



COMMITTEE ON CORPORATE REPORTING

December 14, 2010

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Submitted via electronic mail to [director@fasb.org](mailto:director@fasb.org)

**Re: File Reference: No. 1850-100, Exposure Draft: Leases**

Dear Madam and Sir:

The Committee on Corporate Reporting (“CCR”) of Financial Executives International (“FEI”) appreciates the opportunity to provide its views on the Proposed Accounting Standards Update, *Leases* (ASC Topic 840) (the “ED”). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

We continue to support the convergence of U.S. GAAP and IFRS. As indicated in our July 2009 comment letter on the Board’s Discussion Paper, *Leases: Preliminary Views*, we were supportive of the project’s overall goal of improving the accounting for leases. A lease provides a lessee use of an asset and contains an obligation to pay rent. As a result, we believe the proposed right-of-use accounting model that leads to the recognition by the lessee of the asset and liability is a natural consequence of this analysis and the evolution of the accounting model. However, we continue to have concerns related to the complexity of the proposed model and the operability of a number of the proposed requirements. The accounting for leases under current U.S. GAAP is often difficult to apply and rightly criticized for its complexity, including its mix of subjective judgments and “bright line” tests. While the bright-line tests have been eliminated, the model presented in the ED imposes additional complexity, particularly related to estimating the lease term and in considering contingent rents. Some of this resulting complexity is the consequence of an accounting model that does not

completely consider the economics of many lease transactions or the conceptual framework.

With respect to lessor accounting, we believe the existing models presented in ASC 840 and IAS No. 17, are well understood by preparers, users and auditors and are considered to provide adequate financial information to users of financial statements and investors. These models reflect the underlying economic substance of transactions. Any changes to the lessor accounting model should be carefully considered within that context. We are open to improvements in lessor accounting, but we also believe changes to accounting standards should be judged on whether they represent a noticeable improvement over existing standards at a reasonable cost. If a proposed model is not a clear improvement after cost/ benefit considerations, change should not be pursued.

We believe lessee-lessor symmetry is a commendable but not critical objective. The objectives of ASC 840 notwithstanding, symmetry does not currently exist in practice, and to the best of our knowledge does not appear to be creating any particular financial reporting problems. We believe there will be requirements inside any final Standard that will be unnecessarily complex if achieving symmetrical accounting becomes an overriding factor in the Boards' conclusions. More importantly, however, we believe that it is critical there be symmetry between the final conclusions for lessor accounting and the final conclusions of the revenue recognition project. Many bundled transactions will have multiple elements - some of which will be subject to the revenue recognition standard - and other elements which will be covered by the lessor requirements of this ED. For example, the revenue recognition ED requires a transfer of control before revenue is recognized whereas the leasing ED focuses on the concept of exposure to risks or benefits associated with the underlying asset to determine the timing of revenue recognition. Given the differences between the two ED's we envision a number of implementation questions are likely to arise; we recommend that to the extent possible the Boards, through outreach and the upcoming roundtables, try to identify the most common issues likely to be encountered and resolve the primary differences before finalizing the two projects.

We have highlighted below our primary concerns and issues with the ED and, in the Appendix to this letter, provided additional context and detailed responses to questions raised in the ED.

- Lease Payments: We do not believe contingent rentals or expected payments under term options meet the definition of a liability as any amounts beyond the fixed lease term are not present obligations that are probable and estimable. Such contingent amounts are not a constructive obligation that the lessee has little or no discretion to avoid. Similarly, for lessors, contingent amounts are not an enforceable right to cash, but rather an expectation of a future right to cash, weakening the current definition of a receivable. Since the lessee is not obligated until the lessee exercises the option and it has wide discretion over whether or not it will incur the economic sacrifice (with certain exceptions as noted in our response to Question 8), we do not believe it has incurred a liability as defined. We believe that both **options and contingent rentals should be accounted for when an obligation to pay/ perform has been created** and not before that time.

However, if the Boards proceed, despite our recommendation to the contrary, with an approach requiring inclusion of options and contingent rents in the initial measurement of leased assets and related obligations, we ask the Boards to increase the proposed recognition and measurement thresholds. For lessee accounting we recommend that the threshold for recognition should be 'probable.' For lessor accounting, we recommend the threshold should be higher still – either 'reasonably assured' or 'virtually certain.' We believe it is critical that receivables should represent enforceable claims to cash and weakening of that principle does not improve financial accounting.

