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December 14, 2010

Invitation to Comment – Exposure Draft Proposed Accounting Standards Update-Leases

Dear Board Members and Staff:

I appreciate the opportunity to comment on all matters in the Proposed Accounting Standards Update-Leases. I am a leasing professional with over 28 years experience in financial reporting and lease accounting analysis. I have a strong background in lease accounting software applications and specialize in structuring application data to meet lessor reporting needs. Additionally I am both an investor and user of the financial statements of entities that will be greatly affected by these proposals both as lessee and lessor.

My responses to the questions as requested in the Exposure Draft-Leases can be found below. I urge you to give thoughtful consideration to these and all of the responses you receive. I am aware of the timeline for this and other projects the boards are addressing. While there is a clear need for change to better serve the needs of users of financial statements, the final standard needs to do a better job at addressing the complexity and comparability of lease transactions.

Regards,

Barbara J Simmonds

Responses to Exposure Draft questions – Barbara J. Simmonds
The accounting model
The exposure draft proposes a new accounting model for leases in which:

(a) a lessee would recognize an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortize the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.

(b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease, depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23−BC27).

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?

RESPONSE
I agree that a lessee should recognize a right to use asset and liability.

(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?

NO RESPONSE

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?

RESPONSE
I find the guidance to determine which approach a lessor should choose when booking a lease to be unclear and too subjective. Deciding whether a lessor "retains significant risks or benefits" by considering whether terms are considered "material", "significant" and even "non-distinct" leaves a wide door for interpretation.

Comparability of financial statements is likely to be muddied without clear guidance. The boards' desire to eliminate the bright-line distinction between capital leases and operating leases would instead create a vague allocation between two new approaches that will produce different results for similar transactions.

Alternatively I believe that understanding and clarity of financial statements are better served by requiring one method of reporting leases for lessor. Of the two options presented, the derecognition approach is preferred over the performance obligation approach. The latter does not reflect the economics of the contract as it requires recording both the full cost of the leased asset and the lease receivable. The derecognition approach comes closer to reflecting the transaction as viewed by a lessor with the exception of the treatment of the residual asset. The residual is viewed as part of the investment and should be accreted to fair value over its term.

The derecognition approach should allow lessors to recognize revenue upfront to the extent that control is transferred to the lessee consistent with the proposal for revenue recognition.

Note that my preference overall is to retain current accounting requirements for lessors. Most issues with lease accounting are addressed in the lessee provisions and others by

disclosures. If retaining current standards for lessors is not an option then the derecognition approach serves as the next best model for reasons outlined above.

(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?

RESPONSE
With respect to the derecognition approach, I agree with the proposals with one exception; the residual asset should be included with the lease receivables, not PP&E. Issues with the measurement of the recognized assets and liabilities are presented below.

The Performance Obligation approach is not considered an acceptable method for reporting lease transactions.

(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?

NO RESPONSE

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?

RESPONSE
The complexities that create a need for the short term lease exception arise from the proposals for measuring "probable" lease term and contingent rentals. If these were eliminated, and lessors had one reporting model, there would be no reason to have an exception for short term leases.

As currently written there is not enough information to know how the short term leases are to be classified in the income statement for lessees. The ED also does not address the issue of accruing or straight-lining rents that are not structured as even, monthly payments.

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?

RESPONSE

If the derecognition approach allows lessors to recognize revenue upfront to the extent that control is transferred to the lessee then there is no need to exclude purchase or sale contracts from the scope of the ED. The lease by lease election wording sets up another situation where similar leases will be treated differently both between companies and within the statements of an individual company.

Distinguishing lease versus service components is addressed in question 6 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?

RESPONSE

I believe that the model should the address the conceptual reason for the exclusion of intangibles. Additionally there is inconsistency in the accounting for software licenses when is leased individually or combined with the lease of hardware. Clearer guidance is needed in this area.

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?

RESPONSE
The different treatments afforded distinct and non-distinct services impairs the usefulness of the accounting approaches proposed. When designated non-distinct, the result is either a leased asset or residual asset in the statement of financial position that contains a service component.

In paragraph 6, a distinction could be made to applying the guidance between a lessor/service-provider and a third-party lessor which is providing lease financing to a lessee, but not the services. Many third-party lessors enter into contracts with customers where the contractual payment includes the lease of hardware and financing of soft costs, such as software licenses and upfront sales tax, as well as services such as maintenance or engineering costs. The services are not performed by the third-party lessor, but are paid directly to the service-vendor and financed in the lease payment.

If the concept of a leased asset included all of these costs, upon lease commencement the third party lessor would derecognize from the statement of financial position the portion of the carrying amount of the underlying asset that represents the lessee's right to use the underlying asset during the term of the lease. This would include all of the soft costs, all of the services and only the portion of the hard costs attributable to the lease term. The remaining residual asset on the lessor's books is the same as currently defined in the ED. This approach avoids the complex bifurcation of one contract with the lessee into components that are not viewed as distinct transactions by the lessor or users of the financial statements.

The final guidance should include examples of how to account for leases with distinct and non-distinct service components combined with both tangible and intangible assets for each accounting approach required.

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?

RESPONSE
I agree both that a lessee or a lessor should account for purchase options only when they are contractually exercised and the contract should be considered terminated when an option to purchase the underlying asset is exercised

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?

RESPONSE

I strongly disagree with the definition of lease term as the longest possible term that is more likely than not to occur. The probability of occurrence requirement creates significant complexity and requires subjective estimates which do not provide practical information for users of the financial statements in our estimation.

