



December 15, 2010

Financial Accounting Standards Board
Attn: Technical Director—File Reference No. 1850-100
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via e-mail to director@fasb.org

Re: File Reference No. 1850-100
Proposed Accounting Standards Update, *Leases (Topic 840)*

Dear Technical Director, Board Members and Staff:

The Accounting and Auditing Committee of The Ohio Society of Certified Public Accountants is pleased to express its views on the Proposed Accounting Standards Update, *Leases (Topic 840)*.

We believe that the Board recognizes the significant impact that this standard will have on financial reporting and users of financial statements. Given the magnitude of this standard we urge the Board to finalize any re-deliberations that result from the comment letters received and then allow ample time for organizations to implement the standard. We also note that this standard, in its current form, will result in a one-time EBITDA increase which has significant ramifications to the analyst and banking communities that we, as public accountants, serve. Organizations will need time to assess the impact of a final standard on their individual financial statements and educate impacted users of the same.

In reviewing this draft, we have concerns that we believe can be resolved with clarifications and minor edits to the standard. In some cases we believe the standard should allow organizations more flexibility, while in others we believe the standard should be more rigid. The following response addresses the majority of the questions that the Board has sought comment on:

Question 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?

We acknowledge that a liability to make lease payments should be recorded and that the right-to-asset is the natural extension of that concept.

(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 have two general concerns in this area. First this standard serves to “front load” expense, effectively presuming that all leases exist as financing alternatives; while we acknowledge in many cases this is true, there are many scenarios where the increase in future lease expense called for in the contract is already intended to account for the long term nature of the arrangement. Second requiring the expense to be amortization seems incorrect and would create a significant change in EBITDA that creates challenges for the lending and acquisition communities, as well as, creating challenges for internal management accounting. This further serves to suggest that the lease is a financing alternative, as opposed to being a rental without full ownership rights.

To be comparable; amortization should be allowed only when a lease meets the purchasing criteria. In other leases, traditionally considered as operating leases, the “right-to-use” asset should be expensed over the term as an operating expense, as opposed to being amortization. We believe that there should be a difference between entities that purchase assets and assume the risks of ownership (using leasing as a financing alternative) versus those that lease assets for use (a rental without full long-term ownership rights).

Question 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?

In theory, we agree with the overall lessor accounting objectives and general recognition concepts covered by this exposure draft as it relates to the performance

obligation approach, but we have reservations with the application of the derecognition approach. We believe the performance obligation approach matches the recognition concepts under the right-of-use model for the lessee and therefore should be the preferred approach for lessor accounting. We believe that the derecognition approach should be applicable only in transactions that are effectively sale transactions, which appear to be excluded from this guidance in its current form.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65). (See also paragraphs BC41–BC46.) 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 believe this is an area where the Board should expand upon the standard for purposes of clarity. We do not believe that this area warrants separate accounting for a lessee versus a lessor. Some members of our committee interpreted this section of the standard to offer lessors the option of not recording an asset or liability for short term leases, while not extending that option to lessees. Other members believed that the Board's intention was to extend the same option to lessees. This area of the standard should be clarified to note that for short term leases neither party is required to record a separate asset or liability, other than expense and liabilities as would be recorded under current principles.

Definition of a lease

This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). This exposure

draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

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?

We agree with the definition outlined in this standard.

(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?

We believe the distinction between a lease contract and a purchase contract is critical and is appropriately addressed in paragraphs B9 and B10. However, the exposure draft does not prescribe the proper accounting and presentation for a lease agreement where control transfers at the end of the lease agreement. We would propose that the accounting would be similar in order to recognize the economics of the underlying lease financing obligation with the exception that the related asset is an owned asset versus a “right-to-use” asset.

Scope

Question 6: Contracts that contain service components and lease components

This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, Revenue Recognition (Topic 605): Revenue from Contracts with Customers, to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We believe the board has provided the proper guidance with respect to the need for entities to separate service components from the “right-to-use” component; however we believe the standard needs to afford entities some latitude, recognizing that some professional judgment is required in this area. It should be clear to users that it is not intended for an organization to be required to record a liability for the component of a lease that represents the payments for future services associated with the asset.