- Lessor Accounting: As discussed above, we generally do not believe the existing lessor accounting models require wholesale changes as they are well understood, provide appropriate financial information to users and reflect the underlying economic substance of transactions. However if the Boards believe the lessor models proposed in the ED are an improvement, we believe that both models have legitimacy under different circumstances. We believe the Boards should provide **additional guidance relating to when each model should be applied** and to clarify what constitutes “exposure to significant risks or benefits.”
- Service Arrangements: We encourage the Boards to revisit and **expand the guidance for distinguishing between leases and service contracts**. We do not agree with the proposed definition of an embedded lease and specifically the change whereby an asset included in a service arrangement will be deemed to be leased if it is rarely replaced or substituted in practice by the lessor. We believe that if assets are not specifically identified in some capacity or the lessor can interchange the asset(s) at its discretion, the contract fails to meet the definition of a lease.
- Lessee Accounting Model: We believe the expense associated with leased assets reflected in a given period should reasonably match the lease’s cash outflows (assuming ratable payments throughout the lease). We understand that some members of the user community have expressed a preference that lessee expense under any revised Standard should not be significantly different from expense measured under current U.S. GAAP. We recommend this assertion be confirmed (or rejected) by additional outreach. Assuming this assertion is validated and the Boards agree, we recommend that the final standard be less prescriptive as to expensing methodology and allow for alternative methodologies along with appropriate disclosure of the policy selected.
- Short-Term Leases: We do not believe that leases with maximum rental terms (including renewal options) of one year or less require balance sheet recognition. We believe that lessees should have the same elections for short-term leases as those provided to lessors. Lessees should have the option to **simply recognize such leases on a straight-line basis over the term**, similar to the manner in which operating leases are recognized today. This better matches cash flows, avoids the significant effort and costs associated with accounting for and measuring such short-term assets and liabilities and represents a practical way of handling this class of lease transactions.
- Disclosures: We support **limiting the required annual disclosures** to those that provide users with decision useful information and to focus the quarterly disclosures on significant changes from the annual disclosures. Given the very tight time schedule available to file quarterly reports, it is not feasible to provide all the disclosures on a quarterly basis. In addition, it is our view that the disclosures would be less complex and more meaningful if future events such as renewal periods and contingent rentals were not required to be recognized in the financial statements.
- Leveraged Leases: Regarding the accounting for **leveraged leases**, we believe additional outreach and due diligence is required. Leveraged leases are unique vehicles and are critical to the financing of many types of capital assets and, as recognized by the FASB 35 years ago when SFAS No.13 was issued, there are reasons why an exception was made in accounting literature. Given their importance to certain sectors of the economy, we recommend the Boards engage in targeted field testing and research for this particular type of structure before the final conclusions on the accounting for leveraged leases are determined.

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We appreciate the invitation to participate in the round table session for the Proposed ASU on January 6, 2011. We will be represented by Gary Kabureck, Vice President and Chief Accounting Officer of Xerox Corporation. Please contact Lorraine Malonza at 973.765.1047 or lmalonza@financialexecutives.org with any questions.

Sincerely,

A handwritten signature in black ink, reading "Loretta Cangialosi". The signature is written in a cursive style with a large, looping initial "L".

Loretta V. Cangialosi  
Chairman, Committee on Corporate Reporting  
Financial Executives International

## Appendix

### The accounting model

The exposure draft proposes a new accounting model for leases in which:

(a) a lessee would recognize an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortize the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.

(b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease, depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).

### 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?

- a) We support the conclusion that within a lease contract a lessee has a right-of-use asset and a liability to make payments.
- b) We agree with the amortized cost-based approach for the right-of-use asset and the incurrence of interest on the liability to make lease payments. That said, we believe additional outreach and due diligence is required before the Boards conclude on the expensing model for lessees. We understand that a number of members of the investor and financial statement user community have expressed a preference that the final Standard should not significantly change the annual expense for lessees from the amounts recognized under current U.S. GAAP. Assuming our understanding is accurate, and the Boards concur, we recommend the final Standard be less prescriptive as to methodology and thereby permit any systematic and rational method that reasonably approximates the lessee expense as measured under current U.S. GAAP. We believe there are a number of benefits to a consistent, systematic and rational approach; for example, there would likely be a lower cost to implement because preparers can select a methodology more aligned with their process capabilities and there would be a closer match of expense to cash outflows (assuming rent payments occur ratably throughout the life of the lease). Preparers should be required to disclose the accounting policies selected. We recognize that under the ED's requirements there will be depreciation/ amortization and interest expense that is not reported for operating lease transactions today. Common liquidity measures (e.g. operating cash flow and EBITDA) will change once the ED is effective and we recommend that any final conclusions on how future lessee expense is measured consider the impacts on liquidity measures to ensure there are no unintended consequences.

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

a) As highlighted above, we generally do not believe a change to the lessor accounting model is critically necessary. However, with respect to the lessor models proposed in the ED, the majority of constituents, as indicated in paragraph BC24, support using a derecognition approach for most leases. We also agree with the Boards' conclusion stated in paragraph BC25 which states "a single approach to lessor accounting would not be appropriate for all leases because of differences in the economics of the business models for different lessors." We agree that both models have legitimacy and a lessor should apply either the performance obligation approach or the derecognition approach depending on the specific facts and circumstances. However, we believe further clarification should be provided in order to assist in the analysis of when "the lessor retains exposure to significant risks or benefits." In paragraph BC27, the Boards specify that an entity's business model will indicate which model would be appropriate. To ensure consistent application and comparability between entities, we ask the Boards to provide additional guidance, beyond, or developing further, the ED's reference to 'retention of significant exposure to risks and rewards' as to when each model should be applied.

b) We generally agree with the approaches for recognizing assets, liabilities, income and expenses under the derecognition model. However, as explained in our response to Questions 8 and 9 below, we do not agree with the proposed approaches for options and contingent rentals.

Under the derecognition approach the lessor has a lease receivable and a residual interest in a leased asset. We believe the contracted rentals most faithfully correspond to a receivable. We believe the residual interest in the assets most faithfully presents the portion of leased assets' life affected by options to renew.

We believe the performance obligation approach should be modified to allow the assets, liabilities, income and expenses to be recognized consistent with the current operating lease model. A transaction whereby the lessor retains significant risks or benefits related to the underlying asset is essentially a rental of the lessor's asset and to record gross assets and liabilities to simply net them serves little benefit. Additionally, we think straight line rental expense is more indicative of the transaction entered into by the parties.

In addition, we believe that a lessor should assess how to account for a lease at the commencement date and not at the date of the inception of a lease. During the period between such dates, significant changes may occur in the factors supporting a lessor's decision to account for a lease under the derecognition or the performance obligation approach.

- c) We recommend the Boards conduct additional outreach and due diligence before concluding on the accounting for leveraged leases. We understand in a principles based world the Boards will strive to minimize or eliminate exception based accounting. However, we also believe the Boards would agree that leveraged leases are unique arrangements and have highly specialized income tax, financing and legal attributes. Leveraged leases are significant financing vehicles in many capital asset transactions and it is not apparent to us that the critical importance of leveraged leasing to many industries is fully appreciated by the Boards. When SFAS No. 13 was written almost 35 years ago, the FASB at that time recognized that leveraged leases were unique arrangements and therefore provided special accounting treatment for these arrangements. Further, to the best of our knowledge, the current accounting for leveraged leases has not resulted in any particular problems for the users of financial statements. We observe the ED notes in paragraph BC15 that IFRS does not provide for special treatment of leveraged leases. We acknowledge that statement but also believe that leveraged leases are largely found in the United States and the impacts of changing the current accounting for leveraged leases is primarily a domestic issue. In summary, at this time, we do not believe the case for changing the leveraged lease accounting model has conclusively been made and that additional research and outreach by the Boards and staff are the most appropriate next steps.

### 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 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?

With the proposed simplified requirements for short-term leases, we appreciate the acknowledgment of our previous concerns related to the administrative burden caused by leases with a maximum rental term (including renewal options) of one year or less. However, we believe that lessees should have the same elections for short-term leases as those provided to lessors (i.e. elect on a lease-by-lease basis not to recognize assets or liabilities arising from a short-term lease in the statement of financial position). Rather than the currently proposed option to record undiscounted amounts, lessees should be able to recognize short-term leases on a straight-line basis over the term similar to the manner in which operating leases are recognized today. Not only does this recognition pattern align with the cash flows, but it also avoids the significant effort and costs associated with accounting for and measuring such short-term assets and liabilities. Expensing short-term leases as incurred

would likely also be consistent with the approach and practice many entities use today with respect to fixed asset thresholds in that assets with a useful life of less than a year are normally expensed as incurred. Finally, we would like to note that short-term leases involve an economic bargain that is different than that contained in longer term leases, and the varying risk profile serves as a natural control that limits the chance these transactions would provide the opportunity for abuse.

#### **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 BC29–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).

#### **Question 4**

(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?

- a) We generally agree that a lease is defined appropriately with the exception of the use of an asset within a services contract (traditional operating lease embedded in a services contract – see our response to Question 4(c) below).
- b) We concur with the Boards' conclusion related to the distinction between a lease and a sale. However, we believe further clarification is needed regarding the definition of "all but a trivial amount of the risks and benefits" as defined for the purchase/ sale exclusion in paragraph 8a as compared to the "significant risks and benefits" as defined for purposes of determining the appropriate approach for the lessor. Specifically, we believe the Boards should specify the relative order or importance of "trivial" (e.g. is it less than or equivalent to "not significant"). Additionally, we request further clarification regarding the accounting of those transactions that are determined to meet the purchase or sale scope exemption.
- c) We generally do not believe that the guidance provided for distinguishing between leases and service contracts is sufficient. As currently worded, we believe the guidance will result in entities accounting for similar transactions in significantly different ways. As such, and described in more detail below, we believe that the Boards should reconsider paragraph B1 relating to when a "contract depends on providing a specified asset" and when a "contract conveys the right to control the use of a specified asset."

### Contract depends on providing a specific asset

Under current lease accounting guidance, the embedded leases within a service arrangement are often classified as operating leases. Since the accounting for service arrangements and an operating lease is similar, separating the two components in practice has presented few issues. However, under the proposed guidance, any embedded lease in an arrangement will need to be separated and will result in the recognition of lease assets and liabilities. This new guidance will require considerably more judgment and may lead to significant diversity and administrative complexity in practice.

Specifically, we do not agree with the conclusions reached related to a lease embedded in a service arrangement which, as proposed, varies from the guidance under the exposure draft on revenue from contracts with customers. As such, the accounting for economically similar service transactions will vary significantly depending on whether an embedded lease is identified. Paragraph B2 states “An asset is implicitly ‘specified’ if it is (a) infeasible or impractical for a lessor to provide alternative assets in place of the underlying asset during the lease term or (b) if a lessor can substitute another asset for the underlying asset but rarely does so in practice.”

We believe that the distinction of whether or not the lessor rarely substitutes the underlying asset in question, as proposed in this exposure draft, is the wrong criterion. We believe the current guidance (assets specifically identified, control regarding the outputs, etc.) is more appropriate to determine whether there is an embedded lease. If the assets can be interchanged or substituted by the lessor, the lessee inherently does not unilaterally control the underlying asset and therefore the contract fails to meet the definition of a lease as defined in paragraph B1 since the fulfillment of the contract is not dependent on providing a specified asset. In these situations, the lessee’s “right to use” asset is restricted and distinguishing “control” based on the likelihood of replacement is impractical to apply in practice. Moreover, in these situations, the lessee typically does not believe it controls or has a unilateral right to use the underlying asset, but rather that the lessor controls the asset which is the means to deliver the contracted services – the primary element of the contract.

As a result, if the contract does not specifically identify the assets or the lessor can interchange or substitute the asset(s) at its discretion, we believe the contract does not meet the definition of a lease and the service contract should follow the guidance within the revenue recognition exposure draft. We believe that concentrating on “control” of the asset is the critical element for determining whether a lessee has a right to use asset. However, we acknowledge that there may need to be a different approach or guidance for special-type-use assets if providing an alternative asset is not feasible or practical. Please see the third paragraph in our response to Question 8 below for further discussion.

### Contract conveys the right to control the use of a specified asset

We do not believe that simply because an entity has the right to obtain all but an insignificant amount of the asset’s output that the entity necessarily “controls” the use of the asset. The right to obtain the output of an asset does not equate to “controlling” the asset, as the manner in which the output is provided is a critical aspect of determining who controls the asset. We believe that this is one of the fundamental differences between a service contract (which involves an entity performing actions to provide an output) and a lease contract (which involves providing an asset that the lessee can use in any manner they see fit).

We also believe that the criterion detailed in paragraph B4(e) should be revised to clarify what is meant by the term “contractually fixed price per unit of output”. Presently, we believe there is considerable diversity in practice in how this key element is evaluated in the application of ASC 840. Without additional guidance, we believe that this diversity in practice will continue upon adoption of the final standard resulting in significant differences in accounting and financial reporting for essentially similar transactions.

When considering what represents a “contractually fixed price per unit of output” today, some companies and accounting firms hold to a strict definition whereby the price is considered fixed only if it is established at the inception of the contract and does not change over the life of the contract. Other companies and accounting firms take a more liberal interpretation of what “fixed” is by allowing for the price to change over time but only in a manner prescribed in the contract. At present, this difference in interpretation often results in economically similar contracts being accounted for in different ways. However, the current accounting for leases makes this a moot issue in most cases given the similar accounting afforded to operating leases and executory contracts.

Common examples of pricing mechanisms that can be considered “contractually fixed” include: (i) contracts that specify a different fixed price per unit for each year of the contract; (ii) contracts where the pricing of the output is based on a fixed formula that incorporates the future costs to produce the output (e.g., commodity indexes); (iii) contracts that specify different fixed prices based on the timing of the delivery of the output (e.g., seasonal pricing); and (iv) contracts where the price is initially fixed with an annual adjustment for inflation. We believe that under current practice some entities and accounting firms would conclude that one or more of these pricing mechanisms do not meet the definition of “contractually fixed”. At the same time, we believe that all of these pricing mechanisms meet the spirit of ASC 840-10-15 in that a contract that contains one of these pricing conventions does not, by virtue of the pricing mechanism, convey the right to use the underlying asset.

We therefore encourage the Boards to consider these examples and clarify what is meant by “contractually fixed price per unit of output” to eliminate the current diversity in practice.

## **Scope**

### **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 with the proposed scope and related exclusions for the reasons stated by the Boards in the ED. Many of the assets excluded from the scope require specialized accounting and we agree with the conclusion reached in paragraph BC36 that states “the Boards have decided that they would not include leases of intangible assets within the scope of the proposed guidance until they had considered the accounting for intangible assets more broadly.” However, we recommend that the Boards clearly indicate in the body of the exposure draft that non-depreciable assets (e.g. inventory) are not in scope; currently, this is implied only in paragraph BC33 as “Topic 840 applies only to leases of property, plant and equipment.”

We also agree with the FASB’s decision, as outlined in paragraph BC58, to consider whether lessors of investment properties should utilize a different accounting model. For example, if a lessor of real estate has multiple tenants, we question whether it is appropriate for the lessor to derecognize portions of the asset or whether a different model should be followed.

#### **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?

Other than assets embedded in an overall service contract (see discussion within Question 4 above), if the service components of a lease are not distinct we agree with the FASB’s proposal that the entire arrangement should be accounted for as a lease by both the lessee and lessor. However, there needs to be further clarification in identifying ‘distinct’ services as provided in this ED and the revenue recognition ED as well as whether the analysis of distinct goods or services can be performed at a higher level than at the transaction level. In addition, as mentioned in the CCR comment letter on the revenue recognition ED, the concept of a distinct profit margin does not exist in ASC 605-25, and we are concerned that the requirement that a performance obligation have a distinct profit margin (as described in paragraph B7(b)(ii) and also in the revenue recognition ED) may result in an inappropriate restriction in the identification of separate performance obligations.

We support the principle that an entity shall allocate the value of a contract to the separate components. If the values of the separate components of the contract are not observable, then the entity shall estimate the values consistent with the guidance provided in paragraphs 50–52 of the revenue recognition ED. However, the concept of allocating components of a contract based on ‘transaction price’ is inconsistent with the concept of ‘payments required by the contract’ as indicated in the Lease ED. Payments required by the contract are not defined in the ED and it appears the definition of lease payments is not the same as transaction price. For instance, in considering an option to acquire additional goods or services, under the lease ED, determination of the price is based on the more likely than not term. If it is expected that the option is not going to be exercised within the more likely than not term, then the value of the option would be excluded. However, under the revenue recognition ED, the determination of whether to allocate value to the option depends on whether the option is providing the customer with a material right they would not have received if they had not entered into the contract regardless of when it is exercisable (Revenue Recognition ED paragraphs IG24-26).

Finally, we believe that a practical exception should be provided to the requirement to allocate value to the service components of a contract if the service components are trivial to the overall contract (and conversely if the equipment is trivial in relation to the overall service contract). For example, if a services contract has an insignificant portion of dedicated equipment, the entire arrangement should be accounted for under the revenue recognition guidance. We do not believe that the benefit of parsing out trivial portions of overall contracts and accounting for these trivial portions under a different accounting model outweigh the costs and administrative burden.

#### **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?

We agree that purchase options should be accounted for only when exercised. Although we acknowledge that purchase options may be of some value, we do not believe the likelihood of exercise, and therefore the fair value of the option, can be objectively or reasonably estimated.

## Measurement

This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

(a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.

(c) is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).

### 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?

We generally do not believe 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. We believe that including renewal options unnecessarily adds to the complexity of the accounting for leases, but more importantly we do not believe a renewal option meets the definition of a liability under Concepts Statement No. 6, Elements of Financial Statements (“CON 6”). While the lessor may provide the lessee the right to lease the asset in the future, the lessee has no obligation to exercise the option and therefore we believe it is inappropriate to anticipate the lessee exercising the option.

The ED appears to consider a renewal option a liability because the delivery of the asset created the past event that gives rise to the lessee’s obligation. However, in the context of the lease transaction, the renewal option is not a past event until the exercise of the option by the lessee since, until that point, the lessee does not have a present duty or obligation to pay rent that will give rise to an outflow of economic resources. Since the lessee is not obligated until it exercises the option and it has wide discretion over whether or not it will incur the economic sacrifice, we do not believe it has incurred a liability as defined. This proposed accounting is not consistent with other options for the purchase of services or goods, and we do not believe an option to renew the lease of an asset creates a liability any more than we believe an option to lease a new asset, purchase an asset or service does. Similarly, we do not believe a lessor has an asset (or a performance obligation if under that lessor model) until the lessee exercises the option.

As indicated above, in most cases we do not believe that renewal periods should be included in the calculation of a minimum lease term. We support the retention of the current U.S. GAAP definition of a lease term. For example, we believe that in the case of special-type-use assets (where alternative assets are not feasible or are physically or financially impractical to obtain) renewal options should be included in the determination of lease terms as renewal is considered mandatory or necessary in these cases. Additionally, we would also consider the inclusion of renewal periods when there are factors within the lease or related to the lessee's use of the leased asset that economically compel the lessee to renew the lease, resulting in renewal being reasonably assured. For the broader population of leases, beyond these two examples, we do not support the inclusion of renewals options in considering a lease term. However, if the Boards proceed with an approach requiring the inclusion of renewal options in the lease asset and liability, we ask the Boards to strongly consider increasing the measurement threshold from "more likely than not" to something such as "reasonably assured."

### **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?

We do not 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. Similar to our discussion above, for lessees, we do not believe these amounts meet the definition of a liability. Amounts due beyond the current period are not present obligations that are probable and estimable (and simultaneously do not represent assets for lessors). In the case of contingent rents, payments that are linked to performance are more appropriately recognized as period costs and do not represent receivables for lessors until earned. These amounts are not an enforceable right to cash, but rather an expectation of a future right to cash. This approach is even more troubling for lessors under the derecognition approach, as not only does it require the realization of a receivable, but also the recognition of revenues. A new standard requiring these payments to be considered part of a lease payment could also unintentionally cause changes in current business practice as some industries would strive to eliminate these provisions from their lease arrangements. Furthermore, we believe including these amounts as lease payments in the right-to-use assets and related obligations would make the accounting too burdensome, as it creates the need for periodic reassessment of lessee actions, with limited benefit to preparers and users.

However, if the Boards proceed, despite our recommendation to the contrary, with an approach requiring inclusion of options and contingent rents in the initial measurement of leased assets and related obligations, we ask the Boards to increase the recognition and measurement thresholds. For lessee accounting, we recommend that the threshold for recognition should be 'probable.' For lessor accounting, we recommend the threshold should be higher still – either 'reasonably assured' or 'virtually certain.' We believe it is critical that receivables should represent enforceable claims to cash and weakening of that principle is not an improvement in financial accounting.

