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Sir David Tweedie Chairman International Accounting Standards Board (IASB) 30 Cannon Street London, EC4M 6XH United Kingdom

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Dear Sir David:

The Mortgage Bankers Association¹ (MBA) appreciates the opportunity to comment on the International Accounting Standards Board's exposure draft, *Leases* (Proposed Standard). The stated objective of the Proposed Standard is to develop a new approach to lease accounting that would ensure that assets and liabilities arising under leases are recognized in the statement of financial condition. The Financial Accounting Standards Board (FASB) and the IASB jointly developed the draft as a converged accounting standard for leases. Since MBA represents companies that generally report under U.S. generally accepted accounting principles (GAAP), references throughout this document relate to FASB's pronouncements and existing GAAP.

Background

This Proposed Standard would require lessees and lessors to apply a right-of-use model in accounting for all leases other than leases of biological and intangible assets,

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

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leases to explore for or use natural resources and leases of some investment properties. For leases within the scope of the Proposed Standard, this would mean that:

- (a) a lessee would recognize an asset representing its right to use the leased('underlying') asset for the lease term (the 'right-of-use' asset) and a liability to make lease payments.
- (b) a lessor would recognize an asset representing its right to receive lease payments and, depending on its exposure to risks or benefits associated with the underlying asset, would either:
 - (i) recognize a lease liability while continuing to recognize the underlying asset (a performance obligation approach); or
 - (ii) derecognize the rights in the underlying asset that it transfers to the lessee and continue to recognize a residual asset representing its rights to the underlying asset at the end of the lease term (a derecognition approach).

Assets and liabilities recognized by lessees and lessors would be measured on a basis that:

- (a) assumes the longest possible lease term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease.
- (b) uses an expected outcome technique to reflect the lease payments, including contingent rentals and expected payments under term option penalties and residual value guarantees, specified by the lease.
- (c) is updated when changes in facts or circumstances indicate that there would be a significant change in those assets or liabilities since the previous reporting period.

The Proposed Standard would replace *Leases* (Topic 840) in the *Accounting Standards Codification*. It would basically replace the guidance for lease accounting that was promulgated in 1976 in Statement of Financial Accounting Standards No. 13, *Accounting for Leases* (FAS 13). FAS 13 distinguishes between capital leases and operating leases with four bright line tests. If a lease transfers the underlying asset to the lessee at the end of the lease, has a bargain purchase option, has a lease term of at least 75 percent of the economic life of the underlying asset, or the present value of cash flows under the lease equal 90 percent or more of the value of the underlying asset at the inception of the lease, then the lease is deemed to be a capital lease. Otherwise the lease is deemed to be an operating lease. The importance of this distinction is that a capital lease must be recorded on the balance sheet of the lessee as both an asset and a liability. Operating leases are accounted for off-balance sheet and are disclosed in the notes to the financial statements.

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The following are MBA's general comments on the Proposed Standard. MBA has included its response to IASB's specific questions in Appendix A.

General Comments

If It's Not Broken, Don't Break It

FAS 13 has been in effect since November 1976, and most MBA members believe that it works well. Users already have access to the notes to financial statements information related to future minimum rental commitments and optional lease extensions. MBA does not see that users gain much from the Proposed Standard. If anything, the estimates involved in the Proposed Standard border on speculation and would make financial statement information less reliable, and placing additional linked assets and liabilities on the balance sheet would add unneeded complexity to financial statements. The double-counting of assets on the lessors' balance sheet makes little sense. MBA recommends that IASB and FASB should consider less radical changes to existing accounting including providing information generally included in the lease note to financial statements on no less than a quarterly basis. If further balance sheet recognition of operating leases is essential (which the MBA believes is not the case) putting only mandatory commitments, without optional lease periods and contingent rentals, on the balance sheet would be a superior approach.

Acceleration of Lease Expense

Under the Proposed Standard, the lessee would amortize the lease liability on the books of the lessee as if it were an interest-bearing liability. This would result in a higher expense in the earlier periods of a lease when that liability is the highest. This proposed treatment is in stark contrast to the economic reality of leasing real estate properties where the value is generally deemed to be equal by period or slightly higher through the passage of time related to the long history of price inflation. Further, the front-end loading of lease expense is generally contrary to the actual contractual cash flows. MBA believes that if a lease asset and lease liability must be recorded for what would deemed to be operating leases under FAS 13, the amortization of the asset and the liability should be recorded so that the total lease expense (e.g. interest and amortization of the right-of-use asset) is recognized on a straight-line basis. This method would be closer to the actual cash flows than the proposed method.

