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Technical Director
File Reference No. 1850-100
FASB
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Re: Comments on Proposed Accounting Standards Update: Leases (Topic 840),
File Reference No. 1850-100

Dear Members of the Boards:

The Retail Industry Leaders Association (“RILA”) and its Financial Leaders Council (“FLC”) are pleased to respond to the *Proposed Accounting Standards Update, Leases (Topic 840)*, issued by the Board on August 17, 2010 (the “Exposure Draft”). RILA is the trade association of the world’s largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales and millions of American jobs.

With more than 100,000 stores, manufacturing facilities, and distribution centers domestically and abroad, RILA and its FLC are keenly interested in this topic. While primarily lessees, some of RILA’s members also engage in lessor functions. RILA and its FLC provided comments on the Discussion Paper titled “Leases: Preliminary Views” (File Reference No. 1680-100), and we again appreciate the opportunity to offer our views.

Before responding to the specific questions raised in the Exposure Draft, however, we offer several overarching comments. First, although we are generally supportive of the concept of recognizing a right-of-use asset and related liability, we question the need for wholesale changes made on an expedited basis for a standard that has long been in place and is well understood. The proposed changes will create complex implementation issues necessitating evaluation of and significant changes to system requirements, resources, and internal control processes. Such changes also would likely force some of our members to renegotiate loans and contracts to avoid breaches of covenants – a difficult, time-consuming, and frequently expensive process. For preparers in regulated industries, such as banking, the proposed changes also could impact their required regulatory capital.

Second, several of the Exposure Draft’s proposals are particularly problematic, such as the following proposals which would greatly increase the burden on preparers and introduce several new highly subjective judgments into the application of the standard. In our view, the following are among the most problematic proposals:

- The requirement to consider and include certain renewal periods in the initial measurement;
- The requirement to include estimates (developed with probability-weighted cash flows by individual lease) for contingent rentals in the initial measurement; and
- The effect changes in certain borrowing rates may have on the reassessment provisions of the proposed standard if not specifically excluded from the reassessment requirement.

To minimize these concerns, we suggest that the standard carry-forward concepts from current literature wherever possible. One such example would be to carry-forward the concept of a “minimum lease payment” from current guidance rather than utilize the Exposure Draft’s entirely new, and extremely subjective, concept of a “lease payment.” We discuss these issues in more detail below.

Third, any effective date determination should take these important factors into account. The recent issuance by the FASB of a discussion paper on effective dates and transition methods further emphasizes the need to ensure careful study of the consequences of the Exposure Draft before mandating an implementation date. Further, we believe the Boards should weigh the perceived benefits against the real and substantial costs to preparers and attempt to minimize such costs. In this regard, we specifically question the need to make sweeping changes prior to the SEC making a final determination as to the required use of IFRS by U.S. issuers.

We are not necessarily advocating a “big bang” approach to IFRS conformity.¹ Rather, our concern is that this proposed standard is sweeping in its scope and would not be a fully-converged standard.² We believe that the Boards should work towards a fully converged standard before implementation is required. Further, in any event, completion of the standard and the chosen effective date should be coordinated with the SEC’s final determination on the mandatory use of IFRS. This would allow financial preparers to implement leasing standard changes once rather than twice (potentially in quick succession).

We thank you for the opportunity to comment on the Exposure Draft and offer our specific comments below.

¹ See also response to Question 16.

² That is, the proposed new “GAAP” standard differs from the proposed new IFRS standard (*see, e.g.*, leases of investment property, revaluation, impairment, service components, etc.).

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?**

RILA believes that it is generally appropriate to recognize both the right-of-use asset and the liability for the obligation to pay rentals. This is similar to the current treatment of capital leases under ASC 840 *Leases*. Several operational aspects of the proposals in the Exposure Draft, however, are problematic.

A significant concern is the current definition of the term “lease payment.” We do not believe that the definition is clear and, as a result, will lead to confusion and disparate interpretations. For example, under the Exposure Draft’s definition, the treatment of a gross lease or key money, *i.e.*, a premium paid to obtain lease space, is unclear.³ Our suggestion would be to make the term “lease payment” consistent with the term “minimum lease payment” under current guidance. This term is clearly defined and well understood and does not suffer from the same lack of clarity as the Exposure Draft’s definition. In any event, executory costs should be explicitly excluded from the lease payment definition.

