The Association of Accountants and Financial Professionals in Business

September 16, 2013

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2013-270

Dear Ms. Cosper:

The Financial Reporting Committee (FRC) and the Small Business Financial and Regulatory Affairs Committee (SBFRC) of the Institute of Management Accountants (IMA) are writing to provide their views to the Financial Accounting Standards Board (FASB or Board) on the proposed Accounting Standards Update (Revised), *Leases (Topic 842)* (Proposed ASU).

The IMA is a global association representing more than 65,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. The SBFRC addresses issues that impact small and medium-sized organizations. On behalf of IMA's members, the SBFRC engages and suggests solutions to standard-setters and regulatory agencies such as the FASB, Securities and Exchange Commission (SEC), International Accounting Standards Board, Small Business Administration, American Bankers Association, Internal Revenue Service and others. Information on both committees can be found at www.imanet.org under the Advocacy section.

We continue to support the Board's decision to reconsider the accounting for leases as recommended by the SEC in its June 2005 *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers*, and we agree with the Board's decision to require lessees to reflect an asset and a liability for substantially all leases. We also support convergence. We believe the Proposed ASU represents a significant improvement from the 2010 Proposed ASU and commend the Board for addressing many of the issues we raised in our comment letter on the 2010 Proposed ASU. However, despite the improvements the Board has made, we do not support issuance of the Proposed ASU as a final standard. We believe the requirement to classify leases as "Type A" or "Type B" leases adds complexity, does nothing to do away with structuring transactions to achieve an accounting and reporting objective (with the focus shifting to qualifying for "Type B" lease accounting instead of operating lease accounting), and significantly increases the costs that will be incurred by preparers without a clear benefit to users, who are split over whether leases should be classified as "Type A" or "Type B" leases.

Further, we do not believe the proposed approach to lessor accounting represent a significant improvement in financial reporting over the current approach in Topic 840, nor is it consistent with the approach the Board has taken in the revenue recognition project, which requires a transferee to obtain control over the whole asset for the seller to derecognize the transferred asset. Additionally, we are not aware of significant criticism of current accounting by lessors. Therefore, we recommend the FASB discontinue its consideration of lessor accounting, other than with respect to the elimination of leveraged lease accounting. We support eliminating leveraged lease accounting prospectively to reduce complexity. Retaining the existing accounting for lessors should not result in any additional complexity. In fact, the Proposed ASU introduces many complexities than are not present in the existing approach for lessors.

Below, we have outlined our recommended approach to accounting for leases by lessees. We believe our recommended approach simplifies the subsequent accounting and significantly reduces complexity and costs to lessees while satisfying the FASB's stated principal objective – to recognize assets and liabilities arising from leases in the statement of financial position. It would do so in a cost effective manner, which we think is particularly important given the opposition many users have expressed to the Proposed ASU.

Recommended Approach – Lessee Accounting

We recommend the Board retain the guidance in Topic 840 with the following modifications:

- Exclude in-substance purchases of assets from the scope of Topic 840. A scope exclusion that focuses on the likelihood that control over a leased asset would revert to the lessor is more consistent with the approach in the forthcoming standard, *Revenue from Contracts with Customers* (Revenue Recognition). We also believe it is a preferable approach to the scope exclusion in the 2010 Proposed ASU. Contracts that transfer title to the asset to a lessee by the end of the lease term, contracts that require the lessee to remarket the asset on behalf of the lessor if the lessee does not acquire the asset combined with a residual value guarantee, and contracts for which the likelihood that the lessee would not exercise a purchase option are remote are examples of arrangements that would qualify as in-substance purchases.
- Replace the requirement that lessees determine the classification of leases with a requirement that lessees account for all contracts that remain within the scope of Topic 840 as operating leases, applying all requirements that exist today to account for those leases, with the additional requirement in the bullet below.
- Require lessees to recognize a right-of-use asset and a lease liability at the date of the financial statements for the present value of minimum lease payments remaining at that date using current interest rates. The lease liability would be measured at the reporting entity level, using the reporting entity's functional currency. For purposes of measuring the lease liability, lease payments denominated in a foreign currency would be translated into the reporting entity's functional currency using the exchange rate at the date of the financial statements.

As stated previously, the advantage to our recommended approach is that it is simple and can be accomplished by preparers without making a significant investment in systems and processes. Given the opposition to the Board's proposal by many users and comments that many users will reverse the amounts recognized in the financial statements, it does not seem prudent to require preparers to incur the costs to address the complexity created by the Proposed ASU.

