



September 11, 2013

Technical Director  
File Reference No. 2013-270

I am writing in opposition of the proposed accounting standards update of Topic 842 (File Reference No. 2013-270) on behalf of the Modular Building Institute (MBI). MBI is an international non-profit trade association serving the commercial modular construction industry and representing 75 companies engaged in the leasing of modular, relocatable buildings. We represent a broad range of leasing companies from multi-million dollar publicly trade entities to smaller family owned businesses, both of which would be significantly impacted by these requirements. Collectively, our industry owns and leases approximately 300,000 buildings or units in North America. Despite the fact that these buildings are occupied and take on many characteristics of real property, these units are classified as equipment for accounting and tax purposes.

Several legal and tax cases have established this industry practice including the Whitco and Fox Photo case. The courts have consistently held that property which is affixed to land is not per se inherently permanent simply because it appears to be a permanent structure. As such, our industry treats many of these units as equipment.

In the proposed regulations, it is unclear how these assets will be treated. A high percentage of our industry's leasing activity is currently considered operating leases. Most leases are two years or less, with options to renew. Most companies consider these assets to have an economic life of between 15-20 years. Our companies typically install, lease and subsequently dismantle these units; and frequently lease the same asset to another customer.

The customer typically has no other interest in the building beyond occupancy for a short period of time. As such, requiring the customer to include the lease asset and liability on their balance sheet would create a great deal of confusion and hardship and would do little to improve financial accountability and understanding. About 35 percent of our industry customers are local school districts that utilize these assets to mitigate temporary school population fluctuations.

Given that we feel that most of our leases are NOT property per se, they would seem to fall into a “Type A” lease in your proposed regulations, meaning the lessee would have to recognize the right of use of the asset and book the liability. However, practically speaking, we are leasing a building to the lessee, which appears to fall under “Type B” of your regulations.

Specifically, these are our concerns relative to our industry and in response to your questions:

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as —a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. An entity would determine whether a contract contains a lease by assessing whether:

1. Fulfillment of the contract depends on the use of an identified asset.
2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

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.

**Industry Response to Question 1:** Disagree. We are concerned that the concept of *control* in the exposure draft is ambiguous. Specifically, the exposure draft is unclear as to how to evaluate whether a customer has the *ability to direct the use* of an asset or whether the customer has an *ability to derive benefits from use* of assets in our industry, where the use of the asset is a part of the service we provide -- the other services being installation, transportation, dismantling and lodging.

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?

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?

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?

**Industry Response to Questions 2-4:** Disagree. The regulations indicate that the accounting applied by the lessor could change from case to case "depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset."

At the time of the initial lease of a building, there is no assurance or guarantee that the lessee will renew or extend a lease beyond the initial term. As such, an assumption would have to be made that the initial term is in fact the entire duration of the lease and make the determination as to whether that lease consumed more than an insignificant portion of the economic benefit of the asset. That determination is also based on several variables including the age of the asset, remaining book value and length of the lease. It may be determined that the original lease did not consume more than an insignificant amount for the initial lessor, but upon subsequent renewal of the lease, or if the same asset is leased to a new customer, a new accounting may have to be applied to the same asset.

In our industry's case, one asset may be treated both as Type A and Type B at different points in its life, and may have to be recognized by the lessee in one case and not recognized in another. How will it be ensured that both the lessor and lessee record the lease under the same classification (Type A or B). Will it need to be mentioned in the contract specifically? What if the contract is between international parties wherein one country is not bound by IFRS?

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?

**Industry response to Question 5:** Disagree. The exposure draft currently states that any contracts 12 months or less would be precluded from the new standards. What would happen if we had a contract that was 6 months in length and near the end of the term an extension was granted which now makes the overall contract more than a year? Further, if we need to capitalize leases, we will need to take most likely case as most contracts are extended. This may result in de-recognition of assets if extension is not required for some reason. This may result in residual gain or loss. The parameters to be considered to define the extension are not clear in the exposure draft.

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?

**Industry Response to Question 8:** Disagree. Financial Statement Complexity: Under the new proposed amendments, “lessors would be required to account for all components separately because [they] have the information to do so.” Our contracts do not always differentiate between rates for services versus rates for use of units. Bifurcation will introduce an element of subjectivity into our financial statements that does not currently exist in our revenue recognition model. Many of our contracts have multiple components.

From our customer’s perspective, lessees would be required “to obtain observable stand-alone prices for each component” as lease and non-lease (service) components of a contract would be accounted for separately. Identifying non-lease component, e.g. services of contracts, may change the leasing practices of the lessees. Lessees are currently not focused on identifying non-lease components because their accounting treatment is same as for an operating lease. Under the new proposal, lessees will need more robust processes to identify lease and non-lease components of contracts, which will require judgment when a range of prices exists as well as result in additional costs to bifurcate the lease expenses into separate components with no additional benefit to the lessee, as most of our customers treat lease expenses as operating costs and not SG&A type expenses that need to be segregated (e.g. rent, maintenance or food services).

In summary, we believe that these proposed regulations add complexity to both the lessor and lessee, do not provide additional clarity or transparency to the public, and would have a significant negative economic impact on our industry and its customers. For each unit leased, multiply this scenario by 300,000, and you can see why our industry is concerned about this regulation. There are simply too many variables and arbitrary judgments that would have to be made on a case-by-case basis, creating a myriad of tax circumstances and consequences in an otherwise predictable and consistent industry practice.

Sincerely,



Tom Hardiman  
Executive Director  
Modular Building Institute