September 6, 2013

Technical Director
Financial Accounting Standards Board
Sent via email to: mailto:director@fasb.org

Re: File Reference No. 2013-270
Leases (Topic 840)

The Accounting Principles and Auditing Standards Committee ("the Committee" or "We") of the California Society of Certified Public Accountants ("CalCPA") is pleased to provide our comments to the Financial Accounting Standards Board (the "Board") on the proposed Accounting Standards Update.

The Committee is the senior technical committee of CalCPA. CalCPA has approximately 40,000 members. The Committee is comprised of 53 members, of whom 47 percent are from local or regional firms, 27 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 10 percent are in academia and 4 percent are in international firms.

Question 1: Identifying a Lease

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

The Committee believes in the substance of the proposed requirements for how an entity would determine whether a contract contains a lease. However, the terminology as proposed is cumbersome. Furthermore, the phrase "contract depends on the use of an identified asset" implies a need for the lessee to actually use the asset, rather than just having the ability to use it.

The proposed standard currently reads (842-10-15-3):

At inception of a contract, an entity shall determine whether that contract is or contains a lease by assessing both of the following:

a. Whether fulfillment of the contract depends on the use of an identified asset (as described in paragraphs 842-10-15-5 through 15-8)

b. Whether the contract conveys the right to control the use of an the identified asset for a period of time in exchange for consideration (as described in paragraphs 842-10-15-9 through 15-16).

We recommend simpler language such as:

At inception of a contract, an entity shall determine whether that contract is or contains a lease by assessing whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration (as described in paragraphs 842-10-15-5 through 15-16).
Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We agree with the proposed basis for recognition and measurement of leases by lessees.

The proposal indicates that a lease of less than 12 months containing an option to extend the lease beyond 12 months is not eligible for the "short-term lease" accounting election under paragraphs 842-10-25-14 through 16. We recommend that short-term accounting be permitted for these leases unless the lessee has an economic incentive to extend the lease beyond twelve months, in which case the lessee would not be able to use the election based on other provisions of the proposed ASU.

Some members of the Committee found the structure of the standards in certain cases to be cumbersome and unclear. For example, section 842-20-30-3 describes the initial measurement of the lease payments included in the liability. An introductory paragraph broadly discusses the requirement to include lease payments during the lease term, and then a listing is provided of payments to be included in the measurement. Although lease payments during periods covered by an option to extend the lease when significant economic incentive exists to exercise the option are obviously intended to be included, the listing does not specifically include these payments. Section 842-30-30-2 which deals with the initial measurement of the lease payments included in the lease receivable has the same issue. For purposes of clarity, we recommend the listing be expanded to include lease payments during these option periods.

Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Yes. See Question 2 for a clarification recommendation regarding Section 842-30-30-2.

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Yes.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Yes.
Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Yes.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

The Committee does not agree with the requirement to restate financial statements of comparative periods presented. The principal focus should be on proper presentation of the current and future statements of financial position, operations and cash flows. This is achieved with prospective implementation with a cumulative catch-up as of the beginning of the annual reporting period in which the new standards are first adopted. As a practical matter, little attention is given to restated historical financial statements. Although historical comparisons may be useful in projecting future results, historical results are only one indicator of the future, and often not a good indicator. In addition, information necessary to project future results is included by disclosures of lease commitments in the notes to the financial statements and, for public companies, discussion in the MD&A.

Leases that run out before implementation date should not be restated unless a company opts for the full retrospective approach. It potentially is a significant amount of work for very questionable benefit.

Finally, as a matter of presentation, we recommend that the transition examples 14, 15 and 16 in paragraphs 842-10-55-71 through 55-92 be presented following the standards on transition presented in 842-10-65-1. It was confusing to review the examples when the discussion of the issues was later in the text.

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We agree with the proposed disclosures for annual financial statements. The reconciliations of the opening and closing balances of lease liabilities in paragraph 842-20-50-4 should not be required in interim financial statements. Instead, disclosure should be required if there have been any significant changes from disclosures in the most recent annual financial statements.
Question 9: Nonpublic Entities (FASB Only)

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

2. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

3. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

The Board should request advice from the Private Company Council on possible simplifications prior to the issuance of the Accounting Standard Update. A number of recommendations made for all companies should be considered separately for non-public entities if the suggestions are not incorporated in the final standards. Some additional areas to be considered follow:

- Should nonpublic entities be permitted to immediately charge all initial direct costs to expense?
- With regards to the remeasurement of a lease liability for changes in an index rate, should nonpublic entities be permitted to charge or credit the difference to operations (rather than remeasure the assets)?
- Should non-public entities be permitted to limit reassessment of economic incentives to extend or renew a lease to transactions only where there is a modification to the terms of the lease?
- Should nonpublic entities be able to include all property leases as Type A leases, thereby simplifying their accounting?
- Should nonpublic entities be permitted to implement the proposals on a prospective basis with a cumulative catch-up adjustment at implementation date, even if this is not permitted for public companies? (See response to Question 7 above.)

Question 10: (FASB Only)

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

Yes.
Question 11: (FASB Only)
Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Yes.

Question 12: Consequential Amendments to IAS 40 (IASB Only)
Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Yes.

We would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

Michael D Feinstein

Michael Feinstein, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants