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**Re: August 17, 2010 Exposure Draft of a Proposed Accounting Standards Update (ASU),
Leases (Topic 840) [File Reference No. 1850-100]**

Dear Ms. Cospers:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC appreciated the opportunity to discuss its views on the ED with selected Board members and staff at the November 11, 2010 FASB/TIC Liaison Meeting and is now providing the following written comments for your consideration. These comments were deliberated prior to the Board's recent conclusions on this ED. TIC looks forward to providing the Board with additional feedback at a future date.

GENERAL COMMENTS

TIC generally supports the notion that a lessee's commitment to a long-term lease meets the definition of a liability and should be recognized as such in the lessee's balance sheet. However, the ED includes many pervasive changes in the accounting for both lessees and lessors that will be very costly for a number of private entities on an ongoing basis. Such entities often do not have staff with expertise to implement this standard and in many cases do not have the resources to hire additional internal or external personnel to comply with the additional time commitment this standard will require.

In particular, TIC objects to the probability-weighted approach, which would be a very costly approach for determining the lease term and the present value of lease payments receivable/payable.

TIC also believes revisions are necessary to fix a major omission in the ED. Guidance should be added for related party leases, including a clear linkage between this guidance and the requirements of the former FIN 46R, *Consolidation of Variable Interest Entities*. TIC also recommends additional implementation guidance for lessors.

TIC recommends that additional implementation guidance be provided for the proposed accounting model for lessors. Not enough information was provided about the respective accounting methods for lessors, which prevented TIC from reaching a definitive preference for one of the two approaches.

TIC encourages the Board to keep ongoing implementation costs to a minimum as it reconsiders the provisions of the ED. TIC's remaining comments address the specific questions raised by the Board in the ED and include suggestions for practical expedients to mitigate the cost burden of the new model, especially for those entities that can least afford it.

SPECIFIC COMMENTS

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?

TIC agrees that a lessee should recognize a right-of-use asset and a 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?

TIC agrees that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments. However, most TIC members disagree that the interest method is the appropriate amortization method for the interest on the liability. The interest method effectively recognizes more expense in the early years of the lease, which differs from the expense recognition method under today's operating leases. The straight-line method could also serve as a practical expedient that would mitigate the added complexity of the new model. As a practical matter, if the effective interest rate method is eliminated, there would be no change in current expense recognition for a simple lease.

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?

TIC agrees that a lessor should apply the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset. This is the best reflection of the economic substance of the transaction. The lessor retains ownership of the asset, so the asset should be reflected on the lessor's statement of financial position.

TIC members were split on the issue of the derecognition v. partial recognition approaches. Please see TIC's response to Question 2(b) below for details.

TIC also requests that the implementation guidance in paragraphs B22 through B27 be expanded and deepened. TIC is concerned that the different approaches will not be applied consistently without such guidance.

(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?

Most TIC members agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation approach to lessor accounting.

The majority of TIC members favor the full derecognition approach rather than the partial derecognition approach. They oppose the partial derecognition approach, because, in their view, the estimation of the residual value of the underlying asset will be at best difficult and at worst extremely subjective and prone to manipulation. If the lessor has truly transferred significant risks and benefits of the underlying asset to the lessee, the majority view is that full derecognition is the most appropriate accounting. If risks and benefits are not truly transferred, they believe the lease should be accounted for under the performance obligation approach. In their view, the partial derecognition approach introduces greater complexity without providing commensurate benefits to financial statement users. It also seems inconsistent with the revenue recognition proposal.

The minority view agrees with the partial derecognition approach proposed in the ED. They believe estimation of residual values will not be problematic since estimating residual values is already necessary under current standards. In fact, some equipment lessors have developed a highly refined, intensive process for developing fairly reliable residual value estimates. The minority view believes that estimating residual values under the new model will not be a substantial change from the standards that lessors are already applying. They oppose the full derecognition approach because it doesn't take into consideration the possibility that the leased asset, which still has value, may come back to the lessor at the end of the lease term. Therefore, they believe the partial derecognition method is less complex than trying to account for the return of the asset at the end of the lease term.

