Educational Foundation

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

Via e-mail to: Director@fasb.org

RE: EXPOSURE DRAFT ISSUED AUGUST 17, 2010 - PROPOSED ACCOUNTING STATEMENTS UPDATE - LEASE (TOPIC 840)

Ladies and Gentlemen:

The Accounting Principles and Auditing Procedures Committee ("Committee") is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of members who are affiliated with public accounting firms of various sizes as well as members in both industry and academia. The Committee has reviewed and discussed the abovementioned proposal. The views expressed in this comment letter are solely those of the Committee and do not reflect the views of the organizations with which the Committee members are affiliated.

RESPONSES TO SPECIFIC EXPOSURE DRAFT QUESTIONS

General Comment:

The Committee is widely divided on the entire lease issue as set forth in this proposed exposure draft.

Some members of the Committee believe the proposed change is needed to make the lease standards consistent with the trend to a principle-based accounting approach. They also feel it will be provide consistent and beneficial information to the financial statement users.

Some members of the Committee, on the other hand, see no need to change the existing standards that are already in place. These members say that the existing standards have been in place for a long time and that they are understood by both preparers and users of financial statements and are applied consistently.

The Committee further has a great concern about the cost of implementing these standards by small and medium entities ("SMEs"). The Committee is unanimous in the belief that the cost of implementing these standards will outweigh the benefits to SMEs.

Greater details on these two schools of thought are detailed below under question 1(a) detail.

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The answers to questions 1(a) thru 19 are based on the standard being approved and implemented.

Question 1: Lessees

(a) Do you agree that a lessee should recognise 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?

The members in favor of recognizing an asset and liability agree with this recognition change. They feel that the right-of-use model is consistent with the trend to principles based accounting, will standardize the treatment of leases thus contributing to consistency and comparability between financial statements, will address off-balance sheet transactions and will provide better information to the users of financial statements.

The members not in favor of recognizing an asset and liability see no need to change the existing accounting standards. The phrase used is "if it is not broken, why fix it?"

Other reasons given in opposition are that the present standards are well understood and have been consistently implemented over a long period time, the cost to entities of changing their systems to implement the proposed change will be very large, the transition methods and period required of financial statement preparers and users will be cumbersome, that the standards set forth in measuring assets and liabilities are too subjective and that the standards will change the way leases are negotiated, written and decided upon.

One of the other concerns raised is that the standard has not been reconciled to the conceptual framework regarding liabilities and contract accounting and thus it is premature for this exposure draft to be set forth at this time.

If the proposal is to be approved and implemented, the Committee would favor this approach for lessees.

The alternative on which the Committee is in some agreement is that there should be an opt out exception for SMEs based on total assets that allows these entities to maintain the present lease accounting standards while larger entities apply the proposed standards. The Committee sees that the non-SMEs presentation would result in greater comparability to investors and thus would be beneficial to investors in the non-SMEs. The non-SMEs would also have the available resources to implement the standards. The SMEs under this alternative would not be burdened with the infrastructure cost of the implementation.

(b) Do you agree that a lessee should recognise amortisation 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The committee is in agreement with this treatment. The amortization and interest recognition are consistent with present intangible asset and asset acquired with borrowed funds.

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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with these applications. The Committee feels that the lessor accounting should be consistent with the lessee accounting, thus if the lessee accounting changes the lessor accounting should change to the proposed standard.

The Committee leans heavily toward only one approach being allowed for lessors. That approach is the Derecognition Approach. The Committee leans toward this approach because it would result in greater comparable between lessors. The Committee feels that if the lease transactions are to be treated as acquisitions of an asset by the lessee than the lessor should treat the transaction as sales. There is also concern in the Committee that the Performance Obligation Approach would result in a doubling up of assets on the financial statements.

(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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with the recognition of the items detailed as part of the two approaches.

(c) Do you agree that there should no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP? Why or why not? If not, what alternative model would you propose and why?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee agrees that there should be no separate approach.

Question 3: Short-term leases

The 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 twelve 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 recognise lease payments in profit or loss 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 recognise assets and liabilities arising from a short-term lease in profit or loss, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee feels that this is not a simplication. Entities would have to keep track of all short-term leases during the year. This would result in greater administrative costs. The Committee recommends short-term leases be scoped out of the proposed standards and allowed to be expensed as incurred.

Question 4 Definition of a lease

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee does not agree with this definition. The difference between a lease contract and a service contract will become more important, as a lease contract will always result in on-balance accounting of the asset and the related liability. The definition and additional guidance should clarify such difference. However, the proposed definition is based on IFRIC 4. The existing difficulties with the application of IFRIC 4 (such as with providing capacity for storage or transport) will have to be solved in the new standard.

The leases containing a service component will pose difficulties in assembling and valuing that component under this standard. Another burden to SMEs.

Unless the difference between a lease contract and a service contract are better defined, the new model does not improve comparability and reliability.