How would an entity determine the longest possible term that is more likely than not to occur for leases that have an option to extend on a month to month basis as well as set term options? Add on that the lessee may return partial assets each month after maturity with the rent reduced accordingly. Any lease assets and liabilities based on both estimated term and lease payments would bear little semblance to reality and be of limited use to users.

The lease term should include only the term covered by contractually required payments.

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?

RESPONSE

I disagree with the inclusion of contingent rentals in the measurement of assets and liabilities arising from a lease using an expected outcome technique. Adding the expected outcome measurement for contingent rental assumptions to the requirement for weighted probabilities for the lease term seems to guarantee that the booked assets and liabilities will rarely if ever match reality. Additionally the subsequent accounting for changes in estimates will be complex and may create unnecessary volatility in earnings.

Contingent rentals should be included in the lease asset and liability only when than event requiring them to be due has transpired or when based on a measurable index.

Residual value guarantees specified in the lease should be included in the measurement of assets and liabilities arising from a lease.

Lease payments should include only the amounts contractually required. There is too much estimation included in the expected outcome technique to provide reliable and useful information to users of the financial statements.

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?

RESPONSE
It is difficult to imagine that one could consider that the measurements of contingent rentals, expected payments under term option penalties, and residual value guarantees are ever really "reliably measured" as they are by definitions estimates. If this wording was clarified then I believe that the term option penalties would be included in the lease receivable based on the determination of the lease term.

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?

RESPONSE
As currently written the ED imposes a significant and ongoing burden on both lessees and lessors to capture and reliably document information that could lead to changes in estimating term and lease payments. The remeasurement of the estimate of lease term will lead to volatility in earnings. Additionally, the requirement for remeasurement when there is evidence of "significant change" leaves too much room for interpretation as it does not include any guidance on how "significant" is to be interpreted. These requirements seem to be contrary to the stated goal of reducing the complexity of lease accounting.

As indicated in questions 8 and 9 I strongly disagree with including anything other than the term and payments that are contractually required in the lease receivable and liability. Eliminating the term options and contingent rentals from the determination of lease term and payments removes the complications from reassessments by limiting them to contractual changes.

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?
NO RESPONE

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?

RESPONSE
I agree with the lessee presentation requirements in the statement of financial position.

(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, totaling 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?

RESPONSE
I disagree with the performance obligation approach as a whole. If required however, a net lease asset or liability is preferable with notes disclosing the components. It is also not clear whether the lease asset and liabilities from the two approaches are to be combined or reported separately.

(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?

RESPONSE
I disagree with the inclusion of residual assets in PP&E. A lessor views the residual as part of the lease investment and as such it should be accreted to maturity.

(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?

NO RESPONSE

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?

RESPONSE
I agree with the income statement presentation outlined in the ED for lessees and the Derecognition approach presented for lessors. The performance obligation approach should not be considered.

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?

RESPONSE
I agree with the cash flow presentation requirements

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?

RESPONSE

The disclosure requirements are quite extensive. However they will be both manageable and useful with by eliminating:

1. The inclusion of the lease term options and contingent rentals in the current definition of lease assets and liabilities.

   The maturity analysis required by paragraphs 85-86 for distinguishing amounts required by the minimum lease payments versus the amounts represented in the lease assets and liabilities imposes a significant burden on reporting systems and personnel of both lessees and lessors.

   If these terms are required in the footnotes, additional guidance is needed to indicate how the terms can be summarized for an entire portfolio since descriptions of specific renewal and term options and contingent rental requirements by lease are certainly not expected.

2. The performance obligation approach.

   By limiting lessor accounting to the derecognition approach, disclosure of the complex issues surrounding the decision of which method to apply is eliminated (paragraph 78).

3. The disclosures required for leases not commence (paragraph 73(b)).

   Until a lease commences a user of the financial statements should not rely on any future rights and obligations conveyed.

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?

RESPONSE

Full retrospective application would be an excessive requirement for most entities and allowing it as an option would only contribute to decreased comparability across companies.

One option to consider is to use the simplified retrospective approach only for current lessee and lessor operating leases and allow existing direct finance leases to remain in place.

At the date of initial application, the lessor uses the rate charged at inception of lease to discount the remaining lease payments (94(a)). There may have been changes in the rate after inception due to lost or stolen assets, partial buy-outs etc. Shouldn't the rate in effect at application be used?

Under the Derecognition Approach, the residual asset is recognized by the lessor at fair value as of the date of initial application. For many assets this may require an outside appraisal and add significant time and cost to the approach.

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?

RESPONSE

As currently written the costs will far outweigh the benefits. It imposes a significant onus on entities to gather information at inception regarding lease term options and rental amount that are not contractually required as well as determine a methodology for assigning estimates of probabilities and specific outcomes. Furthermore this information and methodology would need to be updated and potentially revised at every reporting period.

The greatest benefit provided is the requirement for lessees to capitalize their right to use assets and liabilities.

Other comments

Question 18

Do you have any other comments on the proposals?

RESPONSE

I would ask the board to address any possible changes to the transfer and servicing of financial assets based on the changes made to lease accounting. More guidance is needed on how contract modifications should be analyzed for accounting treatment under each approach. Additional examples are needed for the more complex areas including distinct and non-distinct services, service costs included in a lease as well as lease modifications.

I would ask the boards to consider the effort involved in the application and transition to requirements of this scope. For lessee or lessors' that have hundreds or thousands of leases in their portfolios, the potential new information needs are massive. Many have staffs that are already trimmed by recent economic conditions. Additionally most companies with large portfolios use applications that may need significant modification by outside vendors. I believe that this is a serious consideration when considering the scope, cost and the effective date imposed by the final 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?

NO RESPONSE