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Financial Accounting Standards Board  
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Via email: [director@fasb.org](mailto:director@fasb.org).

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RE: FASB Exposure Draft-Leases (topic 842)

Below, please find my comments in response to the questions raised within the exposure draft. All comments are those of mine, and are not necessarily those of the company. The history of FASB 13 and the thousands of pages on interpretations have, by itself, been indicative that the accounting treatment needs to be addressed. I do applaud the effort, and appreciate the strong opinions that the board has heard.

Overall, the general concept of reflecting the liability related to leases on the statement of financial position is appropriate. The disclosures in the notes to financials, while providing useful information, has not proven to reflect to users, the future financial implications. By way of example, I refer back to American West airlines. In the notes to the financials, there was disclosed the lease commitments on airplane leases. Those notes showed that the impact on operations was such that the increase in lease cost was going to be greater than operating income. Yet, many were surprised when the airline went bankrupt. From my perspective, I am convinced that users of financial statements, including bankers, analysts, and other 'experts', do not really look at the notes, but rather the statement of financial position and income statement. Yes, I also wonder if they look at cash flow statements. As such, the inclusion of the commitments on the statement of financial position is a far better communication medium.

1. Identifying a Lease – Overall, there is agreement with the definition of how to identify a lease. However, in 842-10-15-3, item a, seems unnecessary as it implies that one needs to use the asset. As long as the right to control the asset, whether used or not, is exchanged, then a lease is identified.
2. Lessee Accounting- There are a few areas within lessee accounting that I am troubled by 842-10-25-6 and 842-10-25-7 define Type A and Type B leases. I am not convinced that there should be any reason to have such a bifurcation. A lease is a lease whether it involves real property or other tangible assets and the accounting treatment should be consistent.

Example 2, 842-10-55-20-22 should be treated as a lease. This is because even though the machines are intertwined with the purchase of product from the supplier exclusively, the company would still have an obligation related to the coffee machines. Hence, a liability for the machine should be reflected on the statement of financial position. What this area really delves

into is how to handle the accounting for service agreements that have lease type terms. This is something that will be discussed later.

842-10-55-74 discusses the election to not include initial direct costs. But, 842-20-30-4(c) does makes no reference to such election. Note that in 842-20-55-5 there should be the option to exclude indirect costs.

842-20-35-8 uses 'amortize the right-of-use asset on a straight-line basis'. My concern or question back is whether we mean amortize as part of depreciation and amortization as typically reflected within the financial statements, or 'expensed' as to its character (in line with present reporting). To treat the operating expense associated as the former, would I believe grossly mislead a business operation. For example, the lease of a copier is normally treated as an operating expense. As a business manager, I am looking at my operations with that copier as an operating expense, and not part of depreciation and amortization. To both internal and external users, I think that they would evaluate and manage with the cost being considered part of the normal operations. If the use of the word 'amortize' is to be interpreted to mean 'expense', than the nomenclature should be so changed. In my mind, the amortization would be more akin to the treatment of a prepaid expense. Somehow, I also believe that this is an area of major concern to most.

I think that the lease accounting needs further simplification to the real world. To make it far easier to manage, and better reflect how a lessee thinks of a lease, would be to eliminate the use of PV concepts unless the lease term is greater than 5-years. A shorter-term lease, especially less than 3-years, is so short in nature that the concept of interest is irrelevant to management and investors. This would change examples 13 and 14, 842-10-55-69, 842-10-55-71-92. Page 2 would also be modified accordingly. Again, this would also simplify transition if the remaining lease term is less than 5-years. Updates to 842-20-35-2(a), 842-20-35-7.

842-20-45-3 should treat the 'unwinding of the discount' as interest expense. No separate reporting should be needed. If it is deemed that the separation of the lease cost into components, then the treatment of the discount as additional interest, and the reflection in the statement of comprehensive income is sufficient.

842-20-45-4 statement of cash flow should treat all payments as operating activity, not the treatment of Type A as financing.

Disclosure 842-20-50-2-7 needs to be reduced. With the addition to the basic financial reports of the lease commitments, these disclosures are costly, time consuming, and redundant. A brief description of the leases, should be all that is necessary. 842-20-50-4 should be eliminated as it add no real value. I am not sure what 842-20-50-8 is attempting to accomplish. Within, but not stated, is that the lease liability should be bifurcated into current and long-term areas on a classified statement of position.

3. Lessor Accounting- The question being asked in this matter is the treatment of property that is owned by the party. Essentially, I do agree with the concept that a type A lease, given the usual limited future value, can be more closely aligned with it being sold. Therefore, it type A asset is

viewed more as inventory. Type B assets, are property and should be accounted for as such with applicable depreciation.

I do question a possible inconsistency with the lessor accounting for short term leases, 842-10-25-15 and how it relates to 842-30-301-1-3.

842-30-25-3 requires a lessor to record indirect costs. A lessee has an option to not include indirect costs. There should be a consistency, with disclosure of the treatment chosen.

Example 2, 842-30-55-21-29, I disagree with the initial recognition of profit at the time of the lease commencement. The entire profit, should be considered unearned until the asset is sold. This would avoid recording a gain on commencement and the possibility of a loss at a later date which could create volatility. Also, all events have not yet transpired to permit recognition of a gain.

