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December 15, 2010

Mr. Russell G. Golden, Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116 Email: director@fasb.org

Re: Proposed Accounting Standards Update — Leases; File Reference No. 1850-100

Dear Mr. Golden:

PNM Resources, Inc. appreciates the opportunity to respond to the Proposed Accounting Standards Update, *Leases* (the "ED").

PNM Resources, Inc. is a diversified energy company in the United States with approximately \$5.4 billion of assets, \$1.6 billion in annual revenues, and almost \$1.0 billion in market capitalization. Our subsidiaries and affiliates are involved in the generation, transmission and distribution of electricity, as well as energy management and other energy-related services primarily in New Mexico and Texas.

With respect to leasing, we utilize leasing fairly extensively as the lessee, but only have minor activities as the lessor. Accordingly, most of our comments come from the perspective of a lessee rather than a lessor. We are a lessee under arrangements covering portions of two units of a nuclear power plant, a major transmission line, office buildings, and radio antenna space. We also lease nearly 500 vehicles and have approximately 200 leases for office equipment. In addition, we have numerous agreements with government agencies and Native American tribes covering rights-of-way for our facilities to be sited on their lands.

Overall, we support the Financial Accounting Standards Board ("FASB") in its objective to develop accounting principles that enhance the transparency and relevance of financial statement disclosure. We are in general agreement with the basic concepts of recognizing a right-of-use asset and a liability to make lease payments arising from lease contracts and believe that would result in an improvement in accounting principles. However, we are concerned that some of the provisions proposed in the ED necessary to implement the basic concepts will be extremely difficult and time consuming, will introduce significant amounts of subjectivity into the process, and will be very difficult to audit. These issues, as described in more detail herein, cause us to believe that the costs of implementing the ED as proposed will greatly outweigh the benefits of the accounting improvements. Therefore, we would only support the issuance of a final standard adopting the basic concepts if significant changes and practical accommodations are made to simplify the initial and on-going implementation of the standard.

If the FASB does not feel it can make changes to the ED that will address the significant concerns raised by us, as well as others, to a final standard to be implemented in a practical and cost effective manner, we recommend the current accounting for leases be retained. Alternatively, the current accounting for operating leases could be amended to require that liabilities for future lease payments and offsetting right-of-use assets be recorded based on discounted contractually obligated lease payments that are determined under existing standards.

Our responses to the Questions for Respondents and other specific comments are presented below.

#### 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? (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 with these basic concepts. However, as set forth in response to other questions below, we believe there are significant issues with respect to certain items that will make it impractical and cost prohibitive to implement the ED as proposed.

#### 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?
- (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?

We agree with these concepts. However, many entities not in the leasing business will be a lessor under arrangements that are ancillary to their business model. For example, an entity may own or lease a building and lease or sub-lease a minor portion of that building to others. It would not seem necessary to comply with the presentation and disclosure requirements for these arrangements and possibly for the accounting requirements as well. Although these arrangements likely would not be material, rather than having to rely on a materiality determination, we think the FASB should address these situations.

## 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 agree with a simplified approach regarding short-term leases. However, we see no basis for differentiating between lessees and lessors with respect to short-term arrangements. If lessors are allowed to elect not to record assets and liabilities on these arrangements, allowing lessees to do so as well will not undermine the faithful representation of financial statements.

While we understand the logic presented in paragraphs BC39-40 regarding non-core assets, we believe the FASB should develop a practical accommodation for high-volume low-dollar leases. For example, we, as well as many other entities, currently lease many of our vehicles under master lease arrangements that are constructed to meet operating lease criteria under existing accounting standards. These arrangements provide for an initial term of less than 12 months, but contain renewal options that extend beyond that. The arrangements may provide for residual guarantees, excess mileage charges, etc. There is an obvious relationship among these factors in that the longer the term (i.e., the more renewal options assumed exercised), the lower residual guarantees would be, but the more likely excess mileage charges would beincurred. This would indicate an extensive matrix of possible future payments and result in a significant amount of subjectivity in the decision making process. The process would be very difficult to audit and would likely result in increased audit fees, as well as significant internal costs. We currently have nearly 500 vehicles under lease. The initial assessment of these on an individual basis will be a large task, as will the proposed periodic reassessment. Similar arrangements exist for many entities with respect to minor equipment items such as copiers and computers. We believe the concepts set forth in the ED would be more readily received by preparers if the FASB were to develop a practical alternative to deal with such arrangements. At a minimum, we suggest that a final standard acknowledge these types of arrangements and that it would be appropriate to develop averages, groupings, or surrogates in accounting for them.