<u>Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities</u>

Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (Concept 6), defines assets and liabilities as follows:

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Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.²

Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.³

In contrast, the definition of the lease term as used in estimating the lease asset and lease liability has a much less precise probability parameter:

The lease term is defined as the longest possible term that is more likely than not to occur. An entity determines the lease term considering all explicit and implicit options included in the contract and given effect by the operation of statutory law.⁴

The term "more likely than not" connotes a probability of slightly over 50 percent, whereas a "probable" estimate in the conceptual framework for GAAP generally connotes a substantially greater likelihood. MBA believes that this contrast in statistical expectation between the estimate of the proposed impact of options and contingent rentals in the Proposed Standard and the hurdle for recording an asset or liability in the GAAP conceptual framework cuts to the heart of MBA's concerns with the Proposed Standard. MBA believes that the estimates of lease assets and liabilities will be less precise and potentially misleading. In contrast, FAS 13 requires disclosures of future minimum rental commitments under operating leases and a disclosure of contingent rentals.

MBA notes that the proposed threshold for the lessor's recording of contingent rents and optional lease period rents uses a much higher standard of "reliably assured." MBA objects to introducing yet another undefined level of likelihood into accounting for leases.

Further, MBA believes that the contingent rentals associated with a lease should not be included in determining the lease asset and liability because the "past transaction or event", i.e. the signing of the lease agreement, is not the determining event or trigger. Rather, the trigger, if any, would be based upon **future** transactions, such as customer sales. Again, the proposed treatment of contingent rentals appears to be at odds with the conceptual framework for recognition of assets and liabilities in the balance sheet, because it would result in both lessees and lessors recording assets essentially for future sales.

MBA also notes that lessees generally negotiate a fixed initial lease term and optional lease terms because of the uncertainty associated with estimating the length the lessee will require the use of the leased asset. To then force that same lessee to then estimate at inception and on an ongoing basis the extent of expected use of the optional lease contract periods is highly speculative.

² FASB, Elements of Financial Statements, c. 2008, paragraph 25.

³ Ibid, paragraph 35.

⁴ IASB, *Leases*, page 47, paragraph B16.

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MBA also notes that the Proposed Standard is a dramatic departure from FAS 13 with respect to inclusion of optional lease periods. Paragraph 5.f. of FAS 13 defines lease term as:

Lease term. The fixed noncancelable term of the lease plus (i) all periods, if any, covered by bargain renewal options (as defined in paragraph 5(e)), (ii) all periods, if any, for which failure to renew the lease imposes a penalty (as defined in paragraph 5(o)) on the lessee in such amount that a renewal appears, at the inception of the lease, to be reasonably assured, (iii) all periods, if any, covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt directly or indirectly related to the leased property is expected to be in effect or a loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding, (iv) all periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option (as defined in paragraph 5(d)) is exercisable, and (v) all periods, if any, representing renewals or extensions of the lease at the lessor's option; however, in no case shall the lease term be assumed to extend beyond the date a bargain purchase option becomes exercisable. A lease that is cancelable (a) only upon the occurrence of some remote contingency, (b) only with the permission of the lessor, (c) only if the lessee enters into a new lease with the same lessor, or (d) only if the lessee incurs a penalty in such amount that continuation of the lease appears, at inception, reasonably assured shall be considered "noncancelable" for purposes of this definition.

Thus, the existing standard for inclusion of an optional lease term in the lease period is that the renewal options and penalties have to be so strong that the lessee's use of the optional lease terms was **reasonably assured at inception**. MBA believes that this more robust test is more appropriate for inclusion as a recorded asset and liability in the balance sheet than "more likely than not." Conforming this definition with the conceptual framework threshold of "probable" would be even better.

In summary, MBA believes that the current approach of recognizing contingent rentals and lease renewals as they occur or when use of optional lease period is reasonably assured is vastly superior to the Proposed Standard and should be retained. Further, in the rare circumstance that a contingent rental feature or renewal option meets the definition of a derivative, it should be bifurcated from the lease and accounted for in accordance with ASC 815 on a "net" basis. MBA objects to the "gross" basis accounting treatment for options that is inherent in the IASB's and FASB's proposal.

