties. Once those uncertainties become probable, then we believe they should be reflected. Long-term contingent rents based on such items as a percentage of the lessee's revenues or increased use, by their very nature are highly uncertain and should not be reflected in the lease obligation. Those types of contingent rents are based on external events that management cannot control or predict except on the basis of current data. Measuring the right to receive lease payments or obligations based on these types of assumptions could lead to significant adjustments to the lease during the lease term, which could be misinterpreted by users of the financial statements. Eventually, users will come to distrust the accuracy of the recorded right to receive lease payments or lease obligation.

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?

We generally agree that changes in lease assets and liabilities should be recorded when facts and circumstances indicate that a significant change in the liability to make lease payments. We believe that such changes should be reflected in operations over the remaining term of the lease and therefore should be incorporated into the balances of existing lease assets and obligations.

Question 18

Do you have any other comments on the proposals?

Leases involving commercial real estate, such as office space, often include incentive payments paid by the lessor to induce a lessee to lease space. Incentive payments may include items such as up-front cash payments to the lessee to sign the lease and payments, incentives to pay for tenant improvements, or to reimburse the lessee for specific costs such as moving costs or abandoned leasehold improvements. Incentives may also include a lessor assuming a lessee's pre-existing lease with a third party. The ED does not address the accounting for lease incentives and we request the Board include additional guidance on this topic. Also, build-to-suite type lease arrangements are common in the real estate industry and the ED does not address the accounting for transactions where the underlying asset has not yet been constructed.

We think the Board should address termination options and how lessors should account for provisions in the lease that allow the lessee to purchase the underlying asset at a price that is lower than fair value.

Ouestion 19

Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

We believe the proposed guidance should be the same for non-public entities, including private companies and not-for-profit organizations. Different standards for non-public enterprises would undermine the reliability of non-public financial statements and create more confusion in the marketplace.