If under 842-30-55-40 an allowance is recognized for possible losses on a lease, what is the purpose of 842-30-55-43-44? From my perspective, the calculation reflected in the example should be used as the basis for allowance, not both.

4. Classification of Leases-The determination of how a lease is to be classified is based upon economic life and the expected value consumed in relation to the leased asset. Concern is how to necessarily determine if the value consumed is significant or not. Instead, for simplicity purposes, we should consider making type A leases to be personal property and equipment, and type B leases real property. This takes the valuation criteria away, which can be subjective.
  1. 842-10-55-67-69 is an example of lease that is considered not short-term. Virtually all lease agreements contain provisions for renewals (automatic or not). This example would effectively indicate that ANY lease with renewal provisions, would not qualify as a short-term lease. I do not think that was the intention of providing for treatment of short-term leases differently than long-term leases. Instead, of applying only the 'economic incentive' as a test, we should also stipulate an 'intention' factor. While there is a risk that a company may apply a 'no intention' factor to treat more leases as short-term, their ongoing actions and acceptance of renewals would be indicative of a different behavior and the accounting treated accordingly. I know that is more subjective, but without a further means of handling renewal options, I think it is needed. Of course, we may then see more agreements being written without such renewals in the future.
  2. It is stated that type B leases be amortized on a straight line basis. Many property leases contain escalation clauses, which are designed to reflect cost increases (i.e. CPI). Where such conditions exist, the escalation costs should be reflected in the period for which they relate, hence straight line amortization would not be applicable. See Example 4B, 842-20-55-48-53.
5. Lease Term-I agree that when there is a significant event or change in terms that the valuation should be changed. In essence, there is a new lease if the changes are material, and the treatment should be based upon those new terms from the commencement of that "new" lease.

As I say this, I am concerned about renewals, especially automatic renewals. Many leases either have automatic renewal provisions, or revert to a month-to-month basis. I do not think that, without any specific indication otherwise, that renewal options are to be considered until such time as they are exercised. Theory about decisions being made on purely economic basis is flawed. Many decisions are based upon a myriad of factors that are not economic, so assumptions on renewal terms on only that sole factor would be misleading. From a lessee standpoint, a month-to-month lease is expensed each period as there is no longer term accounting. Because the lessee right to the property is only for that month, its rights to the property is severely restricted.

6. Variable Lease Payments-842-20-55-64-65 on variable lease payments I agree with the recording of the expense when incurred, on an accrual basis. In other words, accrual of the pro-rata variable cost should be, based upon the Lessee forecast, reflected in interim financial statements.

It is stated that type B leases be amortized on a straight line basis. Many property leases contain escalation clauses, which are designed to reflect cost increases (i.e. CPI). Where such conditions exist, the escalation costs should be reflected in the period for which they relate, hence straight line amortization would not be applicable. See Example 4B, 842-20-55-48-53.

7. Transition-No comments are the transition accounting other than the accounting as noted with leases.
8. Disclosure-The disclosure requirements are utterly confusing and will add no value. I understand that some analysts said they want this information, but that is a redundancy of what is contained within the financial statements. For years, the concern was that leases were only found in the notes to financial statements. I agree with reflecting leases on the Statement of Financial Position. The fact is that the vast majority, including analysts and bankers, read the Statement of Comprehensive Income and pay little attention to the Statement of Financial Position and Statement of Cash Flow.

Other than a simple paragraph describing in general terms the leases, such as "...terms ranging from 3-10 years, with discount rates of 3.5%-5.0%" other disclosure and the related is not necessary. If there is a material lease then that lease should be discussed briefly. But, the whole reconciliation and such will be costly and add no value. A brief mention of variable cost would be a useful disclosure.

Again, my earlier comment about not treating the Right-of-use asset as depreciation expense but rather in its appropriate character (operating expense, rent, etc), is of greater value to users. Again, the vast majority of users of financial reports ignore depreciation & amortization as a 'non-cash' item.

9. Nonpublic Entities-Item 1 discusses the risk-free discount rate for nonpublic companies. I think that option should be applicable to public entities also, and is to be used when there is not a more valid rate for that entity. As noted in 8 above, that would be included in the disclosure.

As noted in 8 on disclosure, I agree that the reconciliation is not necessary and adds no useful information.

Related party leases should be recorded and disclosed the same as any other lease. There should be disclosure that a lease is with a related party, as well as disclosed currently under related parties.

10. I do question whether some statement as to whether the lease is considered 'arms length' is both appropriate and auditable as to the representation. To have separate accounting would be an exercise in fiction not to mention overly complex. Users of financial statements can use their own judgment and analysis to determine if they feel the need to adjust amounts. I would only see this as being an issue on the potential sale and valuation of an entity, or with a financial institution for which an entity is seeking funds. In the later case, especially with private and small businesses, the financial institution will require guarantees or additional security, so there is no concern over the amounts reflected.

11. See response on 8 above.

12. Consequential Amendments to IAS 40-The use of investment property, whether it be personal or real property is very similar to the residual asset/inventory of type A leases. Type B leases can also be reflected in the same manner. The use of the phrase 'investment property' provides a more identifiable description of lessor assets being used to generate income.

Thank you for the opportunity to express my viewpoints on this highly charged topic. As a user who have leases such as copiers, some land leases, etc, the accounting treatment is very important our company.

Should you have any further questions or wish to talk further, please feel free to contact me directly.

Respectfully submitted,

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