Our concerns with the Board's approach to lease payments are further compounded by those situations where a lease contains a contingent service element that cannot be separated or that is deemed non distinct. In these situations, the ED requires the lessee and lessor to account for these contingent service payments on a combined basis with the lease payments and recognize the total estimated amount to be paid. We believe that the approach to these payments is likewise inconsistent with the definitions of an asset or liability since the related service still needs to be performed. However, the additional element of performance risk increases the exposure to both the lessee and lessor that such payments do not materialize.

In addition, we also believe the new standard should provide better clarity with respect to the definition of a lease payment. Current standards define the minimum lease payment used in measuring a capital lease obligation as "payments that the lessee is obligated to make or can be required to make in connection with the leased property, excluding ... the lessee's obligation to pay (apart from the rental payments) executory costs such as insurance, maintenance, and taxes in connection with the leased property." Under current practice of accounting for triple net leases, preparers estimate and exclude from the lease payment any embedded amounts that relate to maintenance, insurance and taxes, as the amounts are more properly reflective of period charges and not costs of a right-to-use asset. As currently drafted, there is also ambiguity as to whether certain components, such as maintenance, would be considered services that would require additional consideration/ analysis as to whether the contract would meet the definition of a service contract that contains lease components per paragraphs 6 and B5-B8. Accordingly, we believe the current definition of a lease payment, which excludes executory costs, should be included as part of the definition of a lease payment in the new standard. Furthermore, for certain industries, additional clarity of the leased payment definition should also be provided for payments known as "key money." Key money represents a premium paid to acquire a highly desired leased property from an existing lessee or a lessor. Clarity should be provided in the new standard on whether such payments should be considered a part of the lease payment used to measure the right-to-use asset and related obligation or should be considered initial direct costs, as defined in the exposure draft, and included in just the cost of the right-to-use asset. In our opinion, key money should be considered initial direct costs and included in the cost of the right-to-use asset.

#### **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?

We appreciate the Boards' change in the reassessment timing criteria from the position in the Discussion Paper, which requires reassessment at each reporting period on the basis of any new facts or circumstances, to the currently proposed timing of only requiring reassessment when there is a significant change.

However, we would ask for additional clarity and implementation guidance addressing what would be considered a significant event that would warrant reassessment. In developing this guidance, we would suggest the Boards look to ASC 360-10-35, Impairment or Disposal of Long-Lived Assets, that provides similar types of events or changes in circumstances that entities should monitor. As currently drafted, entities would be required to institute a reassessment process each reporting period

to determine whether changes in judgment would be significant. However, if an 'event or change in circumstance' approach is adopted, it would be sufficient to identify significant changes without the significant effort and costs associated with the reassessment. While existing guidance may be faulted for not allowing reassessments until an action had occurred that modified the lease agreement, the proposed requirement in the ED is still too ambiguous to be operational in practice.

### **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).

#### **Question 11**

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 generally agree with the sale and leaseback guidance outlined in the ED (paragraphs 66-69). However, we believe accounting for a transfer by the transferee that does not meet the purchase conditions as a receivable will not properly account for these transactions. In many sale and leaseback transactions the buyer-lessor will include a residual in its pricing assumption and accounting for the entire payment as a receivable will not be appropriate. As such, we suggest that the Boards further explore the accounting if the purchase conditions have not be satisfied.

### **Presentation**

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).

#### **Question 12: Statement of financial position**

(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)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(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?

- a) We agree with the general model related to gross presentation for lessees.
- b) We agree that the performance obligation should be netted with the underlying assets. The linked presentation avoids the overstatement of total assets and liabilities in the statement of financial position and the consequences to financial ratios.
- c) We agree that lessors applying the derecognition approach should present lease receivables separately. Although we believe it is important to account for residual assets separately from lease receivables since they are not part of the financing asset, the guidance should not be prescriptive and require specific classification (such as within PP&E). We believe there should be some flexibility on classification of the residual asset based on the lessor's intended use of the asset at the end of the lease. We would support disclosure of the amount and where such residual assets are reflected within the statement of financial position in the notes to the financial statements.
- d) We agree with the Boards' conclusion to separately present the liability to make lease payments and net the other assets and liabilities associated with the head lease and sublease. This presentation avoids multiple assets reflected in the statement of financial position for the same underlying leased asset.

### **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?

Regardless of the outcome of this leasing project, we do not believe that the significance of leasing in relation to an entity's operations or cash flows will change. Since the current P&L presentation appears to be adequate for users of financial statements today, we do not see the relevance for changing existing practices. Revenue and expense are sufficiently defined in concepts statements and preparers should look to those statements as well as existing standards (i.e. gross versus net presentation) for guidance on presentation. For example, a finance leasing company should only recognize interest income associated with the lease rather than gross revenue and expense for delivery of the asset. We support the current parameters which allow for more judgment on the appropriate P&L classification, rather than the very prescriptive proposals in the ED. This may also be a topic for upcoming round table sessions to further explore whether there is a real user need to change current practices.

Moreover, too much disaggregated information and totals for lease income or net lease expense changes financial metrics, disrupts comparability and obscures true measure of consolidated operational performance. Similarly, the lessor's business model should not change the classification as this variability also decreases the comparability amongst companies. Finally, lessees should have discretion on the P&L classification of amortization expense which should be partially based on the operational use of the underlying assets leased.

