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Technical Director – File Reference No. 1850-100
Financial Accounting Standards Board
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Ladies and Gentlemen:

We thank you for the opportunity to comment on the Exposure Draft (“ED”) “Leases”. We have four main areas of concern (options, short-term leases, income statement presentation and probability weighting) as well as some areas in which we would like additional clarification or flexibility.

1) Inclusion of options to extend leases in the lease term

Paragraph 13 requires that options to extend or terminate a lease be considered when determining the lease term. We believe that options should not be included in the determination of lease term as they do not represent a liability until they are exercised.

FASB Concepts Statement 6 (“CON 6”) defines liabilities as “probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” CON 6 also describes an obligation as “that which one is bound to do by contract, promise, moral responsibility, and so forth.” Finally, CON 6 states:

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it

little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

Although, in many cases, the exercise of an option may be probable, we believe that an option cannot be considered a present duty or obligation as the lessee is not obligated until the option is exercised. A lessee has the discretion to forgo the exercise of the option and avoid the future sacrifice because the event obligating the entity (exercise) has not yet happened. As a result, we believe that including a liability for the option period is inconsistent with the principles of CON 6.

We believe this is very similar to the conclusion previously drawn with regard to planned major maintenance activities. Accounting Standards Codification paragraph 360-10-25-5 indicates that use of the “accrue in advance” method for planned major maintenance activities is prohibited. The FASB Staff Position on this issue indicates that the “accrue in advance” method does not meet the definition of a liability because it causes recognition of a liability in a period prior to the occurrence of the transaction or event obligating the entity. The conclusion on this topic is that when a cost is avoidable, because it is not an obligation, it is not a liability. Maintenance cannot be accrued in advance of an obligation because the owner of the asset can decide to dispose of the asset or allow it to fall into disrepair. This conclusion was reached recognizing that such maintenance costs are often necessary for the entity to continue to run its business – just as it may be necessary for an entity to continue to control a leased asset to run its business. The necessity of the expenditure does not create a liability, however, even if it is probable, if the entity is not obligated.

Although the lessee has unconditional control of the asset when a lease commences, and the commencement of a lease is a past event, the lessee does not control the asset in the option period until the option is exercised. The lessee may have an asset in that it controls the decision about exercising the option, but it does not have an obligation until that decision is made and communicated to the lessor. We are not suggesting that the option should be valued separately from the lease. As was noted in the Discussion Paper and the ED, that type of measurement is extremely difficult and therefore the cost would not justify any benefit provided. Also, we believe separately measuring that option would be reaching for a level of precision that is unnecessary to adequately address recognition of leases in the financial statements.

Instead, we believe that an obligation and asset related to the option period should not be recorded until the option is exercised. This better reflects the legal obligation of the lessee as well as the lessee’s right to use the resource. The Boards concluded that the initial period and the option are all one lease as they are all in the same contract (a single right of use asset and single obligation). Considering them to be separate leases, one that has been executed and one

that has not, however, still results in a single asset and single liability for the use of one resource when the initial lease expires and again when the option is exercised. It also greatly simplifies the accounting and more accurately reflects the economics of the transaction without harming the usefulness of the financial statements. We believe that is the case because it is consistent with the accounting that would occur if:

- 1) the entity decided to enter into a new lease with another lessor for a similar resource rather than exercise the option, or
- 2) the entity decided to borrow cash and purchase a similar resource at the end of the initial lease term.

In both of these cases, the asset and the liability are recorded when the entity has an obligation. Recording the asset and the liability for the option period once the option is exercised would result in the same accounting, and financial statement users therefore would get more consistent information when these similar transactions occur.

This approach is also more consistent with the accounting for other transactions for tangible assets in which the entity does not yet have an obligation.

- 1) Companies have agreements to purchase tangible assets from vendors at fixed prices with no minimum purchases required. Obligations for those purchases are not recorded until those purchases are actually made – until the buyer's option is exercised and there is a legal obligation to pay for a resource that has been received.
- 2) Assets and liabilities are not recorded for firm commitments until the goods are received or the services are performed.
- 3) When an entity pays for an option to purchase an asset, such as a piece of equipment or real estate, the entity would only record the amount paid for the option, and would not record an asset and a liability for the piece of equipment or real estate until the option is exercised.