#### 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?
- (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?

The definition of a lease states there is an exchange of consideration. Although limited, there could be situations where a right to use an asset is granted without consideration. These situations could come within the scope of literature covering non-monetary exchanges or related party transactions, but the FASB should consider addressing these types of situations.

It would also be helpful if the scope section addressed the need to readdress arrangements that are or are not currently accounted for as leases based on determinations made at their inception under accounting literature in effect at that time. See additional discussion under Question 16 below.

## Scope

# Question 5: Scope exclusions

This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why? alternative scope would you propose and why?

We are uncertain as to the benefit of delaying addressing intangible assets at this time. If this provision is retained in a final standard, we believe it should be further clarified. For example, paragraph 5(a) states intangible assets are excluded, but paragraph BC36 states <u>most</u> intangible assets are excluded. This could lead to varying interpretations and inconsistencies. As an example, it might be concluded that a license to use a patent would be excluded, but a computer software license would not. Specifically addressing computer software licenses for a licensee would be helpful since it is unclear to us whether they fall within the ASC Topic 350 definition of Intangible Assets. See comments under Question 3 regarding the need to address high-volume low-dollar leases.

# 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.
- (b) The IASB proposes that:
- (i) A lessee should apply the lease accounting requirements to the combined contract.
- (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
- (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.

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 IASB approach is more theoretically supportable. However, it would introduce additional subjectivity and inconsistency into the process, so we would recommend following the FASB approach unless the terms of the service component are readily and objectively determinable.

The ED appears to contemplate that a final standard for the Revenue Recognition project will be issued before one for Leases. If that is not the case, the final standard for Leases should specify the accounting required for the service component rather than referring to an exposure draft.

# 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?

We agree.

#### 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?

The basic concepts of the ED are to record a liability for lease payments at the inception of the lease and to record a right-of-use asset equal to that liability. To include periods in the determination of the lease term that are beyond the contractual obligation period stated in the agreement records an obligation that does not legally exist and is not legally enforceable, as well as requiring a subjective judgment about future decisions, which will be made based on circumstances that exist at that time. Accordingly, we do not believe lease payments beyond the contractual obligation period meet the definition of liabilities and option periods should be excluded from the determination of the lease term. However, we would not object to the inclusion of periods where renewal is reasonably assured, such as bargain renewals.

If the FASB chooses to include options in the lease term determination, we would point out that similar to issues discussed in response to Question 3 above, there will be a lot of subjectivity in the assessment of the longest possible lease term that is more likely than not to occur. The possibility of renewal will be influenced by numerous business and economic factors, both internal and external to the entity. These factors will lead to entities reaching different conclusions than other entities in similar circumstances. This is particularly true with respect to non-core assets and high-volume low-dollar leases. Paragraph BC119 indicates renewals at market-value must be considered in this evaluation. That provision would be even more difficult to apply and require more speculation, including what market renewal costs will be. Since virtually any transaction can be entered into at market, including market value renewal options in the lease term would not seem to add anything to the faithfulness of financial statements. An alternative would be to include market value renewals only if it is reasonably assured they will be exercised and the costs under the market renewals can be reliably measured. A more workable and practical approach would be to use a criteria such as reasonably assured for all renewal options. This would also reduce the frequency of changes from and the uncertainty in reassessments as set forth at the end of paragraph BC119. Such a provision would necessitate including information in the Basis for Conclusions discussing what reasonably assured means in this context and how to approach making such determinations in order to reduce inconsistencies between entities. However, we believe the inconsistencies under a reasonably assured approach would be far less than under the more likely than not approach.

#### 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?

The concerns and issues raised in response to Question 8 are even greater in regard to the ED proposal for determination of lease payments. Again there will be a great deal of subjectivity regarding contingent rentals that will require estimates or forecasts of the underlying factors leading to the contingent rental payments. In response to Question 7, we recommended excluding lease options from the lease term, which would result in payments related to option periods being excluded from the lease payment calculations. However, if option periods are retained in the lease term and, if market value renewal options are proposed to be included in the determination of the lease term, the market value lease payments must be included. Forecasting future market value rentals will be very difficult and even more subjective, as well as being nearly impossible to audit. The requirement to use a probability-weighted average of cash flows from a reasonable number of outcomes further exacerbates the difficulty and practicality of the approach set forth in the ED.