(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 that there should be no separate approach for lessors with leveraged leases.

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?

TIC agrees with the proposed lessor accounting above but does not support the proposed lessee accounting. TIC believes financial statement users will not find the proposed lessee accounting useful for their needs. For example, TIC believes it unlikely that users will be interested in either a short-term right-to-use asset or information on short-term lease obligations.

TIC therefore recommends that short-term leases be accounted for in the same manner as today's operating leases. This would be an important cost-saving expedient for many lessees. Also, if lessors can opt not to recognize either a receivable or an obligation, TIC believes the lessees should have the same option.

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?*

TIC agrees that a lease is defined appropriately. The definition as presented effectively summarizes the economic substance of the transaction.

(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?

TIC questions the need for separate purchase/sale accounting for the “leased” assets that meet the criteria in paragraphs B9 and B10. The proposed criteria would add unnecessary complexity to the standard and potentially could prompt the need for future guidance if, for example, the lessee does not exercise the bargain purchase option or if certain events occur during the lease term that cause the lessor to exercise its rights or to incur obligations based on its legal title of the leased asset. The majority of TIC members believe the derecognition approach would seem to be a better alternative for a lessor since it avoids recognizing an up-front gain on a “sale” that has not legally occurred and takes into account the uncertainty inherent in such arrangements. In addition, the derecognition approach is not that dissimilar to traditional purchase/sale accounting.

(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?

TIC believes the distinction is clear. However, implementation guidance should be expanded so that the accounting differences between the two types of contracts are clear.

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?

We agree with the proposed scope.

Question 6: Contracts that contain service components and lease components

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

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

(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?

TIC agrees with the FASB's approach to contracts that contain service and lease components. If the service component is distinct, it should be accounted for separately, as that represents the economic substance of the transaction. The fact that the service component is distinct and identifiable indicates that it is economically a separate transaction. If the service is not distinct and identifiable, TIC believes it is appropriate to account for the service as part of the lease.

TIC requests specific guidance as to the accounting for executory costs (such as insurance, maintenance and taxes). Under existing standards, executory costs are expensed as incurred by lessees and not included in minimum lease payments for capital leases. We believe current practice on these charges reflect the economic substance of the transactions. If the Board chooses to not exempt these items, TIC requests additional implementation guidance on how to appropriately account for them.

For example, many real estate leases contain a clause wherein the lessee pays so much a month against actual insurance, taxes and maintenance; and then, at the end of the year, the actual expenses are allocated to all tenants and the amount paid is adjusted up or down, accordingly. In TIC's view, the insurance, taxes and maintenance cost in this type of lease agreement would seem to be clearly distinct (i.e., reasonably identifiable at the inception of the lease). TIC therefore assumes that if such costs are distinct, as defined, then the accounting would mirror today's practice.

However, maintenance costs that are included in an auto lease may not qualify as distinct from the lessee's perspective. The lessee would not have the information to determine how much of the lease payment should be allocated to the rent v. the periodic maintenance of the vehicle. Under this scenario, clarification is needed as to whether the maintenance cost would lose its executory characteristic and be accounted for as a component of the lease payments.

TIC requests that the final standard discuss the proper accounting for insurance, maintenance and taxes, and include examples, to explain when such costs would meet the definition of distinct and the related accounting considerations when they do not. TIC believes this issue will be common to many leases and needs clarification. Referencing the guidance in the Revenue Recognition ED is not sufficient to ensure consistent application of the stated principles.

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?

Generally, TIC agrees that the exercise price under a purchase option is not a lease payment and therefore would be excluded from the measurement of assets and liabilities arising from a lease. However, TIC believes that a purchase option is a factor in assessing the longest possible lease term that is more likely than not to occur. Paragraph B16 of the ED states that all explicit and implicit options included in the contract are considered when assessing the lease term. If the exercise of a purchase option effectively terminates a lease, then the probability of that option being exercised should factor into the estimated length of the lease term. To conclude otherwise seems inconsistent with the concept of utilizing the more-likely-than-not term of the lease and also with the concept of utilizing management's estimate of contingent rentals, residual value guarantees and option penalties. TIC therefore recommends that the Board resolve this apparent inconsistency and provide an explanation of its conclusions in the Basis for Conclusions in the final standard.