Inconsistency of Estimates Between Lessee and Lessor

MBA believes that the right-of-use asset on the books of the lessee should generally be equal to the right to the related liability on the books of the lessor. The Proposed Standard has at least three facets that will likely lead to the lessee's asset not being equal to the lessor's liability:

1. The lessee and the lessor will be required to estimate at inception and on an ongoing basis the amount of optional lease period rentals and other contingent rentals to include in the determination of the asset and liability. The lessee will

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certainly have a better idea of what level, if any, of contingent rentals should be included in the calculation of the asset and liability. The lessor's basis for an estimate will be limited to past experience that is often based on different market and economic conditions.

- 2. The lessee must amortize the lease liability using its incremental borrowing rate or the rate the lessor charges the lessee if it can be readily determined. The lessor will be amortizing its corresponding asset using the rate it charges the lessee. Thus, if the lessee has no knowledge of the lessor's rate, this will further add to creating disparity between the liability on the lessee's books and the asset on the lessor's books.
- 3. The lessor's threshold for the inclusion of contingent rentals of "reliably measured" will cause an additional disconnect between lessee and lessor accounting.

MBA notes that these differences could be eliminated if the IASB and FASB focused on the cash flows stated in the lease agreement, rather than an unwarranted reliance on future forecasts.

Double Counting On Lessor's Books Doesn't Feel Right

As mentioned in MBA's general comment, *If It's Not Broken, Don't Break It,* above, MBA believes that the existing lease accounting guidance provides users of financial statements sufficient information about lease agreements entered into by the reporting entity. The user's criticisms of existing lease accounting standards have generally focused on the lessee's accounting for operating leases. MBA believes that lessor accounting should not be affected by the IASB's and FASB's attempt to "fix" lessee accounting. The reaction of MBA's members is that the double counting of the same asset on the lessor's books just doesn't feel right and is likely to be misleading to users of lessors' financial statements.

Exorbitant Costs to Implement the Proposed Standard

MBA members believe that the costs to implement the Proposed Standard will be huge. Lessors and lessees do not have the infrastructure and systems necessary to initially and on an ongoing basis account for these off-balance sheet assets and liabilities on-balance sheet. For lessees who lease hundreds and thousands of properties, the cost of performing the ongoing review of facts and circumstances with respect to contingent rentals and optional lease periods will be enormous since such considerations cannot be automated. Excel spreadsheets, which are used by many preparers to account for operating leases, will no longer be sufficient. MBA believes the benefit, if any, of the Proposed Standard to users of financial statements will be small relative to the costs preparers will incur to implement the Proposed Standard.

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MBA also notes that loan covenants and regulatory capital ratios are based upon existing GAAP. It will take preparers significant time and effort to change loan covenants and for regulators to amend capital rules. MBA recommends a minimum transition period of at least two years for any change requiring additional balance sheet recognition of operating leases.

The MBA appreciates the opportunity to share these comments with the Board. Any questions about MBA's comments should be directed to Jim Gross, Associate Vice President and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@mortgagebankers.org.

Sincerely,

John A. Courson

President and Chief Executive Officer

Mortgage Bankers Association

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Responses to IASB's Specific Questions

Appendix A

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?
- (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?

MBA's Response: (a) MBA disagrees with the proposed approach for a lessee recognizing a right-of-use asset and related liability for reasons delineated in general comments *If It's Not Broken, Don't Break It, Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities, and Exorbitant Costs to Implement the Proposed Standard above.*

- (b) If the IASB and FASB conclude that balance sheet recognition of operating leases is essential, MBA believes that a better alternative model would include the following attributes:
 - 1. Use the lease period as presently defined in FAS 13 to calculate and record the lease assets and liabilities
 - 2. If contingent rental features and renewal or purchase options are material and meet the definition of a derivative at inception, account for them as a single embedded derivative to be bifurcated from the host lease contract
 - Amortize assets and liabilities to recognize total lease expense on a straight line basis, unless another method more clearly represents the physical use of the leased property.

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?
- (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?
- (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

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BC15)? If not, why not? What approach should be applied to those leases and why?

MBA's Response: (a) and (b) MBA disagrees with the lessor's accounting model in the Proposed Standard for the reasons delineated in general comments, *If It's Not Broken, Don't Break It, Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities, Double Counting On Lessor's Books Doesn't Feel Right, and Exorbitant Costs to Implement the Proposed Standard, above.*

(c) No response.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently,
 - (i) the liability to make lease payments at the undiscounted amount of the lease payments and
 - (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65). (See also paragraphs BC41-BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

MBA's Response: (a) MBA believes that lessees should not have to place on the balance sheet lease assets and liabilities for leases with an initial lease term of 12 months or less, including optional lease periods. The costs to the preparer of accounting for such leases on-balance sheet would far exceed the benefits, if any, derived by the users of the financial statements.