We are further concerned that the inclusion and disclosure of contingent rents could be considered forward looking information and are uncertain if those items would be encompassed under the safe harbor provisions of the SEC rules and regulations. Furthermore, in situations where contingent rents are based on future revenues, operation income, net earnings or other similar metrics, the disclosure of contingent rental arrangements and their amounts could result in users of financial statements being able to calculate management's forecasts of those metrics, which management may not intend to make public. If the concept of estimating future contingent rentals is retained in a final standard, the FASB should obtain the SEC's position on the safe harbor issue and include it in the final standard.

We recommend that contingent rental payments, term option penalties, and residual value guarantees be included in the lease payments <u>for both lessees and lessors</u> only where they can be reliably determined and measured. As set forth in Question 8, we recommend excluding market value renewals, but if retained, market value renewals should be included only if it is reasonably assured they will be exercised and the costs under the market renewals can be reliably measured.

## 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?

Although the concept that leases only need to be remeasured when there is a significant change appears to be a logical approach, it will not be simple or straight-forward to apply. At each reporting date, there will still be a need to assess each lease arrangement in some manner to

determine that there has not been a significant change. Auditors will require that this determination be factually based and documented in a manner that can be subjected to audit procedures. This will be a much more extensive and time-consuming process than we believe is contemplated by the ED even when no remeasurement is necessary. If retained, a final standard should provide additional guidance on the meaning of significant, as well as the methods and extent of making such determinations, including examples.

#### Sale and leaseback

This exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents a sale of the underlying asset, the leaseback also would meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

#### Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We agree with the criteria for transactions entered into after the effective date of a final standard. As discussed under Question 16 below, a final standard should address transactions that were entered into prior to that effective date. We believe those prior determinations should not be readdressed and that transactions that met the requirements for sale and leaseback accounting under accounting literature that was effective at the inception of the transactions should continue to apply sale and leaseback accounting. This would result in a lease obligation and right-of-use asset being recorded in the same manner as other existing leases.

#### 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).

In general, we believe the Presentation and Disclosure sections should be changed to state that the items specified are preferred methods, but to acknowledge that each entity should determine the approach that is best for it based on its facts and circumstances. For example, an entity whose primary business is leasing equipment to others should present the lease liabilities and right-of-use assets on the face of the balance sheet. However, another entity might have significant leasing activity as lessee and/or lessor, but not of the magnitude that it would otherwise disclose on the face of the balance sheet, so disclosure in the footnotes would be more appropriate. The leasing activities of other entities might be minor enough that disclosure is not warranted. To require all entities to present information on the face of the balance sheet would lead to line items being shown on the balance sheet that are not meaningful to users of financial statements. Each entity should be allowed to determine the presentation that presents its fact and circumstances in the manner that is most useful to users. Other comments on these sections are presented below.

## 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?
- (b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

We agree that a lessee should present liabilities to make lease payments separately from other liabilities. The separate presentation appears reasonable as the manner in which the lease liability is being determined is different from other liabilities presented on the statement of financial position. We also agree with presenting right-of-use assets as if they were tangible assets within property, plant and equipment since we believe the right-of-use asset is essentially property and this presentation provides useful information to users of financial statements. If a final statement were to include leases of intangibles, right-of-use assets applicable to those arrangements should be included with other intangibles.

For lessors applying the performance obligation approach, we do not agree that they should present a net lease asset or lease liability (being the total of underlying lease assets, rights to receive lease payments and lease liabilities). We believe netting these balances together would be inappropriate as there is no legal right of offset. Also, if there was a net lease liability, it would result in the owned asset being presented on the liability side of the balance sheet, which seems inappropriate and confusing. Additionally, the concept of netting the amounts on the statement of financial position could create "clutter" on the balance sheet and may confuse users of financial statements. The lease receivable and obligation should be presented separately within the statement of financial position and, if meaningful to an understanding of the financial statements, the net asset or liability should be presented in the footnotes. The FASB should consider providing additional guidance within the ED as to whether a short and long-term presentation would be required on the lease receivable.

For lessors applying the derecognition approach, showing residual assets separately within property, plant and equipment should be left to the discretion of each entity based on its facts and circumstances.

We do not believe that subleases should automatically be required to be presented as assets and liabilities on the statement of financial position but should be left to the discretion of each entity based on its facts and circumstances. For example, if a lessee has sublet an entire building then it might be appropriate to present the assets and liabilities resulting from the sublease on the face of the statement of financial position. However, if the lessee has only sublet a minor portion of a building the additional presentation of an asset and liability would appear better suited to be disclosed in the footnotes.

