Students of Master of Science in Accounting
Indiana University Kelley School of Business, Indianapolis
801 W. Michigan Street
Indianapolis, IN 46292-5151

October 29, 2009

Technical Director
Financial Accounting Standards Board
401 Merrit 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference NO. 1680-100

Dear Director:

We are students in the Indiana University Kelley School of Business Master of Science in Accounting program. We appreciate the opportunity to respond to the Discussion Paper *Leases: Preliminary Views*, issued by the International Account Standard Board (IASB) and the U.S. Financial Accounting Standard Board (FASB) together on significant components of an accounting model for lessees.

We agree with the boards' decision to reconsider the current lease accounting model as it does not represent the rights and obligations that arise from many lease arrangements. With revised lessee and lessor accounting issues, the proposed reconsideration reflects significant accounting changes for leases that are now classified as operating leases. We believe entities that lease assets under finance leases would also be affected by changes in the way leased assets and liabilities are measured under the new standards.

We present detailed responses to the specific questions raised in the Discussion Paper below.

Chapter 2: Scope of lease accounting standard

Question 1
The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

We agree with the boards' decision to tentatively base the scope of the new lease accounting on the scope of the existing lease accounting standards.

We realize that scope is not a significant issue with the current standard, so we support the boards' approach. We believe this would be the most effective approach. As stated in paragraph 2.10 of the Preliminary Views, "The approach to scope adopted in the existing standards is familiar to constituents." Because most leases can be defined within the current scope it is sufficient for the time being. We do agree with others who commented (CL120, CL139) by strongly suggesting that the board consider the differences that currently lie between the scopes in IFRS and US GAAP. Because the goal is to eventually issue a converged standard, we believe the boards should take this opportunity to consider and eliminate these differences before the final Standard is released.

Question 2
Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.
Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

We <u>do not agree</u> with the proposed scope exemption to exclude non-core assets or short-term leases.

We do not believe that there was any substantial basis for excluding these types of leases. All leases should be included, whether the right-to-use asset is related to "core" versus "non-core" physical assets. Not only would it be difficult to define short term leases for exclusion purposes but it would add a level of complexity to lease accounting that does not add value. Both non-core asset leases and short-term leases can have potentially big impacts on businesses and could affect the decisions of users of the financial statements. Including all leases would be most informative and consistent.

Chapter 3: Approach to lessee accounting

Question 3 *Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.*

We agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract.

The boards identified the rights and obligations in a simple lease as right-to-use the asset for the lease term, obligation to pay rentals and obligation to return the asset at the end of the lease term. From our understanding, we agree with the analysis that the rights and obligations of a simple lease contract meet the definition of an asset and liability under the FASB No.6.

Question 4 *The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:* *(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)* *(b) a liability for its obligation to pay rentals.* *Appendix C describes some possible accounting approaches that were rejected by the boards.* *Do you support the proposed approach?* *If you support an alternative approach, please describe the approach and explain why you support it.*

We agree that having a lessee recognize an asset and liability in all cases of a lease instead of having two different types of leases does lead to more comparability between different entities.

The user of financial statements will not have to determine the amounts a given entity has in finance and operating leases. The understandability of financial statements is also improved with this method, because the user will no longer need to make pro forma adjustments the statements to determine the actual amount of assets and liabilities. The approaches in Appendix C may lessen the understandability and representational faithfulness of the statements. The whole asset approach may overstate assets and liabilities alike. This method forces a lessee to recognize an asset based in part on economic benefit produced by the asset after the termination of the lease. The lessee has no rights or obligations to these future economic benefits.

Question 5
The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:
(a) a single right-of-use asset that includes rights acquired under options (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.
Do you support this proposed approach? If not, why?

We agree that the adopted approach seems to be the best choice. The component approach would force a lessee to identify, measure, and recognize the different parts of the lease. This could prove troublesome because very few leases are simple or straightforward. Many of the components of a lease are interrelated. Determining the value of each component by itself may be impossible as they may not have a stand-alone value. Even if not impossible to separate components, it is certainly possible that the costs of valuing the components may outweigh the benefits, particularly on a short-term lease where the asset may be disposed of before the valuation is completed.

Chapter 4: Initial Measurement

Question 6
Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?
If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

We agree with the boards tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate is both the least complex and best method.

This method closely approximates the cost of the lease. Because a lease is not a financial instrument, the accepted value method is cost. The implicit interest rate method includes an estimate based on little knowledge of the actual value. This method could lead to an amount that is unreliable and irrelevant. Ernst & Young brought up a valid question in CL 139. If the lease is to be valued using the lessee's incremental borrowing rate, what happens if a lessee is unable to secure financing outside of the lease? The board should issue guidance on this point.

Question 7:
Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?
If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree with the boards' tentative decision to use the right-of-use to measure the lessee's assets at cost. It is consistent with previous guidance applied to intangible assets per IAS 38 (CL 124) and would provide comparability to other financial statements (CL 270). The finite lease is capable of being measured at cost. Initially, the cost of the lease would be the fair value of the payments discounted using the borrowing rate, which can easily be done at the inception of the lease.

Chapter 5: Subsequent measurement

Question 8:
The boards tentatively decided to adopt an amortized cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset.
Do you agree with this proposed approach?
If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favor and why.

We believe that the tentative decision by the board is consistent with IAS 38 and FAS 142. As stated in the previous response to Question 7, we encourage the boards to not make it a requirement, but allow the lessee to choose it as an option. Adopting an amortized cost based approach would also help the end users to better understand the accounting since the owned and leased assets would be comparable (CL 173).

Question 9:
Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

We do not agree with the measurement of leased assets at fair value. Fair value of most leased items would be difficult at best to obtain, and therefore would be of too great a burden for most companies to benefit. We believe that measuring leased items at fair value would compromise the comparability and consistency of the initial framework.

Question 10
Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

We <u>do not</u> agree with the boards' tentative decision that the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate.

We believe that lease finance is by nature a form of fixed rate borrowing and should be treated as such, because the borrowing rate does not change during the life of contract. In addition, we believe that revising the obligation to reflect changes in its incremental borrowing rate would result in increased complexity and be costly for preparers. Also, the use of revised incremental borrowing rate would be inconsistent with the way many non-derivative financial liabilities are subsequently measured.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

We support the premise that the lease should be revised only when there is a change in the estimated cash flows under the lease. We believe this approach would reduce the cost and complexity for preparation of financial statements, as mentioned previously and continue to provide the useful information that would be beneficial to users. The approach is consistent with the catch-up approach, and both IFRSs and U.S. GAAP agree to adopt it as well.

Question 11
In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.
Do you agree with the proposed approach taken by the boards?
If you disagree, please explain why.

We agree with the boards' tentative decision to specify the required accounting for the obligation to pay rentals within the lease accounting proposals. Aspects of the lease obligation accounting are unique to leases and should appropriately be dealt with in separate leasing guidance. Given the different treatments under IAS 37 and IAS 39, specifying the basis of measurement will resolve uncertainty as to the appropriate approach, providing consistency for accounting.

Question 12
Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortization or depreciation in the income statement.
Would you support this approach? If so, for which lease? Please explain your reasons.

We support the premise that the decrease in value of the right-of-use asset should be described as amortization or depreciation in the income statement rather than as rental expense. The benefits of the right-of-use assets from all leases should be recognized as amortization or depreciation.

However, for the clarity of financial reporting, we support the decision to require separate disclosure of depreciation of tangible assets from depreciation of right-of-use assets. Moreover, referring to the decrease in value of the right-of-use asset as rental expense is inconsistent with classification of assets because a lease contract creates an asset, and the lessee subsequently utilizes it.

Chapter 6: Leases with Options

Question 13
The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We agree with the boards' view that the renewal options should be recognized at the inception of the lease term. However, we disagree with the boards using the basis of the most likely lease term to determine the lease term. We believe that the methodology of most likely lease term would increase inconsistency in determining the lease term: under the most likely lease term approach, a ten-year lease would be recognized as the same obligation as an eight-year lease with an option to extend for another two years that is likely to renew. Nevertheless, the lessee of eight-year lease might decide not to renew in the second period.

We suggest that the boards should keep the existing guidance in the lease accounting standard, which is the fixed noncancellable term plus any optional period if it is reasonably assured. We believe that the reasonably assured approach would be easier to be assessed than the most likely lease term approach (see CL 270 for discussion).

Question 14
The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why. Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

We agree with the boards' tentative decision to require reassessment of the lease term at each reporting date that would provide more relevant information to users. The periodic revising is necessary to ensure that the financial statements accurately reflect the lease contract.

We agree with the boards tentative decision that changes in the obligation to pay rentals from a reassessment of the lease term should be recognized as an adjustment to the carrying amount of the right-of-use asset.

Question 15
The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We agree with the boards tentative decision that purchase option should be accounted for in the same way as options to extend or terminate the lease. There is no difference between providing purchase options and providing renewal options: they both extend the entire economic life of the leased item.

Chapter 10: Lessor Accounting

Question 25
Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

Yes, we believe that a lessor's right to receive rentals under a lease meets the definition of an asset because the right to receive the rentals has met three major elements of the definition under the SFAC No. 6:

1. Controlled by an entity
2. As a result of past events.
3. Provide entity future economic benefits.

The characteristics of an asset are laid out in Paragraph 3.13 of the Preliminary Views. "The entity must control an economic resource or benefit. The item arises out of a past event. Future economic benefits are expected to flow to the entity." The lessor temporarily gives up control of an economic resource, but does receive an economic benefit in lieu of it. The right to receive rentals does come from a past event. Future economic benefit is received by the lessor in way of the payment by the lessee. Given the fact that the right to receive rentals meets all three characteristics laid out in SFAC No. 6, it does meet the definition of an asset and should be classified as an asset.

Sincerely,

William Eason William J Eason

Chun-Che Lo Chun Che Lo

Yuhan Shi Yuhan Shi.

Heather Wilson Heather Wilson

Joseph Cooper [illegible]

Resources Cited

Deloitte Touche Tohmatsu. Letter of Comment No. 120 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/982A3AE2-52EE-4F38-BD0C-7BA2BBC3FF0C/11157/20090717120734_DTT_LeasesDP.pdf

Ernst and Young Global Limited. Letter of Comment No. 139 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/E89C0B43-B0B7-447C-9869-D45BD6586308/11184/20090717170738_CommentLetterDPLeasesPreliminaryViews.pdf

Financial Accounting Standards Board. "Definition of an Asset." Statement of Financial Concepts No. 6 (May 1975) http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175818761018&blobheader=application%2Fpdf

Financial Accounting Standards Board. "Goodwill and Other Intangible Assets." Statement of Financial Concepts No.142. (June 2001) http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175818827708&blobheader=application%2Fpdf

International Accounting Standards Board. IAS 37. "Provisions, Contingent Liabilities and Contingent Assets." (No Date) http://www.iasb.org/NR/rdonlyres/94C8F2F5-FC68-43E5-86AC-211C9B701FE5/0/IAS37.pdf

International Accounting Standards Board. IAS 38. "Intangible Assets." (No Date) http://www.iasb.org/NR/rdonlyres/149D67E2-6769-4E8F-976D-6BABEB783D90/0/IAS38.pdf

International Accounting Standards Board. IAS 39. "Financial Instruments: Recognition and Measurement." (No Date) http://www.iasb.org/NR/rdonlyres/1D9CBD62-F0A8-4401-A90D-483C63800CAA/0/IAS39.pdf

KPMG IFRG Limited. Letter of Comment No. 270 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/25BA8403-9F9F-4B51-8C3F-09FDFE2A69DF/11455/20090729120704_KPMGInternationalCommentLetteronDiscussionPaperLeasesPreliminaryViews.pdf

McGladrey & Pullen LLP. Letter of Comment No. 284 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/49B23111-EB8E-43B3-81FB-607C596EEDB3/0/CL284.pdf

Nokia. Letter of Comment No. 124 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/8F516C04-C335-4922-86E8-FF9AB4DDBE22/11164/20090717140721_DPLeasescommentletterNokia.pdf

PriceWaterhouseCoopers LLP. Letter of Comment No. 173 to Financial Accounting Standards Board. 17 October, 2009. http://www.iasb.org/NR/rdonlyres/E500631F-321B-4406-B295-3A3D9976D81E/0/CL173