Question 7: Purchase options

This exposure draft proposes that a lease contract should be considered terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

Yes, we concur with this section of the proposed standard.

Measurement

This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that: (a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.

(c) is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).

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 are very concerned about this aspect of the exposure draft. We believe that the initial recognition of the liability and right-of-use asset should be based on the firm lease commitment as this more closely aligns to the definition of a liability. The proposed model also raises concerns about the verifiability of the determination of the “longest possible term that is more likely than not to occur” for external auditors.

If the terms of an optional renewal are substantive legal terms that can be exercised at will by the lessee, then by definition, a lessee does not have a firm obligation for

future lease payments under those renewal periods until the renewal option is exercised, and therefore should not record a liability until a firm obligation exists.

However we do recognize that changing the standard in this regard could lead to entities avoiding the spirit of the standard by utilizing leases with multiple short term renewal options.

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 agree with the concept that the present value of future lease payments should include items such as contingent rentals and residual value guarantees. We believe these estimates can be reasonably supported and in many cases can be reliably measured. We would support including these in the initial estimates with subsequent adjustments for changes in facts and circumstances.

Presentation

This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

(A) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

We do not think a separate liability presentation on the face of the balance sheet should be required; but rather, entities should be allowed to make their own

assessment of the items to be presented on the face of their balance sheets, based on materiality and usefulness to readers.

We believe the asset side presentation is appropriate, noting that most entities will include these items as a component of Property, Plant and Equipment on the face of their financials and separately outlined the right to use items in their footnote disclosure.

Question 13: Income statement

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We do not think a separate income or expense presentation on the face of the income statement should be required; but rather entities should be allowed to make their own assessment of the items to be presented on the face of their income statements based on materiality and usefulness to readers.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We do concur that providing users with as much disaggregated information about the uses of cash flows from various financing options is important and relevant. We believe this information will be needed by users to assess cash flow impacts of leasing activities. One would expect that the interest portion of the lease payment would be presented on the cash flow statement as a financing activity, while the payment for use of the asset would be presented as an investing activity. If the board is trying to outline that leased assets equate to purchased assets then one would expect a portion of the cash flows to be presented as an investing activity.

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that: identifies and explains the amounts recognized in the financial statements arising from leases; and describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows? (paragraphs 70–86 and

BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

No, we believe that this portion of the standard is similar to a SEC Management Discussion & Analysis requirement, as opposed to, traditional footnote disclosure. We believe this requirement would be outside the norm for private companies and would present challenges for external auditors. We believe these issues will be addressed by Public Company's as part of their normal SEC filing requirements and thus does not require guidance in this standard.

Transition

Question 16

(a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We do agree that a simplified retrospective approach will be the most beneficial as requiring entities to restate prior periods would be extremely burdensome. We further believe that the transition requirements should be the same for all entities to support consistency.

We believe that the Board needs to consider guidance surrounding how entities address the significant EBITDA change this standard will create in its current form. For many entities EBITDA is an important measure that is used by interested third parties, with this standard converting what had been an operating expense to amortization, many entities will have a need to make estimates of the prior year impact to present comparable amounts to interested users.

As noted in our opening paragraph we believe that the Board recognizes the significant impact that this standard will have on financial reporting and users of financial statements and given the magnitude of this standard we urge the Board to allow ample time for organizations to implement the standard.

Non-public entities

Question 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 overall objectives should be the same for all entities and there is no reason to create an additional “Big GAAP vs Little GAAP” difference in this area.

We believe this standard is one of the most significant being under taken as part of the convergence project. Many in the financial community believe that historic lease accounting presented an accurate reflection of the economic substance of the underlying transactions and that the organizations long term lease commitments were properly disclosed to users in the financial statement footnotes. Most CPA’s understand the appropriateness of recording a liability for these commitments, and thus acknowledge that the “right-to-use” asset approach is the most logical extension of that accounting.

We do have a concern that this change in accounting, in its current form, is so significant that it could have many unintended ramifications and therefore we urge the Board to consider all comments and proceed cautiously.

We appreciate the opportunity to provide feedback to the proposed Accounting Standards Update and welcome any additional opportunities to further discuss or otherwise support the efforts of the Financial Accounting Standards Board in this area.

Respectfully,

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