## 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 agree that the separate presentation of lease income and expense is appropriate if the amounts are material to the overall financial statements of the entity. Again, this should be left to the discretion of each entity based on its facts and circumstances.

## 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?

Fundamentally, we agree that leasing cash flows should be presented separately on the statement of cash flows for both lessees and lessors, assuming the cash flows are significant to the cash flows of the organization.

#### Disclosure

#### **Question 15**

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognized in the financial statements arising from leases; and
- (b) 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?

We believe paragraph 71 should be further modified to indicate that the items listed are suggestions or guidelines that should be considered as each entity develops the disclosures that are appropriate for its facts and circumstances and acknowledge that some items may not be

relevant at all. We also question whether a model that attempts to provide greater transparency related to leases by recognizing assets and liabilities on the face of the financial statements should also result in significantly increased disclosure requirements.

We agree that more quantitative information should be disclosed in the notes to financial statements due to the assumptions that will be required of management to determine appropriate lease assets and liabilities. However, we are concerned that the proposed disclosures may be interpreted as requiring that a very specific set of items be disclosed, with no options given, to meet the quantitative requirements. It does not appear to us that all of these items would be necessary for users to understand that certain assumptions have been made to arrive at the lease asset and liability. Additionally, it is our belief that the volume of these quantitative disclosures in many cases will overwhelm users and they will not fully comprehend what is being communicated, substantially diminishing the usefulness of the information. We also have a concern that by requiring each of the quantitative items to be disclosed that a "boiler plate" disclosure will evolve that will not provide adequate and transparent information to users.

We do not agree with the requirement that a lessee shall disclose a reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments, disaggregated by class of underlying asset, and shall also show the total cash lease payments paid during the period. With the increased presentation requirements this disclosure requirement may be redundant for a lessee if lease income/expense is reported separately in the income statement and lease payments are separately reported in the statement of cash flows. With substantially all of the information already presented on the face of the financial statements, the additional roll-forward disclosure does not appear to add much value. Additionally, we believe that the costs of separately tracking this information outweigh any benefits that users may receive.

We are unclear as to what information is being required by the reference in paragraph 84 to disclosure requirements in the Accounting Standard Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815). If these disclosure requirements are pertinent to certain lease transactions, the requirements should be included in a final standard as opposed to referencing to another section of the current guidance.

We are unclear on what is being requested in paragraph 85. The first sentence discusses a maturity analysis showing undiscounted cash flows but the second sentence asks that analysis to distinguish amounts recognized on the balance sheet (which are recorded on a discounted basis). Furthermore, presenting the analysis on an undiscounted basis seems inconsistent with the basic concepts of the ED that the lease liabilities are essentially long-term debt (where the maturity analysis currently required only includes principal amounts and excludes interest). We recommend that this paragraph be clarified in a final statement.

# 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?

Conceptually, the full retrospective application would provide a better and more accurate representation of the application of the ED. We understand and agree with the need to allow the simplified retrospective approach as a practical accommodation. However, we believe entities should be allowed the option to use the full retrospective application as well since it does provide a better representation. We believe preparers should be allowed to use this option on a lease-by-lease basis. For example, a preparer may have a small number of major leases for buildings, plants, major equipment, etc. for which the effort to apply the full retrospective method would be justified, but a large number of minor leases for vehicles, copiers, computers, etc. for which the effort would not be justified. We understand this alternative would result in a certain degree of inconsistency among preparers, but believe the increased accuracy outweighs the inconsistency.

A full retrospective application would necessitate evaluation of leases that existed during any periods presented including those that have expired at the date of the latest balance sheet presented for which no lease liabilities or right-of-use asset would be recorded. Financial statement amounts related to these expired leases would likely be immaterial and we do not believe there is much value to making the computations necessary to include them in the implementation of a final standard. Accordingly, we recommend that the transition section provide that expired leases may be excluded unless they are of a magnitude that the financial statements would be misleading.

Paragraph 90 provides that upon initial application a right-of-use asset is recorded equal to the lease liability, which is calculated as the present value of the remaining lease payments. There is no provision for dealing with initial indirect costs, which appears to be inconsistent with the application for leases entered into subsequent to initial application.