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(b) MBA generally agrees with the proposed lessor requirements for lessors' with short-term leases.

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

MBA's Response: (a) MBA agrees with the definition of a lease in the Proposed Standard.

- (b) MBA generally agrees with the criteria in paragraphs B9 and B10.
- (c) MBA generally agrees with the guidance in paragraphs B1-B4.

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?

MBA's Response: MBA generally agrees 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 IASB and FASB propose 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?

MBA's Response: MBA's members could not come to a consensus on this issue. However, the following discussion reflects why some members favored the FASB approach, others favored the IASB approach, and some favored neither approach.

With respect to FASB's approach of not bifurcating the lease contract between the lease and performance obligations, implementation cost is a big consideration to MBA's members. As noted in MBA's general comments, primary changes envisioned by the Proposed Standard are not necessary and that the cost to implement would be huge. Accordingly, part of MBA's response to this secondary question is based upon finding the least costly alternative of the two. It appears that the FASB's Proposed Standard would likely be the least costly of the alternatives for preparers since the preparers would not have to bifurcate the asset into a lease component and a service component. Accordingly, the sentiment of some MBA members would be to choose FASB's approach as the "lesser of two evils."

In contrast, the IASB's approach may result in a smaller lease asset and liability being capitalized in certain cases. Again, since MBA believes that putting these assets and liabilities on the books is inherently wrong, minimizing the asset and liability capitalized garners favor on the part of other members of the MBA. They would advocate for lessees to separately account for service components as well.

MBA wonders if FASB and IASB should consider a third possible alternative with respect to leases that contain a service component. For leases where the lessee may withhold rental payments if the lessor does not deliver the services required under the

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lease (e.g. certain real estate leases), account for such agreements in their entirety as executory contracts.

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?

MBA's Response: MBA generally agrees with the proposed accounting for purchase options.

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?

MBA's Response: MBA disagrees with the proposed inclusion of options to extend in the estimation of the right to use asset and related liability. See MBA's general comment, *Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities*, above. MBA believes that options to extend should be generally excluded from the calculation of the lease term. Renewals should be accounted for when exercised, in the same manner as the proposed accounting for purchase options. If, under FAS 13, the lease contains a bargain renewal option or a severe penalty for not renewing, the lease period should include the lease option periods if use by the lessee is reasonably assured at inception. Further, in those rare instances where renewal options are both material and meet the definition of a derivative at inception, they should be bifurcated and accounted for separately. MBA believes that this approach would be more consistent with the conceptual framework for recognizing an asset or a liability only as a result of completed transactions.

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

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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 reliably measured? Why or why not?

MBA's Response: MBA believes that lessee or lessor inclusion of contingent rentals and expected payments under term option penalties and residual value guarantees should be accounted for separately, if at inception, they are material and meet the definition of a derivative. Otherwise, they do not meet the definition of an asset or liability. See *Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities*, above.

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?

MBA's Response: See general comments *Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities* and *Exorbitant Costs to Implement the Proposed Standard* above. MBA does not believe that contingent payments and optional lease periods typically meet the criteria for definition as a derivative. Accordingly, MBA believes that they should generally not result in recording an asset or a liability. Further, the costs of remeasuring such assets and liabilities on a periodic basis would be huge relative to the benefits, if any, that users of financial statements would receive.

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?

MBA's Response: MBA generally agrees with the criteria for classification as a sale and leaseback transaction.

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

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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?

- (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, totalling 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?
- (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?
- (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?

MBA's Response: As noted in MBA's general comment, *It's Not Broken, Don't Break It,* above, MBA generally disagrees with many of the concepts in the Proposed Standard. However, assuming the IASB and FASB move forward with the Proposed Standard, the following are MBA's responses:

(a) In order to minimize the confusion that would result from the Proposed Standard, MBA believes that the right-of-use asset and the liability to make lease payments are so closely linked from a legal and economic standpoint that they should be reported in a linked fashion on the asset or liability side of the balance sheet as:

> Right-of-use assets under leases Liability to make future lease payments Net

MBA has a concern with characterizing right-of-use assets with tangible assets since they are not tangible assets. This would ascribe much more "ownership" than the true legal form and economic substance of these assets, especially those leases previously deemed to be operating leases.

