December 15, 2010

via email: director@fasb.org

Technical Director
File Reference No. 1850-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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

Dear Sir or Madam:

On behalf of the Associated General Contractors of America (AGC), I respectfully submit the following comments in response to the Exposure Draft, Leases (Topic 840). We appreciate the efforts of both the Financial Accounting Standards Board (FASB or the Board) and the International Accounting Standards Board (IASB or the Board), and their staff in preparing the Exposure Draft (ED), and for the opportunity to comment on the proposed principles. We urge the Boards to remove the onerous and non-relevant provisions of the ED described in our comments below and recommend that the Boards address their lease accounting concerns with disclosure requirements only.

AGC is the leading association for the construction industry in the United States. AGC represents more than 32,000 firms, including over 6,000 general contractors, and 12,000 specialty-contracting firms. Over 12,000 service providers and suppliers are associated with AGC through a nationwide federation of 95 chapters. AGC contractors are engaged in the construction of the nation's commercial buildings and industrial facilities, highway and public transportation infrastructure, water and wastewater systems, flood control and navigation structures, defense installations, multi-family housing, and more.

The construction industry has played a powerful role in sustaining economic growth in the United States, in addition to producing structures that add to productivity and quality of life. Unfortunately, the construction industry has suffered as a result of the economic downturn.
 Whereas the construction industry provided jobs for 7.7 million workers in August 2006, there are currently 5.6 million workers in the industry (down 27 percent). The industry’s unemployment rate in November 2010 was 18.8 percent, not seasonally adjusted, nearly double the all-industry rate, and the highest for any industry. Nonetheless, the construction industry is a significant source of good-paying jobs, is a major customer of U.S. manufactured goods, and makes a large contribution to U.S. Gross Domestic Product (6.4 percent in 2009).

After significant input from our contractor and associate members, we have framed our comments along the following lines:

- Lease Accounting Comparability and Complexity
- Executory Contracts
- Lease Term
- Measurement and Presentation – Balance Sheet
- Measurement and Presentation – Income Statement
- Service Components
- Potential Expansion of Lease Accounting for Construction Activities
- Potential Impact on Existing Government and Other Contracts
- Related Party Leasing and Rental Transactions
- Disclosures
- Transition to New Standard
- Implementation Concerns

**Lease Accounting Comparability and Complexity**

The lease spectrum is broad and ranges from short-term rentals to in-substance installment purchases or financings. In the ED, the Boards state that current lease accounting models “lead to a lack of comparability and undue complexity because of the sharp ‘bright-line’ distinction between capital leases and operating leases.” We disagree.

The “bright-line” distinction promotes comparability, and the preparation of financial statements under the current model is effortless compared to the complexities of the proposed requirements. A lessee’s right to temporarily use a lessor’s asset is not equivalent to a financed purchase of property/plant/equipment. The concern by the Boards that the existing accounting model for operating leases omits relevant information about rights and obligations can be efficiently and adequately addressed with disclosures.

Many construction companies rent a piece of equipment specifically for purposes of completing a construction contract and return the equipment when it is no longer needed for production. Contractors charge this rent to job cost as incurred. The ED would require contractors to
capitalize a commitment for a future job cost prior to use of the equipment in producing work in progress. The ED’s position is tantamount in our contractors’ eyes to requiring the contractual agreements with subcontractors and suppliers to be recorded as “right-to-use” assets because those future production costs have been committed to by both parties. We recommend that the definition for “rent” should be retained in accounting standards for such temporary-use contracts for production-related activities, even if a construction contract lasts for a period greater than one year.

**Executory Contracts**

We also disagree with the Boards’ view that “a simple lease is not an executory contract after the date of commencement of the lease.” An attorney, after reviewing the ED, remarked: “That statement evidences a lack of appreciation of the meaning of the legal phrase ‘executory contract.’” Black’s Law Dictionary defines executory as “that which is yet to be executed or performed; that which remains to be carried into operation or effect; incomplete; depending upon a future performance or event.” In our opinion, the term “lease liability,” defined in the ED as the lessor’s obligation to permit the lessee to use the underlying asset over the lease term, is another name for yet to be performed obligations of an executory lease contract. If accountants begin capitalizing every contract that contains performance obligations (e.g., uncompleted construction contracts), company balance sheets will be inappropriately grossed up.