With respect to amortization of the right-of-use asset itself, we believe that straight line amortization over the term of the lease is generally appropriate. Existing guidance is sufficient to account for a situation where the useful life of the underlying property is subsequently determined to be shorter than the lease term. We note, however, that the front-loading of interest expense that would result under the Exposure Draft would be particularly punitive to growth companies.

See also our response to Question 10.

³ In the gross lease situation, any final pronouncement should clarify that non-rental amounts such as insurance, tax and maintenance charges included in the rental payment, should be determined or estimated and accounted for under appropriate guidance and not as a lease payment. Further, key money should be considered an initial direct cost, capitalized, and amortized as part of the right to use asset.

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 it currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?**

In our view, the lessor accounting model should be simplified and the Boards should strive for a single model. Having two different models will undoubtedly result in less comparability because of the increased judgments that would have to be made in determining which model to apply. Further, because of the basic nature of a lease (as opposed to a sale), lessors ultimately retain exposure to benefits during and after the expected lease term because they retain the legal rights to the underlying asset.⁴ Moreover, lessors retain exposure to risks after the lease term expires, again, because they own the underlying asset. Accordingly, we do not believe that the distinction the Boards are attempting to draw is realistic or meaningful.

We also have particular concern with the performance obligation approach because of the artificial grossing up of the statement of financial position that results. This, in turn, could obscure the lessor's true financial position and may not result in meaningful or useful information. As a result, consideration should be given to retaining the direct financing leasing model from current guidance as the sole lessor model. This model has worked well and does not create the distortions that could result from application of the performance obligation approach.

⁴ Because the lessor owns the underlying asset it necessarily retains exposure to benefits and burdens of the property and controls the disposition of the property after the lease term concludes. Thus, its rights are, by definition, "significant."

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 the 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?

We agree with the Boards that short term leases (BC43) and leases of non-core assets (BC40) may give rise to significant assets and liabilities. We also agree that disclosure alone is not sufficient and that a simplified method of accounting is appropriate. However, we do not believe that the current proposal is workable. We believe that all short term leases and leases of non-core assets that individually are not material should be excluded. If applied to every short term and non-core asset lease, even the simplified method proposed in the Exposure Draft would be unduly burdensome and costly to apply with little, if any, corresponding benefit. RILA previously commented in connection with the Preliminary Views, that existing accounting guidance for operating leases should continue to be applicable to short-term and non-core asset leases. We continue to believe that this would strike an appropriate balance between providing the users of financial statements with meaningful information while minimizing the costs associated with changes to the existing leasing standard.

Question 4: Definition of a lease

This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1-B4 and BC 29-BC32). This exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59-BC62) and on distinguishing a lease from a service contract (paragraphs B1-B4 and BC29-BC32).

- 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?**

We believe that the definition of a lease provided in the Exposure Draft is generally appropriate. The additional guidance provided on distinguishing a lease from a purchase or sale or from a service contract also is helpful and appropriate. With respect to distinguishing leases from service contracts, however, we believe there is still ambiguity. Under current lease accounting guidance, service contracts that may contain a lease component are often classified as operating leases. Since the accounting for service arrangements and operating leases is similar, separating the two components in practice has presented few issues. However, under the Exposure Draft, service arrangements that contain a lease component would require recognition of assets and liabilities for that lease component. More judgment will be required because of the differences in accounting treatment which, in turn, may lead to significant diversity and complexity in practice.

In particular, we believe there is diversity in the understanding of paragraph B4(e) and specifically with respect to the term “contractually fixed per unit of output.” Today, some view the price as “fixed” only if the price established at the inception of the contract can never change. Others take a more liberal view, where even if the price may change over time, it would be considered fixed if the manner in which the price could change is dictated by the contract. Under the Exposure Draft, differences of interpretation could result in economically similar contracts being accounted for differently (*i.e.*, as a lease and the corresponding asset and liability recognition or as a service contract and a period cost). One particular example that our members have noted is that it is unclear how a contract for a remote server would be categorized, whether the fact that it is shared or dedicated would make a difference, etc. Accordingly, clearer

guidance is necessary to assist preparers in determining how to identify distinct components (*i.e.*, the lease component and the service component).

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?

We agree that the scope exclusions are appropriate, but also believe that short term leases and leases of certain non-core assets also should be excluded. See response to Question 3.