Measurement

This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

(a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

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

(c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

TIC does not agree with the proposed definition of the lease term or the proposed probability-weighted approach for estimating the lease term. Defining the lease term as “the longest possible term that is more likely than not to occur” would require arbitrary judgments and would not improve the existing definition. Alternatively, TIC believes the lease term should be defined as management’s best estimate of the expected period of the lease, taking into account all explicit and implicit options. Based on this definition, a probability-weighted approach would not be necessary.

The probability-weighted approach adds complexity without added benefit. For an entity with many lease agreements, a tremendous amount of data would have to be obtained to fulfill the requirement in the ED to consider “all explicit and implicit options.” An inordinate amount of time would be expended to perform the necessary probability-weighted calculations. Furthermore, these calculations would be more difficult to audit than management’s best estimate.

In our client base, TIC believes that generally management’s intent can be readily determined at the time of the lease inception and is the best method to determine the term of the lease. Of course, if management’s expectations subsequently change, the length of the lease term and the measurement of the right-to-use asset and the related liability would need to be reassessed.

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?

TIC agrees that these payments should be included in the measurement of assets and liabilities but only if they can be reliably measured. We do not believe the standard for determining inclusion of these amounts should be different for lessees and lessors. As indicated in paragraph B20 of the ED, lessors and lessees may reach different conclusions about the most likely outcome for a given lease concerning lease payments that are contingent on future events. TIC believes this is an indication that a reliable measurement cannot be obtained.

TIC believes the AICPA Guide, *Prospective Financial Information*, provides guidelines for preparers and practitioners as to the reliability of forward-looking measurements:

When evaluating the period to be covered by a financial forecast, the responsible party should balance the information needs of users with its ability to estimate prospective results; however, a reasonably objective basis should exist for each forecasted period (month, quarter, year) presented. [Source: paragraph 8.32]

However, the degree of uncertainty generally increases with the time span of the forecast and, at some point, the underlying assumptions may become so subjective that a reasonably objective basis may not exist to present a financial forecast. It ordinarily would

be difficult to establish that a reasonably objective basis exists for a financial forecast extending beyond three to five years^{fn 16} and, depending on the circumstances, a shorter period may be appropriate (for example, for certain start-up or high tech companies, it may be difficult to support an assertion that a reasonably objective basis exists to present a financial forecast and, if so, for more than one year). [Source: paragraph 8.33]

Fn¹⁶: Financial forecasts for longer periods may be appropriate, for example, when long-term leases or other contracts exist that specify the timing and amount of revenues, and costs can be controlled within reasonable limits.

To the extent that a lease agreement does not specify the timing and amount of revenue and thereby requires subjective judgments about contingent or expected payments, TIC believes the ability of management to develop a reasonably objective basis for a forecast of future lease payments is nonexistent. For example, TIC believes it would be almost impossible to predict the sales override rents over a 15-year period of time for a strip mall lease. The quality and relevance of the estimate would be minimal.

Reassessing uncertain outcomes at each balance sheet date, when significant uncertainty regarding the actual outcome remains, adds complexity without commensurate benefit. If the payments cannot be reliably measured, TIC believes they only should impact the assets and liabilities at a future period of reassessment when they can be reliably measured (i.e., using the criteria from the FASB *Accounting Standards Codification*TM (ASC) Topic 450 (Contingencies).

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?

As discussed above, TIC agrees that lessors should only include contingent rentals and expected payments as an element of the lease payment if they can be reliably measured. The financial reporting model does not benefit from the inclusion of numbers that cannot 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?

TIC agrees that remeasurements should occur when changes in facts or circumstances indicate that there is a significant (material) change in the liability to make lease payments or in the right to receive lease payments compared to the previous reporting period. TIC believes material changes in assets or liabilities will impact the decisions of the users of the financial statements. TIC also believes the following statement from paragraph BC133 in the

Basis for Conclusions appears critical to an understanding of the Boards' intent and should be elevated to the final ASU:

[A] detailed examination of every lease is not required unless there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability.

