



CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION

The Source and Resource for Construction Financial Professionals

December 15, 2010

Financial Accounting Standards Board

401 Merritt 7
PO Box 5116
Norwalk CT 06856-5116
Attn: Technical Director – File Reference No. 1850-100
(Via U.S. Mail and Electronic Mail)

Re: CFMA’s Comments on the FASB and IASB’s Exposure Draft on Leases (Topic 840)

The Construction Financial Management Association (CFMA) is pleased to provide our response to the FASB and IASB’s Exposure Draft on Leases (hereafter, “Exposure Draft”).

CFMA is uniquely focused in its representation of the financial interests of the construction industry. Our membership is comprised entirely of financial statement issuers, auditors, and users of financial statements within the construction industry. As such, CFMA is particularly qualified to supply FASB and IASB with feedback, as both Boards work to establish accounting standards that impact our industry.

The Boards’ Efforts to Improve Lease Accounting Rules

We applaud the Boards’ efforts to improve financial reporting with respect to lease accounting. CFMA appreciates that the current standards for leases have often been criticized as being a form of off-balance-sheet financing and that the use of a bright-line test determining lease presentation is arbitrary in nature. We also fully support efforts to achieve convergence with international standards.

Structure and Areas of Focus in Our Response

CFMA seeks to provide meaningful and constructive input, with our only objective being the preservation of high-quality financial reporting for the construction industry.

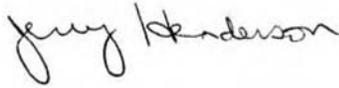
Our suggestions attempt to work, as much as possible, within the core principles of the Exposure Draft, and are focused solely on the unique issues affecting the construction industry. As a result, our comments in the attached Appendix are limited to the following questions:

- Question 1: Lessees
- Question 3: Short-Term Leases
- Question 8: Lease Term
- Question 14: Statement of Cash Flows

Conclusion

We sincerely appreciate the opportunity to respond to the Boards' request for comments and look forward to the opportunity to continue our participation in this process in order to help the Boards achieve their objectives of convergence and increased transparency.

Sincerely,

Handwritten signature of Jerry Henderson in cursive.

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APPENDIX: CFMA's Comments on the FASB and IASB's Exposure Draft on Leases (Topic 840)

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?

CFMA's Response:

We agree with the principle-based approach that a lessee should recognize a right-of-use asset and liability to make lease payments. However, we have concerns regarding the measurement and accounting of complex and short-term leases, as well as the associated cost of compliance. We have addressed these concerns in our response to Question 3 below.

- (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?

CFMA's Response:

We agree in principle with the recognition of amortization for the right-of-use asset and interest on the liability; however, we have significant concerns regarding the economic effects on contractors who perform work for the federal government and who are subject to the Federal Acquisition Regulations (FARs).

Under the current standards, operating leases are allowed under FAR 31.205-36 "Rental Costs," as defined by FASB Statement 13, to include these costs in a contractor's billing rate.

Government contractors are allowed to include certain costs for depreciation in a financing lease. However, interest and finance costs are typically not allowed when developing billing rates. Therefore, the use of interest on the liability model would likely have significant economic consequences relative to the development of billing rates and the resultant gross profit. We believe that this issue can be addressed through a modification to the treatment of short-term leases, as outlined in our response to Question 3 below.

We also understand that the users of financial statements need to know about the existence of lease commitments. In the construction industry leases, or more appropriately rentals, of construction equipment specifically for the performance of a construction project are already included in the work in progress schedules, and in the software tracking systems as "committed costs."

When outside users of construction financial statements review construction projects, these rental commitments are included in the projected costs to complete. Although there is no specific identification of these leases/rentals, there is a strong level of confidence that they are, in fact, included.

Question 3: Short-Term Leases

This Exposure Draft proposes that a lessee 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).

Do you agree that a lessee should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

CFMA's Response:

While we agree with the Boards' efforts to simplify the accounting for short-term leases, we have significant concerns that the proposed treatment of short-term leases remains overly complex and will present undue burdens to the construction industry. Specifically:

1. The use of the "12 months or less" test to determine if a lease is short-term does not appear to be in the spirit of a principle-based approach and is similar to the bright-line tests under the current FASB standards. Twelve months is not the best definition of short-term and may not reflect the normal operating cycles of certain industries, construction in particular.

For example, throughout the industry, it is not uncommon for contractors to enter into construction contracts that will last for 18-24 months, and to enter into a rental agreement for a piece of equipment they expect to use *only* for that particular project. Under these circumstances, all rental payments are charged to the specific project in the job cost system.

For this reason, we recommend that the Boards expand the definition of short-term to incorporate a principle-based concept that includes the entity's normal operating cycle in defining short-term leases.

2. The cost of compliance for construction companies will be excessive because construction jobs can require a significant number of short-term leases, and the effort applied to record-keeping and reporting will increase considerably.
3. The benefits of recording an asset and related liability for short-term leases are minimal at best and appear to gross up the balance sheet for leases that typically have a negligible effect on the long-term health of a company.

We strongly recommend that the simplified requirements for a short-term lease be similar to current operating lease requirements, such that lease payments are recorded as a rental expense, that the underlying related assets and liabilities are not recorded on the balance sheet, and that the definition of a short-term lease be expanded to encompass a principle-based approach correlating to a company's normal operating cycle. By affording this treatment to short-term leases, we believe that most of the potentially adverse affects noted in our response to Question 1 will be mitigated.

Question 8: Lease Term

Do you agree that a lessee 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 should determine the lease term and why?

CFMA's Response:

We have concerns with the proposed standards relating to the lease term, specifically in reference to the determination based on the longest possible term that is "more likely than not" to occur.

Under the proposed standards, companies would be required to record a liability (and the related asset) they do not have a contractual obligation to honor. In addition, the nature of the re-measurement requirement – coupled with the "more likely than not to occur" requirement – may cause financial statements to be volatile in nature, as the "more likely than not" determination could change on an annual basis.

We also believe that an estimated probability test leads to significant subjectivity and complexities, especially for small companies that might not have the resources to effectively make this determination. We realize that leases with options are priced in a distinct manner and are not always comparable to similar leases without options; however, the benefits of measuring an embedded option in the lease does not appear to outweigh the added complexities.

We ask that the Boards consider a model closer to the "virtually certain" requirement, where the lessee would record the liability and asset related to the option extension if the lessee does not have any economic choice other than to extend the lease. If the Boards are uncomfortable with making this modification to the entire standard, we ask that the Boards permit private companies to follow this model.

We also believe that the Boards should provide additional guidance for related-party leases that may have no written agreement and no contractual minimum or maximum lease period.

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?

CFMA's Response:

Contractors enter into leases for a variety of reasons, both for financing and operational (job-related) purposes. The proposed standards suggest that a purchase of assets financed by debt is the only cash flow presentation option available. It may be more useful to the users of a contractor's financial statements to be able to differentiate the cash flows relating to leases based on the purpose of the respective leases.

Specifically, we request that any lease payments for leases that meet the revised definition of short-term (as proposed in our response to Question 3) be presented as a part of operating cash flows and that any payments related to long-term leases be presented as financing cash flows.