The scope of the proposed standard, in our view, also should be clarified with respect to software licensing agreements. While intangible assets as a whole are explicitly excluded from the proposed standard, ASC 350-40-25-16 directs issuers to topic 840 in determining whether the present value of license payments may be capitalized. The guidance that issuers are directed to is the present guidance used to determine which leases are capital. This guidance will not exist if the Exposure Draft moves forward. We have obtained differing opinions on this issue from our various auditors and believe clarification specific to software licenses is necessary.

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 FASB proposes 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?

We believe that the approach proposed by FASB is generally an appropriate approach. This is also consistent with our view that a single model for lessors should be applicable (although, as discussed in response to Question 2, we believe that the direct financing leasing model contained in current guidance should be applicable to all lessors). However, we note that the Accounting Standards Update for Revenue Recognition is not yet in effect and it is therefore unclear whether or to what extent changes to that standard would impact our response. In addition, we believe there needs to be more clarity with respect to gross leases (see response to Question 1). Finally, the proposed guidance for determining if a service component is distinct is too strict. Many leases include services costs (such as common area maintenance, real estate taxes, utilities, etc.) as part of the “lease payment.” These distinct services costs are not always segregated in the lease. We propose that the guidance allow for estimating these clear services costs regardless of whether or not stated separately in the lease.

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?

Once an option to purchase the underlying asset is exercised, the lease contract should be viewed as being terminated. At that point in time, the contract is most appropriately accounted for as a purchase by the lessee and a sale by the lessor.

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?

No. This proposal is one of the most troubling in the Exposure Draft. While we acknowledge that the initial lease term may not always represent the most likely outcome of a leasing arrangement with one or more renewal options, we have concerns about the proposed standard's model for determining the lease term. Within the proposed standard, BC6(d) states that the right-of-use model is consistent with the FASB's conceptual framework and that an obligation to make lease payments is a present obligation of the lessee arising from entering the lease, the settlement of which is expected to result in an outflow from the lessee of resources embodying economic benefits. While we agree with the Boards that excluding all optional periods from the lease term may understate the right-of-use asset and lease liability, we believe that using the "more likely than not" threshold as the point at which a company would recognize additional terms has the potential to include liabilities on the balance sheet that do not meet the definition of a liability.⁵ Until a company has obligated itself to a renewal period, the optional renewal period is not a present obligation and therefore does not meet the definition of a liability: "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. [emphasis added]." Again, where there is no firm commitment, no present obligation can exist.

In many instances, the existence of a potential renewal term is nothing more than an opportunity to essentially negotiate a new lease. Mandatory inclusion of such renewal terms is distortive given the speculative nature of the exercise. The analysis would be largely dependent on unknown and unknowable future events. For example, any such analysis would necessarily require an estimation of economic factors such as market conditions, demographics, consumer spending, etc., many years, perhaps even more than a decade, in the future. Adding this level of speculation and uncertainty to the financial statements will not provide useful information. For companies such as our members, many of which have thousands of leases, it also would be extremely costly to make a lease-by-lease assessment of any potential future renewal options.

Inclusion of potential renewal terms also is problematic because a lessor and a lessee could make entirely inconsistent assumptions concerning the same lease. Also weighing against inclusion of any potential lease renewal period is the fact that inclusion could tilt the balance of power in any subsequent lease negotiations in favor of the lessor because the lessee would have already

⁵ Moreover, a renewal decision for a lease will often be based on the company's ability to extend the lease at a lower or discounted rate than that which is in the contract (*i.e.*, the company will decline to extend/renew unless lower rent is negotiated). The guidance is not clear as to whether this factor is considered in determining the longest duration more likely than not to occur. In this case, the probability of renewal under the current terms may be different than the probability of negotiating a renewal at a lower rate. If the requirement to assess lease term using a "more likely than not" criterion is retained, we believe the final standard should include specific guidance regarding how to address expected renegotiation of the existing renewal terms in regard to both lease term and lease payments.

assumed renewal for purposes of its financial statements. Financial accounting should reflect the transactions that actually occur – not drive behavior or shift the balance of power in negotiations.

Moreover, because of the assumptions necessary to determine a speculative maximum lease term, the proposal would not promote objectivity, but would compromise comparability between entities, increase complexity, and make verification difficult because of the myriad and speculative assumptions that would have to be made.