The ED is not clear on how it is to be applied to contracts that were entered into prior to the effective date of certain prior FASB technical pronouncements that were to be applied prospectively. For example, certain sale and leaseback transactions entered into prior to the effective date of SFAS 98 would not be accounted for as sales and leasebacks under current literature. Similarly, contracts that were assessed prior to the effective dates of EITF Issues 98-10 and 01-8 might be evaluated differently under current literature. The FASB should clarify if the intent is that arrangements entered into and accounted for as specified under accounting literature existing at that time are to be reevaluated or if the intent is that a final standard would be applied to the accounting that already exists. We believe it would be inappropriate to require these arrangements to be readdressed. Therefore, a final standard should accept the prior determinations and provide that the new accounting apply only to such arrangements that previously have been determined to be leases.

Similar to comments made under Question 3 above, the FASB should consider developing a practical accommodation for the transition of high-volume low-dollar leases. Determining the lease term, contingent rents, remaining payments, etc. for what could be thousands of leases, with relatively low payment amounts, for many entities will require cost and effort that will be significantly above the benefit gained.

# Benefits and costs Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

We do not agree that the benefits of the proposals as set forth in the ED outweigh the costs of implementing the proposals, primarily for the reasons outlined in responses to the above questions. We agree with and would reiterate the concerns set forth in paragraph BC203. Those concerns continue to be very significant even acknowledging that changes were made in the ED as set forth in paragraph BC205. While the treatment of options and contingent rentals may have been modified, it will still be extremely onerous for many entities as proposed in the ED. Although the ED does not require a detailed examination of every lease unless a significant change is expected to occur, every lease will still need to be assessed every reporting period to make a determination that a significant change is not expected to occur. What constitutes a significant change is not a universally agreed to concept so it will be determined very subjectively and will result in great variability and inconsistency in application. Auditors will require documentation of this process that undoubtedly will have to be much more extensive than a statement that a cursory review of overall circumstances was made and no significant changes in leases are expected to occur.

Paragraph BC205 indicates accommodations were made in developing the ED, including a simplified approach to short-term leases. The definition of short-term leases is arrangements having a maximum possible term of 12 months, including renewal options. We believe that only very minor rental arrangements will come under this provision and that the amounts involved will be immaterial. Defining short-term leases so narrowly does not accomplish much in the way of accommodating the extensive effort that will be required to implement the ED as proposed.

We are a relatively small entity, but have over 700 individual lease arrangements. We believe many entities will have much larger lease portfolios than we do. Each of our leases would need to be assessed at initial implementation and monitored/updated at each reporting period going forward. We believe the costs of applying the accounting and disclosures proposed in the ED would greatly outweigh their benefits. It should be noted that the vast majority of the <u>number</u> of our lease arrangements are for vehicles and equipment similar to the non-core assets discussed in paragraph BC39. However, the vast majority of the <u>dollars</u> associated with our leases are from core assets, which are integral to our business, that are covered by four lease arrangements. If a final standard were to contain a more simplified and straight forward approach to some of the concerns such as lease term, contingent rentals, and reassessment as well as the concerns outlined in Question 3 above regarding high-volume low-dollar leases of non-core type assets,

we believe that the benefits would justify the costs. Otherwise, we cannot support the issuance of a final standard in the form proposed in the ED.

As stated above, many of the determinations that need to be made to implement the basic concepts of recording liabilities for future lease payments and offsetting right-of-use assets will involve extensive detailed computations that will be developed using assumptions that will involve extensive subjectivity. The entire process will be very difficult to audit and we believe will likely result in significant increases in audit fees thereby further widening the gap between the costs and benefits.

#### Other comments

#### **Question 18**

Do you have any other comments on the proposals?

The FASB should consider addressing if or how a final standard would impact the accounting for Asset Retirement Obligations or other end of life obligations and whether those are to be included in lease computations and disclosures.

We agree with the concerns and positions of the Edison Electric Institute regarding power purchase agreements and the application of lease accounting to regulated entities raised in their letter dated December 15, 2010.

A final standard should address the treatment between related parties as currently discussed in ASC Topic 840.