A lease is simply a vehicle that allows a customer to pay for the use of an asset. As such, we fail to see the relevance to financial statement users of disclosing various amounts recognized as a result of leases versus other contracting structures. However, to the extent financial statement users rely on such information, we propose to present the lease data within the notes to the financial statements.

#### **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 agree with the Boards' conclusions relating to the presentation within the statement of cash flows and as separate line items with the following two exceptions:

- For lessees, we note that the proposed treatment on the statement of cash flows of interest within financing activities is inconsistent with that for other indebtedness. We ask the Boards to reconsider this inconsistency during their redeliberations.
- We believe the current treatment within investing activities should be retained for financial services companies. Direct transactions with customers should be classified within operating activities; however, a financial intermediary should be allowed to classify the associated lease cash flows in a similar manner to those related to a loan, which are typically classified in cash flows from investing activities.

#### **Disclosure**

##### **Question 15**

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?

We have significant concerns related to the extensiveness of the disclosure requirements as proposed in the ED. As discussed in our responses to Questions 8 and 9 above, we believe that the proposed standard requires recognition of certain items that do not meet the definition of an asset or a liability. Specifically, we do not believe it is appropriate to anticipate future events such as renewal options and contingent rentals in the measurement of assets and liabilities. These requirements create disclosures that would not be necessary in the absence of these items.

For example, paragraphs 85 & 86 require disclosures that distinguish between the minimum obligations under the lease from contingent rentals, expected payments under term option penalties and residual value guarantees. It seems that the Boards recognize there is a difference between minimum obligations which meet the definition of a liability versus future events that do not. We would also add that disclosures will be confusing to financial statement users unless there is also an exclusion of rents associated with renewal options that have not occurred. We do not feel it is possible to summarize this information for footnote presentation in a way that would be sufficiently meaningful for users.

In summary, many of the disclosures are focused on the variable features in a lease contract (i.e. renewal options, contingent rentals and residual value guarantees). Additionally, other disclosures are necessary because the amounts recognized are not synchronized with the actual cash flows. The number and complexity of the disclosures would be reduced if contingent/ variable items were excluded and income/ expense better matched cash flows. Further guidance is also requested regarding the level to which entities with numerous and varied lease arrangements may aggregate leases.

We do not believe it would be useful to users of financial statements to classify obligations into different types of assets. We believe that inconsistency in definitions of groupings would be problematic. In addition, we believe this requirement is inconsistent with existing requirements for other areas of the financial statements, such as fixed assets.

Finally, it is our interpretation that the disclosure requirements are mandatory in both annual and quarterly filings. If this is correct, it is our opinion that this is disclosure overload and that the requirements for quarterly filings should be more limited in scope. Although extensive, the disclosure requirements are more palatable if only required annually when there is more time to accumulate, summarize and report the data. Large accelerated filers have 40 days to file their Form 10Q's. Given all the other processes such as auditor reviews, Audit Committee clearance, XBRL, etc. there simply is not enough lead time for yet another extensive quarterly disclosure, especially when one takes into account that much of the information may not be contained within an entity's general ledger requiring additional time to accumulate. Moreover, in large stable companies dollar values reported in the disclosures would rarely change materially on a quarterly basis. Repeating all of the disclosures on a quarterly basis, when the figures to a large degree would be very comparable, is simply not needed and would serve little benefit to financial statement users. Instead, the quarterly disclosures should focus on any significant changes that occurred since the year-end disclosure.

## Transition

### Question 16

(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?

a) We support some form of simplified initial application of the guidance and appreciate the Boards' recognition that full retrospective application would be very difficult. For example, the proposal for lessees to discount remaining payment obligations based on their incremental borrowing rate as of the initial application date (rather than as of inception of each lease) appears to be a reasonable accommodation.

However, we question whether the proposed simplified retrospective method is widely understood. For example, we believe that the Boards should clarify that amounts reflected in the financial statements under the simplified retrospective application would be based on the actual results incurred using hindsight rather than just the available information as of the respective balance sheet dates such as for estimated term options and contingent rents.

Finally, similar to the on-going simplified requirements for short-term leases, we recommend that the Boards consider an exception as of the application date for those leases with maximum possible remaining lease terms, including options to renew or extend, of 12 months or less (i.e. the option to reflect undiscounted amounts for lessees and not recognizing the assets and liabilities for lessors). This would help ease the administrative burden that will be required to adopt the standard.

b) Full retrospective application should be a permitted alternative. Since the lessor guidance is essentially revenue recognition guidance, we believe the Boards should clarify the application for multiple element contracts that contain lease and non-lease elements that would result in portions of contracts retrospectively applied. This may be an example where it is less complex for the entity to apply full retrospective application to all elements. As a result, we believe that full retrospective application should be permitted on an election basis.

c) We appreciated the Boards' recognition that a transition to a new lease accounting model, such as those contemplated within this exposure draft, will require significant time and effort to develop and implement systems, processes and associated controls. This exercise cannot be achieved on spreadsheets and, although software tools will be developed in due course to accommodate the requirements, such software packages currently do not exist. Additionally, SEC registrants may need to restate their financial statements for five years for the earnings to fixed charges calculation, five year table, etc. which adds to the complexity of adoption and lengthens the required implementation period.