Assuming the Board does not agree with our recommended approach, we present below an alternative recommendation, which again will satisfy the Board's stated objective while simplifying the application and reducing the burden on preparers.

Alternative Recommendation – Lessee Accounting

Similar to our recommended approach, our alternative recommendation would exclude in-substance purchases of assets from the scope of the revised standard.

For contracts included in the scope of the standard, the lessee would apply the recognition and measurement provisions in the Proposed ASU to determine the right-of-use asset and lease liability to be recorded at the commencement date of the lease. Subsequently, a lessee would recognize expense related to lease transactions on a straight-line basis, similar to the pattern outlined in the Proposed ASU for "Type B" leases. While our committee had (and continues to have) mixed views on how a lessee should account for leases subsequent to initial recognition, we strongly believe that there should be only one type of lease for the lessee. Further, the "Type B" lease pattern to subsequent measurement will reduce the cost to implement the new standard while achieving a significant improvement in financial reporting by requiring recognition of right-to-use assets and lease liabilities on the statement of financial position. We believe lessees would be able to utilize many of the systems and processes presently in place to account for leases under this alternative and would only need to adjust the balances (deferred rent debits or credits) resulting from that process by the present value of the remaining lease payments at the date of the financial statements to achieve a result consistent with the accounting for "Type B" leases in the Proposed ASU.[1] In addition to this alternative providing significant cost savings versus the approach in the Proposed ASU while satisfying the Board's primary objective of recognizing assets and liabilities arising from leases in the statement of financial position, our alternative recommendation eliminates the complexity of two types of leases and is consistent with the views of some users.

Other Comments

In addition to our recommendations regarding lessee accounting, we have the following comments on other conclusions in the Proposed ASU.

Scope

We disagree with the Board's decision to exclude from the scope of the Proposed ASU contracts where an entity will obtain the output or other utility of an asset during the term of an arrangement. The arguments made to the Board in favor of the exclusion were no different than the arguments made to the Emerging Issues Task Force when it considered Issue No. 01-8, ***Determining Whether an Arrangement Contains a Lease***.

We are concerned with the conclusion reached in Example 5B (paragraph 842-10-55-41 of the Proposed ASU) in the Illustrations section because it does not appear that Supplier has substantive decision-making rights. Customer has the ability to determine when Supplier produces power, Supplier is required to operate the plant in accordance with industry-approved operating practices, and Customer and Supplier agreed to a maintenance schedule. What substantive decision-making authority does Supplier have?

We believe having control over the economic output of an asset is consistent with the control principle proposed in the exposure draft on Revenue Recognition. During the term of the lease, Customer has the

[1] Although the accounting becomes more complicated if a lessee is required to recognize an impairment of the right-of-use asset, impairments are expected to occur rarely and, therefore, the complications presented do not influence our views on the approach to the recognition of the cost of leases in the income statement.

right to direct the use of the plant through its ability to determine when Supplier produces power. Supplier's control is limited by contractual agreement to operate the plant in accordance with industry-approved operating practices and to perform maintenance activities as scheduled. Further, Customer has the right to substantially all of the benefits from the plant during the term of the arrangement.

We believe the Board's decision to exclude contracts such as the one described in Example 5B represents a significant step backward in accounting.

Residual Value Guarantees

As noted in our letter on the 2010 Proposed ASU, we believe a lessee that provides a guarantee of the residual value of a leased asset should include an amount equal to the maximum amount it could be required to pay in measuring the lease liability and right-of-use asset. We believe requiring a lessee to estimate the amount it expects to pay under a residual value guarantee adds complexity to the accounting model and understates the liability and the risk that it has incurred. We believe including the full amount of the residual value guarantee in measuring the lease liability and right-of-use asset is consistent with the conceptual framework definition of liabilities and assets.

Including the full amount of a residual value guarantee in the measurement of the right-of-use asset and lease liability will also result in inventory financing arrangements structured as leases receiving the same accounting as they would receive under ASC 470-40. We are not convinced by the rationale in paragraph BC89 of the Proposed ASU that such arrangements will not meet the definition of a lease in the Proposed ASU ("A contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration").

For example, assume the following:

- Developer enters into an arrangement under which Finance Company acquires undeveloped land;
- Finance Company leases the land to Developer;
- The lease includes an option for Developer to purchase individual lots for an amount equal to the original purchase cost plus interest incurred by Finance Company; and
- Developer provides a residual value guarantee to Finance Company under which proceeds from selling a lot (including any improvements) in the event Developer does not exercise its purchase option are first paid to Finance Company, with any proceeds in excess of the cost of the lot plus accrued interest paid to Developer.