(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?

The Committee does not agree. The criteria for distinguishing leases and sales/ purchases are inconsistent with those set in the Revenue Recognition Exposure Draft.

(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?

See comment under question 4(a) above.

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS 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 IFRS? Why or why not? If not, what alternative scope would you propose and why?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee agrees with scoping out leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources.

The Committee does not agree with scoping out leases of intangible assets since there is no conceptual basis for excluding these leases.

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in 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 proposals in *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?

The Committee is confused by this question. The Committee believes that the service component of a lease is either distinct or not. Thus we are unsure what is meant by the term "not distinct". The Committee needs examples to define the question and formulate an answer.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with this treatment of non bargain purchase options.

The Committee feels that it would be appropriate to treat bargain purchase options as part of the original measurement of the asset and resulting liability. The Committee concludes it is more than likely a bargain purchase option will be exercised and thus should be included in the original valuation.

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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee questions whether the measurement of a liability that will not necessarily result in an outflow of resources meets the definition of a liability as included in the current and new Framework. We believe that the liability should be measured on minimum lease payments including bargain options. All other contractual options will have to be disclosed.

The Committee believes the use of the more-likely-than-not method to establish lease terms calls for significant judgments which may result in significantly wrong answers.

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?

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 measured reliably? Why or why not?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee believes capitalization of contingent rentals and other estimated rental revenue will require considerable judgment that would not be beneficial to SMEs. The Committee is also concerned that the use of probability-weighted averages could result in recording of amounts that are not to be paid.

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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with remeasuring but the requirement of reassessing these estimates will however significant incremental accounting efforts that would not be beneficial to SMEs.

Question 11 - Sales and leasebacks

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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with treating a transaction as a sale and leaseback only if the transaction meets the conditions of 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.

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 or investment property as appropriate, 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with this presentation.

(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?

The Committee is agreement with this presentation.

(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?

The Committee is in agreement with this presentation.

(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?

The Committee feels it would less confusing to the users of the financial statements if this information were disclosed in the notes to the financial statements.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with this presentation.

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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with this presentation provided the amount involved is material.

Question 15: Disclosure

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee is in agreement with this presentation. Because of the subjective judgments required by the exposure draft, it would be very important that the underlying assumptions be disclosed so users of the financial statements would be fully informed of these assumptions.

Question 16; Transition

(a) The exposure draft proposes that lessees and lessors should recognise 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?

See schools of thought and proposed alternative detailed in item 1(a) above. The conclusion below is based on the standard being approved and implemented.

The Committee feels the simplified approach would be less cumbersome and should be adopted.

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

The Committee feels the full retrospective application should be available for those situations where is it is deemed necessary to present the best result.

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

Transition to the new standards will require investment in information systems to handle additional burdens, will require extensive dual record keeping for GAAP vs. tax purposes and will change the way leases are negotiated, written and decisions are made. Changes as proposed by this exposure draft may result in unintended violation of existing debt covenants under present loan agreements. These loan agreements may need to be rewritten at a cost to the debtor entities.

Judgments under the new standard as proposed by the exposure draft will be time consuming and subjective.

The Committee believes many entities will be forced or will choose to report on alternative reporting frameworks in order to avoid the additional burden of this exposure draft if adopted and implemented. The Committee feels this will be especially true of SMEs.

Question 17: Benefits and costs

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?

The Committee feels the benefits do not outweigh the costs at least to SMEs. The costs to SMEs' infrastructures as detailed above would be great as opposed to the benefits to the users of the SMEs' financial information. The cost of educating the users and preparers of the financial statements should be considered.

As suggested under question 1(a) above there should be a provision for certain SMEs to opt out of the provision of this exposure draft due the cost implementing these provisions.

Question 18: Other comments

Do you have any other comments on the proposals?

The Committee is concerned about the effects on this exposure draft of other standards that are under present consideration by the FASB and IASB. These standards, such as the one on revenue recognition, are subject to ongoing review of comments and possible revisions and could impact this exposure draft.

The Exposure Draft refers to other projects of the FASB and IASB, such as the revenue recognition project; as if the projects are already finalized and will not be further revised until the final standards are issued. However, we would expect that all comments will be considered by the Boards and, as a consequence could be revised due to comments received.

The Committee requests that the need for changing the lease accounting standards needs to be better demonstrated by the advocates of this proposal. The Committee believes that the Exposure Draft has not set forth in detail the present problems with the current lease accounting standards and the need for change.

Question 19; Non-public entities

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 the Committee has stated above, there should included an opt out provision to the requirements of this exposure draft for SMEs. Our reasons have been detailed above.

The Committee further feels that the same opt out provision should be available to not-for- profit organizations.

Thank you for allowing us the opportunity to comment on this proposal.

Very truly yours.

Philip B. Pacino, CPA, Chairman

Accounting Principles and

Auditing Procedures Committee

Massachusetts Society of Certified Public Accountants