## Benefits and costs

### Question 17

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?

We appreciate the fact that the Boards are evaluating the benefits as well as the costs of implementing the proposed guidance. It is our recommendation that this should be a prominent discussion topic at the upcoming round table sessions. The Boards may also consider some field tests in this area particularly relating to changes to lessor accounting since many consider the current model to be adequate (i.e. minimal benefit of changes).

As we have studied this ED over the last few months, it is clear that the model will be administratively difficult to operationalize. Besides the initial implementation efforts, the costs of maintaining the proposed model will also be significant, especially as it relates to: (i) short-term leases; (ii) contingent rentals and payments under term options; (iii) reassessment of amounts recognized; and (iv) complying with the extensive disclosure requirements. We believe many insignificant leases will not qualify as short-term leases due to renewal options, which will significantly increase the volume of leases accounted for under the proposed model. The cost, time and effort to monitor the facts or circumstances of a particular lease to determine whether a significant change has occurred will also be burdensome for preparers with large volumes of leases. Furthermore, we believe it will be difficult to capture the various terms, estimates and assumptions in the notes to the financial statements in such a manner that will provide additional benefit to users. The disclosures will be extensive and confusing, likely mitigating the perceived additional value to users.

Finally, we would like to note that users of financial statements already factor leases into their respective models based on information currently provided in the financial statements and notes. We believe that simplifying the accounting, especially in the areas noted above, will significantly reduce the costs while rectifying the perceived problems with the current accounting model as the majority of lease assets and liabilities will still be reflected on the balance sheet. We believe this will address the major needs of analysts and other users of financial statements while balancing the costs for preparers.

### Other comments

#### Question 18

Do you have any other comments on the proposals?

#### Residual value calculation

We recommend that the Boards reconsider the residual value methodology as outlined in paragraph 50. In our opinion the expected use of the asset and the manner of expected recovery at the end of a lease should be the primary factors considered in the calculation of the residual value. Stated differently, the residual value should be established consistent with the lessor's business model. If the business model considers the residual value to be a financing asset to be recovered by continued leasing or remarketing activity after the initial lease term, then a fair value method similar to current methodology in ASC 840 would generally be appropriate. Alternatively, if the leased asset is expected to be returned to the lessor and is considered the equivalent of inventory for consumption in manufacturing operations or internal operations, then a residual based on an allocation of original cost

would be appropriate in most circumstances. Lastly, if there is no intended use or other forms of expected recovery of the leased asset at the end of the lease, then the entire asset value should be expensed upon commencement of the original lease. We believe that measurement of the residual value consistent with a lessor's business model is the most faithful representation of the economic effects of the residual asset and also provides the most predictive value of future operational results. Finally, we believe reference to the lessor's business model is consistent with Statement 157's principle of measuring fair values consistent with highest and best use.

#### Incremental borrowing rate

We generally support the proposals to discount the lease payments utilizing the rate the lessor charges the lessee or, for lessees, their incremental borrowing rate. We note that these are practical approaches as the rate implicit in the lease is more of an academic model and difficult to apply in practice. However, we believe that the Boards should clarify that the "rate the lessor charges the lessee" must represent a reasonable market rate. As such, leases with promotional rates such as 0% financing would be discounted using a more reasonable market rate.

We recommend that the Boards develop additional guidance as to the intended operational definition of the 'incremental borrowing rate'. Depending on a company's capital structure, both consolidated and geographical, and funding strategy a company may have several incremental borrowing rates. For example, one strategy may be for local subsidiaries to be the direct borrower and their cost of funds may be different than if the funding was provided by the parent entity. Another strategy may be for the parent to guarantee subsidiary borrowing such that the subsidiary has effectively the same cost of funds as the parent. Further still, there may be a global lease agreement negotiated by the parent but individual leases are locally originated in international subsidiaries such that the cost of funds would be different than if locally financed. It is also possible that through interest rate and currency derivatives that a local variable borrowing rate can effectively be converted into a synthetic dollar-denominated fixed rate. We offer these scenarios as examples of the practical challenges of identifying the incremental borrowing rate applicable to a specific lease. We are not recommending a particular conclusion for the Boards to reach but are only identifying the need to address a problem encountered frequently in practice.

#### Deferred taxes

The proposed ED increases the requirement to account for and control deferred taxes associated with operating leases and results in the need to separately track leases for book and tax purposes. Accordingly, this will increase the costs associated with adoption and should be considered as part of the cost/ benefit analysis. However, a consistent, systematic approach for lessee expense recognition, such as the methodology discussed above that more closely matches cash outflows, will help alleviate these concerns.

**Non-public entities**

**Question 19**

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?

As you are aware, CCR's mission does not extend past the financial accounting for public corporations. FEI's Committee on Private Company Standards is preparing a comment letter of their own on this Proposed ASU. With respect to not-for-profit organizations and based on our general business experience, we believe the Proposed ASU should fully apply to those types of organizations.

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