In all of these cases, no liability is recorded until an obligation exists. We believe lease options should be treated consistently.

We recognize that our approach ignores the value of the option during the initial lease period. As we noted above, however, we feel that capturing that value before it is exercised is a level of precision that is not necessary in order to achieve the Boards' broader goal of recognizing existing legal obligations in the financial statements.

2) Month to month leases and short term leases

In the event that the Boards do not agree with the points above, and decide to retain the requirement that options be considered when determining the lease term, we ask that the Boards clarify the definition of an option to extend or terminate a lease. We believe that month to month

leases that are cancellable by either the lessor or the lessee do not include an option to extend the lease.

We are an engineering and construction (“E&C”) contractor that operates throughout North America. E&C contracts are by their nature non-recurring. A contractor constructs a project in a particular location for a period of time, and then moves on to another project in another location. Sometimes the next location is reasonably near the last location, but normally it is not. As a result, a contractor may not own necessary resources, primarily equipment, at the location of the work.

Further, projects are composed of multiple different processes and operations that occur at different times and require different resources. The result of this is that certain pieces of equipment will be used for a very short time period. They may be needed again later in the project, or they may not.

Lastly, an E&C contract normally requires a wide variety of types of equipment, tools and property. Resource needs range from cranes, earthmoving equipment and office trailers to portable restrooms and traffic cones.

Contractors make cost/benefit decisions to determine whether to own or lease assets based on these factors, and often enter into numerous leases at each project. These leases are typically short-term (less than one year) or are month to month as the related equipment typically is not required for longer terms. If the equipment is needed for longer terms, typically the lease is terminated and a separate transaction occurs to purchase it.

We have thousands of month to month leases for the full range of equipment described above – from large pieces of equipment to portable restrooms and traffic cones. Our month to month leases may be terminated by either the lessor or the lessee with as little as one day’s notice. (These are not termination provisions in the event of default by either party. Lessor and lessee may terminate on as little as one day’s notice even when both parties are in full compliance with all other provisions of the agreement.) We believe these types of leases do not contain an option to extend as the lessee does not have a unilateral or unconditional right to extend the lease. The lessor may recover the resource without lessee consent and the lessee has a contractual right to terminate the lease and avoid paying rentals. Although we believe that the concept of an option includes the notion that the ability to exercise is unilateral and unconditional, the ED does not provide a definition of an option to extend a lease. As a result, if the Boards conclude in the final statement that options must be considered when determining the lease term, we believe the Boards should provide a definition that indicates a lessee’s option must be unilateral and unconditional in order to be included in the lease term.

We understand that the Boards are very concerned about creating a standard that does not provide opportunities for companies to structure transactions to avoid its provisions. We believe, however, that when both the lessor and the lessee have the unilateral right to terminate a lease, such a provision is substantive as both parties have agreed to put themselves at risk for lease termination. As noted above, our month to month leases are for pieces of equipment that can be transported to new locations. When we enter these agreements, the lessor takes the substantive risk that we will send the piece back before he has another customer. Similarly, we take the substantive risk that the lessor will take the piece back to lease it to another customer at a higher rate or for a longer term.

In addition, we continue to believe that short-term and month to month leases should be explicitly excluded from the scope of the proposed standard as the effort necessary to meet the requirements would be extremely burdensome. We recognize that the Boards have felt the benefits to users outweigh the costs to the preparers, however we ask that the Boards once more reconsider this position. Short-term and month to month leases are by their nature much more similar to the payment of utilities or payroll costs than they are to long-term leases which include a much more significant financing aspect. (Certainly, short-term leases are priced considering the lessor's cost of capital, but utilities and even payroll costs implicitly include the cost of capital of the supplier.)