Developer improves the land, constructs homes, exercises the purchase option as each home is completed, and sells the completed site. Although Developer will eventually record a liability equal to the cost of the land plus interest, during the development period, that liability will equal the lease payments plus, under the Proposed ASU, the amount it **expects** to pay under the residual value guarantee (which would be expected to be significantly less than the cost of the lot). Under ASC 470-40, the developer would recognize an asset and liability for the cost of the lots when purchased by the third party. If the Board does not agree with changing the measurement of residual value guarantees, we recommend it exclude inventory from the scope of the standard to avoid accounting that differs from the guidance in ASC 470-40 for transactions that are subject to that guidance today.

Multiple Elements in a Lease

We disagree with the Proposed ASU's guidance on the measurement of a right-of-use asset and lease liability when there are no observable standalone prices for components (such as service agreements) included with the lease. We believe a lessee should be required to estimate the portion of the payment attributable to the non-lease components and should only use the portion of the payment attributable to the lease component in measuring the right-of-use asset and lease liability. That accounting is required today, so it would not create any complexity that lessees have not already addressed. Including the consideration attributable to non-lease components in measuring the right-of-use asset and lease liability overstates both and is inconsistent with the accounting that would be applied if an entity were to purchase the asset instead of enter into a lease.

Sale-Leaseback Transactions

The criteria in paragraph 842-40-25-2 of the Proposed ASU to determine whether a seller-lessee has maintained control over an asset it has transferred to a purchaser are not consistent with the principle of control in the forthcoming Revenue Recognition standard, which focuses on whether the buyer-lessor obtains substantially all of the remaining benefits from the asset. We do not believe a lease that covers the major part of the asset's economic life or on which the present value of lease payments accounts for substantially all of the asset's fair value necessarily precludes the buyer-lessor from obtaining substantially all of the remaining benefits from the asset, particularly where the lease payments are set at market rates. We believe the Proposed ASU should determine whether the buyer-lessor has retained control of the asset by assessing whether the lease would qualify as an in-substance purchase. For example, if it is remote that the asset will be returned to the buyer-lessor, the arrangement would not qualify as an in-substance purchase.

We also believe the Proposed ASU should specifically address the impact of purchase options on the accounting for a sale-leaseback transaction. We believe a purchase option would preclude sale accounting, consistent with the forthcoming Revenue Recognition standard, but believe the FASB should make that clear in the final standard.

Finally, we believe the Board should retain the existing guidance on gain recognition in a sale-leaseback transaction. The terms of sale and leaseback arrangements are usually negotiated as a package. Because of the interdependence of the terms, we believe the Board's rationale for its decision in FASB Statement 13, *Accounting for Leases*, to require deferral of any gain on the sale continues to be relevant today.

Reassessments

We do not support the Proposed ASU's requirement to reassess lease payments for changes in CPI or interest rates. We believe the cost to companies to do so will be significant but will provide limited benefit. We support current GAAP for recognizing changes in lease payments due to changes in such indices as they become payable.

Private Company Exceptions

We disagree with the Board's decision to allow private company lessees to use the risk-free rate to determine the lease liability if they are unable to determine the rate the lessor charges. The use of the risk-free rate will result in overstating the right-of-use asset and the lease liability. We are opposed to exceptions that result in companies measuring the same economic transaction at different amounts based solely on one being a public company and the other being private. Our experience is that private companies have a sense of their incremental borrowing rate and need that information under current GAAP.

We do not oppose the Board's decision to exempt private companies from certain disclosures, but we are not as convinced as the Board that all users of private company financial statements necessarily have the ability to directly access management and obtain additional information. Only those users who have negotiated the right to additional information would necessarily have the right to that information. Other users will have to rely on the information provided in the financial statements, just like a user of public company financial statements does. Further, it is our experience that in times of stress, access to management of private companies may be limited.

Effective Date

For public companies, we believe our recommended approach could be effective for 2017, the same as the proposed new Revenue Recognition guidance. However, for our alternative recommendation, given the additional complexities, we support an effective date for public companies of one year later.

If the Board does not agree to our recommended approach, we recommend that the retrospective measurement of the lease liability be determined without considering changes in foreign currency exchange rates to reduce the effort required on adoption of the new standard.

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We appreciate the Board's consideration of these comments. We are available to discuss these matters at your convenience.

Sincerely,

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