**Lease Term**

Estimating the probability-weighted average of each possible lease term would be unnecessarily burdensome. Furthermore, a renewal option does not create a legal liability until/unless exercised. The lease term should only include the non-cancellable period of the lease.

**Measurement and Presentation – Balance Sheet**

If the Boards mandate that lessees capitalize leases that are currently classified as operating leases, the lease liability should equal the undiscounted contractual liability existing at the statement date. Any future contingent rental payments should be expensed when incurred. A discounted lease liability would understate the total of the lessee’s remaining payments. Application of the simplified (undiscounted) method proposed for short-term leases to all performance obligation type leases would be preferable.

On the lessor’s balance sheet, we do not support comingling assets, receivables, and liabilities within the property, plant, and equipment section.
Measurement and Presentation – Income Statement

A lessee’s recognition of amortization and interest expense (in lieu of expensing lease payments) would result in an acceleration of expense recognition for lessees (due to front-loading of expense from the use of the interest method). An accelerated expense pattern does not reflect the economic benefits of most leases (e.g., the economic benefits derived from an office lease are distributed equally over the lease term). FAS 13 appropriately required:

Rental on an operating lease shall be charged to expense over the lease term as it becomes payable. If rental payments are not made on a straight-line basis, rental expense nevertheless shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived from the leased property, in which case that basis shall be used.

Application of the simplified (undiscounted) method proposed for short-term leases to all performance obligation type leases would facilitate straight-line rental expense recognition.

Service Components

The ED requires an entity to allocate payments between distinct service components and lease components. A service component is distinct if any entity sells an identical or similar service separately and, therefore, virtually all services must be allocated. If an entity enters into a simple lease for office space which includes maintenance, janitorial service, utilities, and insurance, do the Boards expect all such services to be allocated?

Potential Expansion of Lease Accounting for Construction Activities

Paragraphs B2 and B3 of Appendix B discuss specified assets. Contractors are concerned that certain contractual arrangements currently treated as subcontracts may be considered leases under the ED definition. Specifications in construction documents may require certain cranes, scaffolding, etc. to be used for up to the entire length of the construction project. We are concerned that the specific equipment utilized and accompanying set-up, operation, maintenance, and tear-down services may be considered a lease under the ED, while the construction industry has historically treated this transaction as a subcontracted service.

Potential Impact on Existing Government and Other Contracts

Contracts performed in accordance with the Federal Acquisition Regulations (FAR) and similar laws allow rents and operating lease costs (FAR 31.205-36) as allowable reimbursable costs. FAR 31.205-10 allows a calculated cost of money as an allowable reimbursable cost, but
disallows actual interest in lieu of the calculated imputed cost of money. The Boards should consider the potential direct financial cost to all contractors subject to the FAR and similar laws due to discontinuing operating lease and rent accounting principles.

Related Party Leasing and Rental Transactions

It is typical that construction companies rent equipment or facilities from the owner of the business or from a related entity. Many of these rental arrangements are provided on a month-to-month or as-needed basis without a written agreement. ED paragraph 13 states that the lessee shall determine the lease term by estimating the probability of occurrence for each possible term, taking into account the effect of any options to extend or terminate the lease. Such an assessment of terms by a related party is highly subjective. Currently, such leases and potential variable interest entities are addressed in ASC 810 for consolidation. However, is it now the Boards’ intent that each individual leasing transaction be evaluated under this ED when the entity has been determined not to be a VIE requiring consolidation with the reporting entity? We believe such transactions with related parties would most efficiently and effectively be accounted for as rents, and appropriately disclosed under current related party standards.