Assuming a lease was negotiated between two unrelated parties, the fixed, agreed upon term should control the accounting. Should this not be acceptable to the Boards, we believe that the current leasing guidance's definition of the lease term to include all renewal options that appear at lease inception to be *reasonably assured* would better achieve the goal of reflecting the present liabilities and assets associated with a lease agreement. This methodology would be easier for users to understand due to consistency with past practice. It would also be easier to audit due to less subjectivity involved in management's assessment. Additionally, we believe that retention of the "reasonably assured" threshold, with which issuers and users are familiar, will make adoption of the standard's core model easier for preparers, and make the changes easier to understand for users.

Finally, we suggest that as an alternative to a lease-by-lease analysis, a clear pronouncement allowing groupings of leases with similar attributes would be extremely helpful. Our members with leases in the hundreds have estimated that implementation of the Exposure Draft assuming grouping of leases is allowed would require 1 to 2 full time employees. If the ability to group leases is not permitted, and for our members with thousands of leases regardless of whether grouping of leases is permitted, an entire new staff may be required to implement the proposed standard. In our view, the Boards must consider the practical difficulties with their proposal and attempt to reach a reasonable balance.

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 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?

Similar to our response in Question 8 above, we do not believe that contingent rentals are consistent with the definition of a liability. We believe that the retail industry presents a clear

example of our concern. In our industry, the most common type of contingent rental is a “percentage rent” lease where a portion of the rent is calculated as a percentage of store sales potentially years in the future. The percentage rent is *not a present obligation* until those sales actually occur. Further, should the store be closed, the contingent rental payments cease. Accordingly, we do not believe that it is appropriate to recognize a liability for contingent rentals at the inception of the lease.

A requirement to include contingent rentals in the measurement of the lease asset or liability, like the requirement to determine an entirely speculative maximum lease term, is extremely problematic for other reasons as well. This proposal would require a probability-weighted approach based on factors entirely outside the control of the lessor and lessee. Moreover, a lessor and a lessee could make entirely different assumptions for the same lease. In our view, such a requirement increases cost and complexity with no added benefit. We believe that a contingent rental should be expensed in the same manner as under current guidance. Again, accounting should reflect behavior, not drive the behavior.

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?

The requirement to reassess the carrying amount of the lease liability or asset if facts and circumstances indicate that there has been a “significant change” is not particularly helpful for purposes of clarifying that a lease-by-lease analysis is not required at each measurement date. It is unclear to us how one could determine that there has *not* been a significant change *unless* a lease-by-lease assessment were made. Moreover, because of the vagueness of the term “significant”, we believe that a clear statement allowing a grouping approach and the establishment of specific “triggering events” requiring a reassessment would be helpful and appropriate.

Question 11: Sale and Leaseback

This exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents a sale of the underlying asset, the leaseback also would meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66-67, B31 and BC160-BC167).

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?

We view the criteria for classification as a sale and leaseback transaction as generally appropriate.

Question 12: Statement of financial position

This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25-27, 42-45, 60-63 and BC142-BC159).

- 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 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, totaling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)?**
- 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?**

While we understand the Boards' desire for uniformity in presentation, we do not believe that a one size fits all approach is appropriate. RILA believes that financial presentation should be based on the facts and circumstances specific to the individual lessee and therefore financial presentation should not be prescriptive. For this reason, we believe the final standard should not require separate disclosure of either the asset or liability on the face of the balance sheet.

Specifically with respect to question 12.a, disclosure in the footnotes should be allowed as an option, similar to the guidance contained in paragraph 26 related to interest and amortization deductions.

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?

No. See also response to Question 12, above.

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?

We do not have a uniform opinion on this issue. Many of our members believe that cash flows from leases would more appropriately be reported in the operating (as opposed to financing) section of the statement of cash flows along with the other store operation cash flows (like payroll and utilities). These members believe that including these cash flows in the financing section of the statement of cash flows would be inconsistent with their presentation on the income statement, where these costs are included in operating income.

Some of our members believe that financing cash flow classification is more appropriate and consistent with current capital lease accounting.

In any event, if lease cash flows are presented in the financing section of the statement of cash flow, we agree that a separate line item would be appropriate if they are material. This additional disclosure would be warranted because the proposed lease accounting model does not correspond to the underlying cash flows of the lease agreement as closely as the current lease accounting model does.

Question 15: Disclosure

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?