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- (b) MBA believes that the presentation of underlying assets, rights to receive lease payments and lease liabilities totaling to a net lease asset or lease liability in the statement of financial condition makes sense because they are so linked from an economic and legal standpoint.
- (c) MBA generally agrees with the proposed presentation in paragraph 60.
- (d) MBA opposes distinguishing assets and liabilities that arise under a sublease in the statement of financial position. The Proposed Standard would already make the balance sheet line items for lease related activities complex enough. It may, however, be appropriate of the intermediate lessor to make such disclosures in the respective notes to financial statements.

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?

MBA's Response: Separate line item treatment or disclosures in the notes to financial statements should relate only to items of a material nature. If lease income and lease expense are material items, they should be presented separately from other income and expense items in the financial statements.

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?

MBA's Response: MBA disagrees with the lessee recognizing a right-of-use asset and related liability for reasons delineated in general comments *If It's Not Broken, Don't Break It, Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities,* and *Exorbitant Costs to Implement the Proposed Standard* above. If the IASB and FASB move forward with the Proposed Standard, changes in lease assets and liabilities should be afforded prominent treatment in the statement of cash flows if deemed by the preparer to be material. The proposed treatment in paragraph 27 for lessees to present cash payments for leases as financing activities as opposed to operating cash flows is flawed at least for short term duration leases. This treatment makes an erroneous assumption that all leases are in essence a financing transaction, whereas the vast majority of leases are entered into for operating purposes.

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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?

MBA's Response: MBA disagrees with the lessee recognizing a right-of-use asset and related liability for reasons delineated in general comments *If It's Not Broken, Don't Break It, Treatment of Optional Rental Terms Would Be Inconsistent with Concept Statements and An Imprecise Measure of Assets and Liabilities,* and *Exorbitant Costs to Implement the Proposed Standard* above. With that said, assuming the IASB and FASB move forward with the Proposed Standard, some of the additional disclosures in the Proposed Standard may be needed to help users sort through the myriad additional line items in the balance sheet, income statement, and statement of cash flows and to understand the high level of uncertainty involved in the estimates required under the Proposed Standard.

Question 16

- (a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

MBA's Response: See general comment, *Exorbitant Costs to Implement the Proposed Standard*, above. MBA believes that the costs and time required by lessors and lessees to implement the Proposed Standard will far outweigh the benefits, if any, the users may receive from the proposed accounting. In order to minimize the impact of the Proposed Standard on preparers, MBA recommends that the Proposed Standard be implemented on a prospective basis for new lease transactions entered into after the effective date.

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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?

MBA's Response: See general comment, *Exorbitant Costs to Implement the Proposed Standard*, above. MBA believes that the costs and time required by lessors and lessees to implement the Proposed Standard will far outweigh the benefits, if any, the users may receive from the proposed accounting.

In arriving at the conclusion in Paragraphs BC200-BC205, that the benefits to users will exceed the cost to preparers, MBA believes that the IASB's and FASB's analysis may not be sufficiently robust. It doesn't take much time for users to add the future minimum rental commitments disclosed under FAS 13 to their respective pro forma estimates of future cash flows, leverage ratios, and other key financial metrics. It will require material cost and significant effort for preparers to initially implement the Proposed Standard, and the ongoing costs will, likewise, be enormous.

MBA recommends that prior to implementing the Proposed Standard, the IASB and FASB should undertake robust field testing at a variety of lessors and lessees. The field test should likewise include a variety of users of the financial statements of those lessors and lessees subject to the test. For the users field test, the analysis should review the quality of the analysis with and without the information from the Proposed Standard and the time required for the analysis with and without the information required by the Proposed Standard.

Question 18

Do you have any other comments on the proposals?

MBA's Response: See MBA's general comments above.

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?

MBA's Response: MBA is consistently in favor of reducing the cost of new accounting principles to all preparers, particularly including small businesses and not-for-profit organizations. MBA believes that the changes in the Proposed Standard are so pervasive, that to create separate accounting for small businesses and not-for-profits may make their financial statements significantly less comparable to other entities. Rather than doing a carve-out for small businesses and not-for-profits, the IASB and FASB needs to re-visit the conceptual framework issues that MBA raises with respect to

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optional lease extensions and contingent rentals and consider allowing straight-line amortization of the lease assets and liabilities. Those changes would likely result in a cost/benefit metric that could work for most preparers of financial statements.