Disclosures

The breadth of the proposed disclosures is overwhelming. For performance obligation type leases, the following disclosures should be sufficient:

- The general nature of an entity’s lease arrangements;
- The amounts included in the financial statements arising from leases; and
- A maturity analysis disclosing undiscouned lease receivables and obligations for the first five years and the total for remaining years with appropriate groupings by class, nature, and/or function.

Transition to New Standard

The effect of this ED on the construction industry will have significant impacts to working capital, debt-to-equity and EBITDA ratios important to sureties, banks, and other users of the financial statements. We believe that a company should not be required to adopt the new lease accounting policy until at least a full transition period has transpired. Further, we believe that private companies should have one additional year beyond the implementation date of publicly-traded companies and be allowed to grandfather in current lease or rent arrangements. Private companies would then record under the new standard new leases that are entered into after the adoption date. We can only hope such timing and/or the grandfather provisions will provide
private companies with adequate time to educate users and modify covenants imbedded in long-term arrangements to comply with the new lease accounting policy.

**Implementation Concerns**

To illustrate the effort required to comply with the ED, we have attempted to apply the requirements to a simple operating lease example.

Assume a contractor rents an operated crane for a cost-plus type construction project. The minimum lease term is 13 months, but the lease may be extended at the contractor’s option on a month-to-month basis for another 12 months at the same monthly rate. The lease also includes mobilization and demobilization fees for transporting the crane to and from the job site.

To comply with the ED requirements, the contractor would need to:

1. Determine if the arrangement is a performance obligation lease and not a purchase.
2. Determine whether the implicit rate charged by the lessor can be ascertained.
3. Determine if the mobilization fee is an initial direct cost (to be capitalized and amortized) or service cost (to be expensed when incurred).
4. Estimate the probability-weighted lease term more likely than not to occur based on the contractor’s preliminary construction schedule.
5. Determine the crane operator service cost component of the lease.
6. Calculate the present value of the estimated lease payments for the estimated lease term (excluding the crane operator service cost component).
7. Prepare amortization schedules for the right-of-use asset (straight-line method) and lease liability (effective interest method).
8. Only after the crane is delivered to the job, record the right-of-use asset and the lease liability.
9. Record monthly amortization of the right-of-use asset to a separate account.
10. Record monthly lease payments as (i) interest expense per the amortization schedule, (ii) reduction of the lease liability, and (iii) job cost (for the crane operator service cost).
11. Since this is a cost-plus type construction contract, regroup or restate the amortization, interest expense, and service cost to be able to bill the project owner for monthly reimbursement of job costs.
12. Before preparing the financial statements, assess whether the crane will be needed for more or less time than the originally estimated 13-month period. If there is a change to the estimated lease term, adjust the amortization schedules, the right-of-use asset amount, and the discounted lease obligation.
14. Prepare the required disclosures (the following list includes those applicable to this particular lease only):
a. a general description of the lease arrangement
b. the existence and term of the renewal option
c. a narrative about the options that were recognized as part of the right-of-use asset and those that were not
d. the assumptions and judgments relating to amortization methods and changes to those assumptions and judgments
e. the initial direct costs incurred during the reporting period and included in the measurement of the right-of-use asset
f. information about the principal terms of the lease if not yet commenced
g. a reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments
h. the total cash lease payments paid during the period
i. information about significant assumptions and judgments and any changes in assumptions and judgments relating to the renewal option and other features of the lease
j. the discount rate used when determining the present value of lease payments
k. a maturity analysis of the liabilities to make lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years, distinguishing the minimum obligations specified in the lease and the amounts recognized in the balance sheet.

Hopefully from this simple example, the Boards can envision the efforts required to apply the ED requirements to many (perhaps hundreds) of lease contracts. Also, imagine a bookkeeper employed by a small company trying to comply with the ED requirements instead of simply charging a lease payment to rental expense or job cost.

Conclusion

Instead of the onerous and non-relevant provisions of the ED, as currently written, we urge the Boards to address their lease accounting concerns with disclosure requirements only.

Thank you for your consideration of our views.

Sincerely,

[Signature]

Stephen E. Sandherr
Chief Executive Officer