Comments regarding specific paragraphs in the ED not addressed in response to the above questions are as follows:

- 19. We believe this paragraph would more clearly set forth the intent of the ED if it was worded similarly to paragraph BC135 with respect to changes in the discount rate. To accomplish this the first sentence would be replaced with the following taken from paragraph BC135 The discount rate used to determine the present value of lease payments should not be revised when there are subsequent reassessments of the expected lease term or contingent rentals, unless the lease payments are contingent on variable reference interest rates.
- 24. This paragraph requires that a determination under Topic 350 be made at each reporting date to determine if there is an impairment loss related to the right-of-use asset. The reference to Topic 350, which is Intangibles seems inconsistent with paragraph 25 that states right-of-use assets should be presented within property, plant, and equipment as if they were tangible assets. In addition, the reference to Topic 350 could lead to a determination that the impairment analysis should be done on a discounted cash flow basis similar to the approach used for goodwill. That approach would result in an impairment and adjustment of the right-of-use asset when the appropriate discount rate exceeds the incremental borrowing rate at initial measurement. We believe a fundamental purpose of the ED is to create a right-to-use asset that is essentially property. Therefore, we believe the reference in this paragraph should be to Topic 360. If a final standard ultimately includes leases relating to intangibles, there would need to be a

differentiation based on the nature of the leased item. Also, the requirement to make an impairment assessment at each reporting date would appear to be inconsistent with the impairment assessments required under both Topics 350 and 360. We recommend the reference to each reporting date be removed and simply state that right-of-use assets should be assessed for impairment in accordance with Topic 360 (and 350 if leases of intangibles are ultimately included).

A1. Consideration should be given to providing definitions for the terms – head lease, intermediate lessor, and term option penalties.

B12. This paragraph requires the lessor to discount lease payments using the rate the lessor charges the lessee. For many entities being a lessor is not an integral part of their revenue generating activities, but they may enter into leases or subleases of assets not currently used in their normal business activities as a means of maximizing earnings. In those cases, the entities do not charge the lessee an interest rate as part of the lease payment. The lease terms, including the monetary amounts of lease payments, are merely negotiated and agreed to by the parties without an interest rate being considered. These types of transactions should be addressed if a final standard is issued. We recommend that the lessor's incremental borrowing rate be used for these transactions.

B17. Although we have raised concerns about the determination of the lease term in our response to Question 8 above, if the proposed determination is retained we have this comment on paragraph B17. We find the example provided in this paragraph to be confusing. Perhaps changing the probabilities so that those listed in (b) and (c) are not the same, such as 45% for (a), 35% for (b), and 20% for (c), would be helpful. The last part of the paragraph could then be reworded to say – There is a 100% chance the term will be 10 years or longer, a 55% chance the term will be 15 years or longer, but only a 20% chance the term will be 20 years. Therefore the longest possible term more likely than not to occur is 55% so the lease term is 15 years.

## 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 do not believe there is any conceptual basis for having different guidance for non-public entities. Furthermore, if there are suggestions for different guidance merely because the proposed concepts are too difficult or time consuming for non-public companies, those suggestions would be equally applicable to public entities.

\* \* \* \* \*

As set forth above, implementation of the accounting and disclosures proposed in the ED will be a very time-consuming process that must be adequately planned and executed. Significant amounts of data must be accumulated and analyzed. Many subjective decisions must be made that will require input from many different levels and departments within the entity. Since a new standard would be applied retrospectively, public companies would need to recalculate the

impacts not only for the three years of income statements required to be presented, but probably for the additional two years presented in the Selected Financial Data section of public company filings. In addition, consultation and coordination with independent auditors will be required. This will be the case even if our recommendations and accommodations outlined herein are reflected in a final standard, although to somewhat of a lesser degree. Accordingly, there needs to be adequate time between the issuance of a final standard and its implementation date to all for an accurate adoption. We believe this period should be least one year and preferably longer. Consideration should be given to delaying the implementation of a final standard for leases, as well as the other major projects currently under consideration, to coincide with the adoption of IFRS. This would allow for financial statements to only be restated once reflecting all of the proposals rather than restating multiple times as each new standard becomes effective. A single restatement would be better understood by and less confusing to users of financial statements.

We believe that there are significant concerns regarding the implementation of the ED as proposed that have been raised by us, as well as many other respondents. Many respondents have different views and recommendations on various issues. Because of the magnitude and complexity of the proposed changes, as well as the significant issues involved, we recommend that a revised exposure draft be circulated for comment before a final standard is issued.

In closing, PNM Resources, Inc. appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update, *Leases*. In light of the concerns expressed above, we do not support the issuance of a final standard in the form proposed in the ED and believe that significant changes to ED should be made in order to make the basic concepts set forth in the ED workable. We urge the FASB to make the necessary changes to facilitate implementing the basic concepts.

Sincerely,

Henry A Ingalls

Director, SEC Reporting and GAAP Analysis

PNM Resources, Inc.