On a construction project, for example, a contractor may hire a crew of craft workers and lease equipment to complete a six month task. At the end of the six months, the equipment is returned and the crew is terminated. Throughout the performance of the task, the contractor's obligation to the crew and the lessor are similar, particularly if the lease is month to month as described above. We believe that these transactions should therefore be accounted for consistently. Maintaining processes to record assets and liabilities for leased pieces of equipment that will be returned to the lessor in such a short time frame does not provide financial statement readers benefits that exceed the cost. This effort would certainly not materially affect the income statement for leases of such short durations. Presumably, the assets and the liability would be considered current (it does not seem appropriate to reflect the asset related to a lease that lasts less than one year as non-current), so working capital would be essentially unaffected. We believe that disclosure of lease expense and future legal obligations for short term leases that extend into future periods provides financial statement users with useful and transparent information that is significantly less burdensome to prepare.

Lastly, in construction, we believe that the short-term lease is far less significant to the lessee than it is to the lessor which is typically a leasing company. The use of the leased asset is only a portion of our costs of doing business, but, for the lessor, the lease is their entire business. The

ED allows lessors, even leasing companies, to recognize short-term lease payments in the income statement over the lease term rather than recognizing an asset and a liability in the statement of financial position. We believe that if the Boards will not exclude short-term and month to month leases from the scope of the standard, then the Boards should allow this treatment to be symmetrical so that the lessee may have the same treatment as the leasing company and recognize the lease payments in the income statement over the lease term rather than recognizing an asset and a liability in the statement of financial position.

3) Presentation of lease payments in the income statement

The Federal Acquisition Regulations (“FAR”) refer to current US GAAP with regard to leases. Under the FAR, the interest component of a capital lease is not an allowable cost. The provisions of the ED will effectively make all leases capital leases, and will result in an interest charge for all leases other than those that are short term. This accounting change will likely have an enormous financial impact on federal contractors even though there has been no change in the economics of the leases themselves. As a result, we ask that the Boards consider allowing lessees to report the amortization of the right-of-use asset and the interest expense as a single rent expense in the income statement. Also, we ask that the Boards consider allowing lessees to amortize the right-of-use asset using the same pattern used for amortizing the liability. The interest component of the lease payments could be disclosed in the notes to the financial statements. Allowing this type of presentation achieves the objectives of presenting lease obligations on the statement of position and reporting the related interest expense without affecting federal contractors’ ability to bill for lease costs. We also ask that the Boards discuss the potential impact of the proposed standard with the FAR Council before the standard is finalized so that any financial impact to federal contractors may be minimized. Mr. Daniel Gordon is the Administrator of Federal Procurement Policy and is the Chair of the FAR Council.

4) Probability weighting

The ED requires the use of probability weighting when determining lease term and the present value of lease payments in paragraphs 13 and 14. We do not understand how probability percentages would be determined, or how they would be supported in audit. We therefore ask that the Boards reconsider this requirement. Although there likely are cases in which entities perform probability analyses when assessing their leases, we believe that the vast majority of assessments are based on the current concept of best estimate. Best estimate incorporates the consideration of factors, like those listed in paragraph B18, in a qualitative assessment of outcome. Adding probability weighting would appear to change the nature of this assessment from qualitative to quantitative. We believe, however, that will not be the case because the probability weightings will be qualitatively determined. They will therefore be no more easily

substantiated than the current best estimate approach. In fact, when you consider the entire population of financial statement preparers, we believe that most will assess their leases using best estimate, and then back into the probability weighting necessary to arrive at the same answer. Consequently, we believe the Boards should not require probability weighting. Instead, we believe the principle of determining lease term and the present value of lease payments can be met by allowing flexibility in determining the best estimate (considering factors like those listed in paragraph B18), and probability-weighting should be an acceptable, but not required, method.