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?

TIC agrees with the criteria for the classification of a sale and leaseback transaction. If the initial transaction meets the definition of a sale, it would not be logical to treat the leaseback as anything other than a lease.

Presentation

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

Question 12: Statement of financial position

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

We agree that a lessee should present liabilities to make lease payments separately from other financial liabilities. Lease payments are different in nature from other liabilities, and they should be presented separately.

TIC believes lessees should present right-of-use assets in a manner that allows users to easily distinguish leased assets from owned assets. This objective could be accomplished in a number of ways. However, most TIC members believe the presentation requirement from the current leases standard, which permits disclosure in either the lessee's financial statements or footnotes, should be carried forward to the new standard:

The gross amount of assets recorded under capital leases as of the date of each balance sheet presented by major classes according to nature or function. This information may be combined with the comparable information for owned assets.
[Source: ASC, paragraph 840-30-50-1(a)]

However, others believe right-of-use assets should be presented in other assets or in a section immediately after property, plant and equipment. TIC is uncertain whether financial statement users will have a preference regarding the classification and disclosure of right-to-use assets.

(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?

TIC does not agree that the lessor applying the performance obligation approach should include the underlying assets with the rights to receive lease payments and the lease liabilities. TIC believes the underlying assets should be presented separately from the rights to receive lease payments and lease liabilities. They represent tangible assets that the lessor has ownership of and the rights to future risks and benefits of these assets. Thus, TIC believes they merit separate presentation. TIC agrees that the rights to receive lease payments and the lease liabilities should be presented gross totaling to a net lease asset or liability. However, TIC believes the final standard should include an option to allow disclosure of the gross information in the notes.

(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?

TIC agrees that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets. The majority of TIC members do not support the presentation of the residual asset (i.e., partial derecognition). However, if partial recognition is adopted, most TIC members believe lessors should present residual assets separately within property, plant and equipment. TIC also recommends that any debt related to the underlying assets be presented separately from other financial liabilities. However, TIC believes the final standard should include an option to allow disclosure of the gross information in the notes.

(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?

TIC members agree that a lessor should distinguish assets and liabilities that arise under a sublease in the statement of financial position. To do otherwise would be inconsistent with

the underlying intent of the entire lease standard revision. However, TIC believes the final standard should include an option to allow disclosure of the gross information in the notes.

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?

TIC believes the income statement presentation of specific items of expense, such as lease expense, should not be dictated by standard. However, the presentation should be consistently applied across similar income and expense. The presentation of expenses, such as lease expense (currently an overhead item in most presentations), would be best left to the judgment of the preparer of the financial statements. TIC believes this view is consistent with a principles-based reporting system. TIC recommends disclosure in the notes instead.

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?

TIC members were split on this issue. If the Board continues to allow the indirect method of cash flow reporting, some members do not believe it is necessary to require separate presentation of the cash flows arising from leases. If the Board decides to require the direct method of cash flow reporting, those members believe the exact breakdown of line items in the cash flow statement should be left to the preparer's determination, as discussed in Question 13 above regarding the income statement. These members believe it would be appropriate to require disclosure in the notes instead.

Other TIC members believe that cash flows from leasing activities should always be disclosed separately from other cash flows, although opinions differed as to whether such disclosure should be presented on the face of the statement or could be presented optionally in the notes.

In addition, TIC believes the final leases standard should explain when a lease transaction is a financing or an investing transaction (or has components of both) and when it represents an operating activity within the statement of cash flows.

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?

TIC believes it is appropriate to disclose a relevant amount of quantitative and qualitative information regarding leases. TIC believes the extent of the disclosures mandated by this standard is somewhat excessive. TIC believes the level of detail proposed for the disclosures departs from the spirit of a principles-based system of financial accounting and appears to veer into a rules-based system. TIC recommends the disclosures be modified to reflect more of a principles-based approach and less of a checklist of disclosures. An example of a disclosure that could be eliminated for private companies is the reconciliation of opening and closing balances of right-to-use assets and liabilities to make lease payments (especially reconciliations that are disaggregated by class of underlying asset).

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?