Again, we do not believe that a one-size-fits all approach is appropriate. We believe that individual lessees and lessors should make additional disclosures if such disclosures would benefit the users of the financial statements by enhancing their understanding of the lessee's or lessor's material matters and contingencies. The disclosures set forth in b, above, may be appropriate under the specific facts and circumstances of the lessee or lessor. Other potential disclosures could include, for example, the existence of potential renewal periods for leases of material right-of-use assets and situations when control of a material right-of-use asset is not held by the lessee. All such disclosures, however, are more appropriate for disclosure in MD&A rather than as part of the financial statements themselves. Such speculative information should be subject to the safe harbor protections for forward-looking information.

Question 16: Transition

- 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?**

Our members collectively have, at a minimum, hundreds of thousands of leases currently in existence. The extraordinary cost that would be associated with a wholesale change in accounting for these existing leases as the Boards propose justifies a simplified retrospective approach. Any simplified approach, however, should take into account our other comments. We are generally not in favor of full retrospective application, but if allowed at all, it should not be required. Moreover, we suggest that the Boards consider the comments received from us and others on the pending Discussion Paper, *Effective Dates and Transition Methods* (Issued 10/19/10) before making any final determinations on transition and effective date issues.

In terms of additional transitional issues, we note that the significant changes proposed would warrant a relatively long period between final adoption of a standard and mandatory implementation. Companies with large numbers of leases, like many of our members who individually have many thousands of leases, would need sufficient time to perform all of the

tasks necessary to implement the standard. Such tasks would include, but not be limited to, the following:

- § Allow for development of software that will contain lease data including items such as key dates associated with the base term and renewal option periods, the amount of each periodic payment over the base term of the lease, the number of remaining renewal options and any related rent changes, the method for calculating contingent rent (if applicable), lease incentives and co-tenancy terms, etc.
- § If the final accounting guidance does not allow for the exclusion of non-rent costs from the scope of lease payments for gross leases, ensure that there is a process to identify and link estimated and actual non-rent costs with the applicable lease. If the final guidance does allow for exclusion of such costs, develop a process to segregate and value non-rent costs from the gross payment.
- § Develop a process to calculate the incremental borrowing rate on a lease-by-lease basis.
- § Evaluate the entity's current or available software packages to determine their ability to accept data, to calculate lease liabilities/assets, and to calculate/summarize the required accounting for any given period. Develop and test new programs as necessary.
- § If a third party software is not used, develop files/databases to accept data and calculate lease liabilities/right-of-use assets, interest expense and asset amortization on a lease-by-lease basis.
- § Develop internal control procedures and a process for tracking and assessing all changes in lease terms on a monthly or quarterly basis for purposes of determining whether a significant change in the lease liability has occurred since the prior period.
- § Identify the impact on income tax accounting and develop processes to provide necessary data to the tax department on a recurring basis.
- § Unless excluded from the final standard, identify a team and develop a process to evaluate and determine the longest possible lease term that is more likely than not to occur for all leases.
- § Unless excluded from the final standard, develop a process to assess and reassess expected contingent rental payments.

Question 17: Benefits and costs

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?

RILA and its FLC do not believe that the benefits to be derived from the proposals in their current form would outweigh the costs. We have attempted to provide specific suggestions that we believe would make the proposals more operational and reduce the costs to a point where the benefits, in our view, would outweigh the costs of the proposal.

Question 18: Other comments

Do you have any other comments on the proposals?

The Exposure Draft provides that the guidance would supersede Topic 840 of the Accounting Standards Codification. We also understand that the guidance contained in EITF 97-10, *The Effect of Lessee Involvement in Asset Construction* and EITF 96-21, *Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities* also would be superseded. Additional guidance on how situations covered currently by EITF 97-10 and EITF 96-21 would be accounted for under any new guidance would be helpful.

In addition, we believe that guidance on the appropriate accounting for lease incentives granted by landlords to lessees and the transitional treatment of existing deferred credits related thereto would be appropriate.

Question 19: Non-public entities

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?

RILA's membership does include some private companies. We believe that the same rules should be applicable to private companies, but that the effective date of any new guidance be delayed for private companies.

RILA's membership is not comprised of any not-for-profit entities so we do not comment thereon.

Conclusion

While we agree in concept with the direction in which the Boards are moving on this topic, as discussed herein, changes to the Exposure Draft are necessary for it to be operational. We appreciate the opportunity to offer our comments on this important topic.

Sincerely,

A handwritten signature in black ink, appearing to read "Casey Chroust". The signature is fluid and cursive, with a long horizontal stroke extending from the end of the name.

Casey Chroust
Executive Vice President, Retail Operations
Retail Industry Leaders Association