5) Reassessment of the liability

Paragraph 17 requires that, after the commencement of the lease, the lessee reassess the carrying amount of the lease liability if facts or circumstances indicate there would be a significant change in the liability since the previous reporting period. We believe the intent of this language was to limit the burden of periodic reassessment across hundreds or thousands of leases each period. “Significant change” is not described, however. We are concerned that without a description, preparers may be required to create processes and controls that are in excess of the Boards’ intentions. Preparers, for example, could be required to document and quantify all changes each period for each lease in order to demonstrate they are not significant in the aggregate. We therefore ask that the Boards provide clarification of the meaning of significant change, and that the final standard allow the reassessment to be a qualitative assessment rather than a documented quantitative assessment. For example, preparers could qualitatively assess the following factors indicating a significant change:

- A change in a previous management decision regarding the exercise of an option to extend a lease.
- A significant forecast change (cumulative since lease commencement) in a factor used in determining contingent rentals that would lead to a significant change in the amount of the contingent rental.
- A significant change in the guaranteed residual value.

If none of these factors are present, then no significant changes would be deemed to have occurred.

6) Scope of the standard

Paragraph 5a indicates that intangible assets are excluded from the scope of the ED. We believe that software is considered an intangible, and therefore software licenses would be excluded; however we are unsure. We ask that the Boards clarify that software is excluded from the scope.

7) Incremental borrowing rate

The ED provides a definition of incremental borrowing rate, but does not provide guidance on how to determine the rate. We ask that the Boards provide guidance for determining the rate. For example, guidance regarding whether the rate is determined with or without consideration of existing lease obligations, how entities with little or no borrowings should determine the rate, and how subsidiaries should determine the rate would be helpful so that a clear rate determination process can be developed and consistently applied. This guidance would improve comparability between companies.

8) Leases with service components

Paragraph 6 requires that a lessee shall apply the ED on revenue from contracts with customers to a service component of a lease if the service component is distinct and the lessee is able to do so. We believe that asking lessees to allocate amounts paid under a lease to separate obligations based on standalone selling prices is asking them to do something that is beyond their typical capacities and knowledge. We believe that most lessees will find it extremely difficult to determine standalone selling prices. Lessees typically purchase based on combined price, and may not enter into large numbers of similar leases. As a result, they likely will not have data on standalone prices. We therefore believe that lessees should be allowed the option to allocate price based on the terms of the lease agreement. Although this would allow for opportunities to structure the amounts considered the lease and the monthly service costs, we believe this is a practical expedient for lessees. Similarly, such an expedient should be allowed for lessors who are not significantly in the business of leasing. For example, a company that is a lessor simply because it is subleasing excess office space is not in the practical position to determine standalone selling prices even if the lease is material.

Summary:

In summary, we ask that the Boards:

1. Exclude unexercised option periods when determining lease term as we believe that an unexercised option is not an obligation and therefore not a liability.
2. Clarify (in the event that the final standard retains the requirement that options be considered when determining the lease term) that an option to extend a lease must be unilateral and unconditional in order to be included in the lease term.
3. Either exclude short-term and month to month leases from the scope of the final standard, or allow lessees to recognize the payments in the income statement over the lease term as is proposed for lessors (including lessors that are leasing companies).
4. Consider the potential impact of this standard upon federal contractors by:

- a. Allowing lessees to report the amortization of the right-of-use asset and interest expense as a single rent expense in the income statement,
 - b. Allowing lessees to amortize the right-of-use asset using the same pattern used for amortizing the liability, and
 - c. Discussing the potential impact of the proposed standard with the FAR Council before the standard is finalized.
5. Allow flexibility in determining the best estimate rather than prescribing the use of a probability weighted method.
 6. Clarify the meaning of significant change when reassessing lease liabilities, and specifically allow for a qualitative approach to this reassessment based on certain factors.
 7. Clarify that software is excluded from the scope of the standard.
 8. Provide guidance for determining incremental borrowing rate.
 9. Allow all lessees, as well as lessors who are not significantly in the business of leasing, the option to allocate price to the lease and service components of an agreement based on the terms of the lease agreement as a practical expedient.

Thank you for your consideration of our views. If you should wish to discuss them further, please don't hesitate to contact us.

Very truly yours,

Peter Kiewit Sons', Inc.

/s/ Michael J. Piechoski
Michael J. Piechoski
Chief Financial Officer

/s/ Michael Whetstine
Michael Whetstine
Controller