TIC believes this is appropriate.

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

TIC believes an option to apply full retrospective application of the leasing requirements will be necessary. The FASB/IASB ED, *Revenue from Contracts with Customers*, proposes to require full retrospective application. If there is a transaction that contains a lease and service element, it would add too much complexity to adopt full retrospective application for the service component and only partial retrospective application for the leasing component.

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

Lessee's Incremental Borrowing Rate—TIC believes the final standard should include guidance on how to determine the lessee's incremental borrowing rate. Although paragraph 12(a) allows the lessee to use the rate that the lessor charges the lessee, the lessor's rate is equally difficult to determine and to independently substantiate in an audit engagement.

Sale and Leaseback Transactions—ASC Topic 840, *Leases*, requires the seller-lessee to defer any profit realized from the sale of the property subject to the sale and leaseback under certain circumstances. It is unclear how any remaining deferred profit related to

pre-existing sale and leaseback transactions would be accounted for at transition. For example, it is not clear whether the deferred profit should be recognized in the income statement at transition, whether it should continue to be deferred, or whether it should be recognized as an adjustment to retained earnings consistent with impairment.

Please see TIC's response to Question 19 for transitional issues for private entities that should be considered by the Board.

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?

TIC does not believe the benefits will outweigh the costs for our constituency. The users of private entity financial statements tend to have direct access to management and ownership. This mitigates the need for much of this information. Lenders have adapted their loan models to accommodate current accounting principles. TIC believes the benefits realized by the users of private entity financial statements will be minimal.

Other comments

Question 18

Do you have any other comments on the proposals?

TIC believes a major omission in this ED is the lack of guidance on related party leases. Extant guidance has not been carried over to the ED, and no guidance replaces it. Related party leases are very common among private entities. Without appropriate guidance, including application criteria to evaluate economic substance as referred to in ASC paragraph 840-10-25-26 (Classification of a Lease Between Related Parties), TIC is concerned that diversity in practice will continue to be widespread; especially since there is no guidance to link this proposed ASU to the standard on consolidation of variable interest entities. Structuring of lease transactions may also occur such that related party leases may be written as 364-day leases (with no renewal options) to avoid the capitalization rules. The key issue is whether a different filter is needed for related party leases. For example, is disclosure of the related party lease sufficient when no variable interest entities are involved?

Leases involving commercial real estate, such as office space, often include incentive payments paid by the lessor to induce a lessee to lease space. Incentive payments may include items such as up-front cash payments to the lessee to sign the lease, incentives to pay for tenant improvements, or payments to reimburse the lessee for specific costs such as moving costs or abandoned leasehold improvements. Incentives may also include a lessor assuming a lessee's pre-existing lease with a third party. The accounting for these incentives is not addressed in the ED. Guidance will be needed for lease incentives under the new model and should be added to the final standard to ensure future implementation issues do not arise.

Similarly, build-to-suit lease arrangements are common in the real estate industry. Specifically, it is not clear how construction period lease payments or rental expense incurred during the construction period should be accounted for. TIC suggests that the Boards consider incorporating the concepts currently contained in ASC paragraph 840-20-25-8 into the final leasing standard.

For lease modifications, clarification is needed as to whether:

- the prohibition in paragraph 29 against changing the lessor accounting approach after the date of inception of the lease applies even if a lease has been modified substantially, or
- there are any situations where a substantial modification should be considered a new lease that may warrant a change in the lessor accounting approach.

TIC is also concerned with the numerous differences between the FASB's and the IASB's exposure drafts. Given the significance of some of the open issues, TIC questions whether substantial convergence is possible in this area.

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?

As discussed above in Question 18, additional guidance, including application criteria, on related party leases is particularly important for private entities.

In addition, a differential effective date will be needed for financial statement users, practitioners and preparers in the private sector to provide sufficient time for awareness, education and implementation of the new standard. TIC's specific recommendations are included in a separate comment letter on the FASB Discussion Paper, *Effective Dates and Transition Methods*.

As discussed in TIC's response to Question 8 above, the probability-weighted approach would be particularly burdensome for private entities.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,



Philip J. Santarelli, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees