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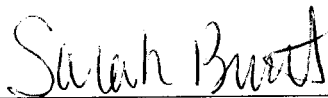
Project: Discussion Paper, Leases: Preliminary Views
Reference Number: 1680-100

Dear Director:

Thank you for this opportunity to comment upon Discussion Paper 1680-100, Leases: Preliminary Views. We are a group of five graduate students studying Professional Accountancy at the Indiana University Kelley School of Business in Indianapolis. Specifically, we are studying the relationship between the Conceptual Framework and the accounting standard setting process. Such studies are challenging in October 2009 given that Objectives and Qualitative Characteristics of Financial Reporting (Phase A) of the joint FASB/IASB Conceptual Framework Project is less than three months from being released in its final form. Elements and Recognition (Phase B) has only defined "Assets" and "Liabilities." Therefore, in our response to Preliminary Views on Leases, we will primarily refer to the FASB's SFACs 1-7. When appropriate, we will draw attention to the direction that the Conceptual Framework is heading as the FASB/IASB moves towards completing Phases A and B. In our comments we address some, but not all, of the questions in the Discussion Paper.

Three of the five members of our group are part-time students holding full-time jobs. The members of this sub-group work in the areas of property management, software development and undergraduate college education. As a result we have an immediate interest in the outcome of what our entire group perceives to be a needed change in the guidelines for lease accounting. We conclude that fundamental change in lease accounting is necessary in order to properly capture "the substance of an economic phenomenon" as described in the definition of "faithful representation" Phase A of the Joint Conceptual Framework. In the appendix to this letter you will find our responses to selected questions from the discussion paper.

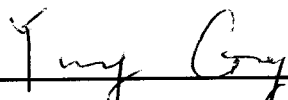
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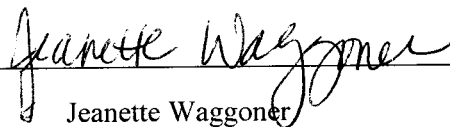
Sarah Burton



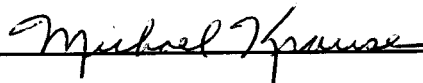
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Appendix – Response to Specific Questions in the Discussion Paper

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.

For practical purposes, we agree with the boards' decision to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. The existing lease standards increase understandability, and the information will allow for more consistency over time. In order to develop more consistency, we recommend that the boards use this joint lease project to reconcile the differences between U.S. GAAP and IFRS. Conceptually, we believe that all rights to use an asset should be included in the scope of lease accounting, regardless of whether or not the asset is tangible. We recommend that the proposed new lease accounting should be based on IAS 17 and include all assets.

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 do not believe leases of non-core assets should be excluded from the scope of the proposed new standard because it is difficult to define core and non-core assets. In keeping with the materiality concept, we believe that focusing on an asset's "economic substance" is more important than focusing on whether it is a core or non-core asset. Non-core assets may give rise to material assets and liabilities which could significantly affect the operations of an entity and the interests to the users of financial statements. The exclusion of non-core asset leases from the new standard would reduce the comparability for financial statements users

Also, we believe short-term leases should not be excluded from the scope of the proposed new standard. We believe that the attempt to define and exclude short-term leases would be arbitrary and difficult to apply in practice, and would encourage structuring of leases.

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 arising from a simple lease contract, specifically that the right to use a leased item is an asset, and the obligation to pay the rental is a liability, but the obligation to return the leased asset at the end of the term is not a liability. The matrix in paragraph 3.25 is especially useful for understanding this analysis based on whether those rights and obligations meet the definitions of assets and liabilities. By recognizing assets and liabilities arising in leases in the financial statements, and applying the same accounting to all lease contracts, comparability is enhanced for users of the financial statements. The boards are currently working on the joint project

Conceptual Framework Phase B: Elements and Recognition, and we believe the tentative definitions proposed therein for assets and liabilities would not have a substantial impact on the analysis of rights and obligations.

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 with the boards' proposed right-of-use model that recognizes assets and liabilities arising from lease arrangements. The rights and obligations arising from a simple lease meet the definitions of assets and liabilities respectively. This approach places more emphasis on faithful representation of the assets and liabilities arising from the lease contract. The proposed approach is easier to implement and increases comparability.

We agree with the boards' rejection of the "whole asset" approach. This approach fails to reflect an entity's true economic position, specifically that the lessee has no right to the asset at the expiration of the lease, absent a renewal or purchase option. We agree the resulting accounting would overstate assets and liabilities, especially for short-term leases.

We agree with the boards' rejection of the "executory contract" approach, as it fails to recognize the lessee's assets and liabilities as defined in the Conceptual Framework, and would continue to require users of financial statements to adjust the assets and liabilities of lessees in order to recognize the true rights and obligations.

We support the boards' decision to reject existing standards on the basis that similar arrangements can be accounted for differently depending on whether the lease is classified as capital or operating lease, thereby decreasing comparability.

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 support the single asset and single liability approach proposed by the board. A components approach would not adequately represent the interdependency of components. Identifying, recognizing and measuring components would be a difficult process. In addition determining fair values of components may prove to be challenging as components are not priced separately from the lease, and there may not be a market for all components (see our response to question 25). Leases are generally recognized as one unit of accounting, thus separating out components that meet the definition of an asset or liability may not provide users with additional useful information. Confusion over how to treat components may lead to decreased comparability between entities.

The asset and liability in a lease cannot be recognized separately from one another, so it would follow that components cannot be considered independently either.

We agree with paragraph 3.22 that the obligation to return a leased asset at the end of the term does not meet the definition of a liability, as the lessee has no right to the asset's economic benefits at the expiration of the term, there is no outflow of economic benefit.

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' 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. We believe this discount rate creates a more realistic value of the lease. This is the best and simplest approach, as implicit rate information may not be obtainable and entity-specific factors are ignored. A single approach is more practical and increases comparability if entity-specific incremental borrowing rates are properly disclosed.

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 board's tentative decision to measure the lessee's right-of-use asset at cost. This method is consistent with other non-financial measurements and maintains an easier calculation for lessees. The method creates an easier transition in calculating both right-of-use assets and regular leases because both use the incremental borrowing rate.

Chapter 5: Subsequent Measurement

Question 8

The boards tentatively decided to adopt an amortised 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 favour and why.

We agree that the subsequent measurement of both the obligation to pay rentals and the right-of-use asset should be accomplished using an amortized cost-based approach. To do otherwise would be inconsistent with paragraphs 4.15 and 4.23 of this Discussion Paper, which establishes the appropriate treatment of the initial recognition of these two elements as the present value of the lease payments discounted using the lessee's incremental borrowing rate. However we share Nestle Corporation's opinion, found in CL18, that "the right-of-use asset should be depreciated on a straight line basis unless a different method better represents the pattern of consumption of the rights by the lessee". An accelerated pattern of amortization for the asset would only be appropriate where the economic benefits derived from such an asset are front loaded consistent with precedents established for capitalized software costs in FAS 86.

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 believe that a lessee should be allowed to measure its obligation to pay rentals at fair value. In our opinion the guidance provided under FAS 159 for a fair value election for financial assets and

liabilities should continue to expressly deny such an option to financial assets and liabilities under leases. We agree with the New York State Society of CPA's, as expressed in CL 107. Specifically, The New York State Society comments that "a fair value approach to leases would be inconsistent with the amortized cost approach favored by the boards". The inconsistency resulting from making a fair value election available is impractical at best because the New York State Society maintains that "fair value information on leases is not readily available." PricewaterhouseCoopers, in CL 173, and KPMG, in CL 270, predict that preparers would rarely make such an election.

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. 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 believe that a lessee should not be required to revise its obligation to pay rentals in order to reflect changes in its incremental borrowing rates. Borrowing rates for all obligors change on an ongoing basis because of regular market adjustments for factors like risk free return or inflation expectations. Such a requirement for a lease obligation would be inconsistent with the treatment of other obligations and reduce comparability. However, should there be a material change in the estimated future cash flows as provided for in the lease contract, a new revised obligation has been created. As a result of this revised economic event, a change in the estimated cash flows is an appropriate time to reassess the lessee's incremental borrowing rate to reflect current market conditions. A rational lessee would likely extend a lease term if the current locked in borrowing rate was more favorable than the current market rate which would have to be negotiated for a new lease contract. Automatic revision of the incremental borrowing rate at each reporting date would not provide cost effective information. What would be cost effective and relevant information to users of financial statements is a simple disclosure of the incremental borrowing rate used. Such a disclosure about the incremental borrowing rate would provide information as to whether an obligor currently functions with or without favorable credit terms as compared with current market conditions.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for obligations 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 that they should specify the required accounting for the obligation to pay rentals rather than to scope such obligations to pay rentals into existing guidance for financial liabilities. Lease obligations have a unique nature that differs considerably from other types of financial liabilities. When the boards start considering operating leases (as currently defined in SFAS 13), they will have to contend with a material residual value which is a distinctive concern in lease accounting. We agree with Ernst & Young's argument, as explained in CL 139, that a separate standard for obligations to pay rentals will do a better job of promoting convergence between U.S. GAAP and IFRS.

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 leases? Please explain your reasons.

We would not support the approach that describes in the income statement the decrease in value of the right-of-use asset as rental expense rather than amortization or depreciation. The term rental expense should be reserved for immaterial transactions where the temporary contractual use of others' assets are

motivated by economic expedience or operational prudence. For example, an organization would have immaterial rent expense for the use of a hall for an awards banquet instead of building a suitable facility or leasing one for an extended time. Or if an organization has skilled workers of its own to renovate a building, it would have immaterial rent expense cost for construction tools to be used for two months rather than buying them or leasing them for an extended time.

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, ie 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 do not support the proposed approach of recognizing the lease term as the most likely lease term. We believe that using a lease term of 10 years and disclosing that a five year option exists and can be exercised is consistent with the definition of a liability in the Conceptual Framework. When recognizing the lease as a 10 year liability, it coincides as a present economic obligation, whereas recognizing the lease with the five year option is not a present obligation due to the fact that it is unknown as to whether the option will be exercised. If the lease were to be recognized with a term of 10 years and disclosed the five year extension option, the facts would be considered more relevant and consistent with the meaning of a present obligation, therefore providing a greater amount of faithful representation. Furthermore, Example 5 (6.35) fails to logically support the boards' tentative decision to use "the most likely" lease term. Example 5 selects 10 years with a 35% probability of happening as the most likely lease term. This selection appears difficult to defend; and verifiability would defy consensus given that in the example there is a 55% probability that the most likely lease term is 15 to 25 years. The example appears to be contrary to the concept of neutrality in standard setting as the example is biased towards a shorter time period, which would in turn generate greater depreciation calculations.

We support a qualitative assessment of the lease term. We agree with the boards' assessment (6.32a) that simplicity is the main advantage of this approach. However we disagree with the boards' stated disadvantage (6.33a) that "it may reduce comparability for users because ...different lessees could account for the lease in very different ways." The boards' argument is contrary to the entity perspective adopted by Phase A of the IASB/FASB Conceptual Framework. If the fundamental economic phenomenon is the same, then two reporting entities with similar economic and business circumstances should account for a similar lease without material differences provided that both entities share a commitment to faithful representation.

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 board's decision to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances by recognizing changes in the lease term as a prospective adjustment to the carrying amount of the right-of-use asset. At the reporting date preparers should be

acutely aware of the need to have faithful representation that is free of material error. We agree with the board's stated view in Paragraph 6.46 that reassessing the lease term at each reporting date due to a material economic event, such as exercising an option, provides greater relevancy of the information presented, and we believe it becomes more verifiable among leases of its type. Although the reassessment might make the lease term complex and more costly for preparers, we believe that the benefits will outweigh the costs by increasing the understandability for the users of the financial statements. The boards' approach promotes the understandability of the financial reports as this would have no income statement impact on previously published financial reports. Such prior reports were based upon economic events as previously understood. This prospective approach carries current lease knowledge into future periods that will benefit from the asset as assessed for usage.

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.

Yes, we agree with the proposed approach that purchase options should be accounted for in the same way as options to extend or terminate the lease. By doing so, the information can be presented fairly and accurately. The proposed approach will also make the information consistent over time and across entities. This view is also consistent with our approach in Question 13 that this proposed method will be equally definable as a present obligation when the specific options are exercised. We believe that the boards' views are consistent with recent standards concerning arrangements with multiple deliverables (EITF Issue 08-1.) The purchase option has no standalone value as it is available only to the original lessee.

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. According to *Statements of Financial Accounting Concepts No. 6*, assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. We believe that when the leased item has been transferred or delivered to the lessee, the lessor has the right to receive rentals or payments. The right to receive rentals is controlled by the lessor, and it is legally enforceable through the lease agreement or lease contract. Also, the lessor's right to receive rentals arises from a past event: the lease contract and the delivery of the leased item. The lease provides future economic benefits, and the lessor can collect the rent or sell the rent receivable in the future to increase cash flow.

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