Investors Technical Advisory Committee
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Via Email

August 20, 2009

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Leases: Preliminary Views Discussion Paper

Dear Chairman Herz and Chairman Tweedie:

In conjunction with the Financial Accounting Standards Board's ("FASB") and International Accounting Standards Board's ("IASB") (collectively, the "Boards") joint project, the Investors Technical Advisory Committee ("ITAC") would like to take this opportunity to share its opinion on the preliminary views reached by the two Boards on its accounting for leases. Our input is based upon our perceptions as users of financial statements; our goal is to improve the clarity, completeness, and usefulness of financial reports.[1]

ITAC concurs with the Boards' view that "it is important that lease accounting provides users with a complete and understandable picture of an entity's leasing activities." We believe the existing lease accounting standards have been inadequate and do not produce consistently useful information for investors, especially with regard to operating lease accounting by a lessee. We commend the Boards for addressing the most pervasive problems in leasing first, which are found in the accounting standards employed by lessees. We believe that this approach will provide greater benefit to investors than by taking longer to address *all* aspects of lease accounting.

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[1] This letter represents the views of the Investors Technical Advisory Committee ("ITAC") and does not necessarily represent the views of its individual members or the organizations by which they are employed. ITAC views are developed by the members of ITAC independently of the views of the Financial Accounting Standards Board ("FASB") and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml.

We strongly support the tentative decisions of the Boards to require that both the right-of-use assets and the related financing obligations arising from lease arrangements be recorded in the balance sheet. This decision addresses one of the most problematic areas in financial reporting and we commend the Boards for taking this step. The Boards are currently considering proposals for a parallel project on the reporting of financial instruments. The FASB and the ITAC have affirmed their views that all financial instruments should be reported at fair value in the balance sheet with changes in the values reported in other comprehensive income as incurred. Although these obligations have been carved out of reporting for financial instruments in the past, we would expect that they would be included in this project unless the Boards determine that they are not financial instruments, in which case we would be interested in the Boards' logic for this conclusion.

We would like to address the issues raised in the Discussion Paper by the following topics.

1. Scope of lease accounting standard

The Boards have tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. The ITAC agrees with this proposed approach, and does not believe the Boards should permit an exclusion for "non-core" asset leases or short-term leases. We believe that definitions of core and non-core assets can be very subjective and mean quite different things to different constituents. We also believe that allowing an exemption for short-term leases, no matter how a "short-term lease" is defined, will be an open invitation to game the terms of leases so as to fall outside the scope of the standard.

2. Approach to lessee accounting

We strongly support the Boards' proposal of a right-of-use asset model, wherein a lessee would recognize an asset representing its right to use the leased item for the lease term and an associated liability for its obligation to pay rentals. We believe that this approach captures the economics of leasing transactions for lessees in a far more descriptive manner than current lease accounting standards. We also believe that the right-of-use model, as developed in this Discussion Paper, will also successfully depict the economics of more complicated variations of the basic leasing model.

3. Initial & subsequent measurement

The Boards have reached a tentative decision that lease obligations should reflect the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate, and the right-of-use asset will be measured at cost, with subsequent asset measurement on an amortized cost-based approach. The ITAC supports this approach on the grounds that the results will be the provision of more investor-useful information than the current non-recognition of lease obligations because of the alignment of the accounting with the economics of the transaction. Relative to the current state of lease obligation reporting by lessees, overall transparency to investors would be greatly enhanced.

At the same time, we find it difficult to reconcile the Boards' endorsement of an amortized cost-based approach with their long-standing commitment to the improvement of reporting for all financial instruments at their fair values. The ITAC has long been a proponent of fair value reporting for all financial instruments, and we believe that lease obligations fit into that category. We consider the Boards' endorsement of an amortized cost-based approach for lease obligations to be only an interim step toward that end, and recommend that the Boards give serious consideration to the larger question of whether or not they want to perpetuate mixed-attribute reporting of financial instruments by staying with this approach.

The Boards have also posed several questions about subsequent measurement issues. Our following responses are framed in the context of the Boards' proposed amortized cost-based approach.

Fair value option. One question was whether or not there should be a fair value option for measurement of the lessee's obligation to pay rentals. The ITAC did not believe that such an option would improve financial reporting for investors. To date, the salient issue for investors has not been whether or not a lessee's obligation to pay rentals is shown at fair value or amortized cost, but whether a liability has been shown *at all*. Furthermore, the optionality of making a fair value presentation of a lessee obligation would hamper comparability. We favor one basis for reporting; as discussed above, the Boards' need to decide whether or not they want to perpetuate a mixed-attribute model in a broader context.

Revision of lessee obligation: changes in incremental borrowing rate. The ITAC did not support a requirement for lessees to revise the obligation to pay rentals to reflect changes in the lessee's incremental borrowing rate. It is our belief that such revisions would not frequently result in sufficient new information about the lessee's financial status to justify the requirement.

Rental expense vs. amortization/depreciation. Some Board members believe that the decrease in value of the right-of-use asset should be considered rental expense instead of depreciation or amortization. The ITAC does not agree; we believe that depreciation or amortization is more descriptive and that using the term "rental expense" would carry a different connotation indicating a lesser degree of asset involvement in a lessee's operations.

4. Leases with options

The Boards tentatively decided that when options to extend a lease exist, the lessee should recognize an obligation over the most likely lease term. They also decided to require reassessment of the lease term at each reporting period, based on new facts and circumstances, with changes in the obligation to pay rentals recognized as changes in the right-to-use asset. Purchase options are considered to be the ultimate option to extend, and would be accounted for in the same fashion as extensions.

The ITAC supports the "most likely lease term" approach, along with a required reassessment at each reporting period and the recommended treatment for purchase options. We believe that the "most likely lease term" approach to lease terms and purchase options, with required reexamination at each reporting period, forces the lessee to make an honest assessment of whether or not a change in its lease obligation position has occurred. We also believe that the "most likely" principle is clear enough that practitioners should be able to implement it without great difficulty.

5. Contingent rentals/residual value guarantees

The Boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Contingent rentals would be measured on the basis of the most likely rental payment when considering a range of possible outcomes, and changes in contingent rentals will result in remeasurement of the lease obligation. The FASB favors recognition of changes in contingent rentals in income; the IASB favors recognition of changes in the carrying amount of the right-of-use asset. The ITAC supports the proposed approach for accounting for contingent rentals for the same reasons we support the "most likely" principle in determining a lease term: if honestly applied, it should adequately account for the lessee's responsibility for contingent rentals, yet the principle is flexible enough and sufficiently clear that practitioners should be able to apply it without undue difficulty.

We support the FASB's approach regarding the accounting for contingent rentals, on the grounds that we do not believe that an increase in contingent rentals always provides evidence that an increase in the value of the leased asset has simultaneously occurred.

We understand that the Boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same, and have tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. We also understand that the Boards differed on how to measure residual value guarantees, with the IASB favoring a probability-weighted estimate of amounts payable, and the FASB favoring a most-likely payment amount. The ITAC supports the FASB's approach for measuring residual value payments. The "most-likely payment" principle runs throughout the principles espoused in the Boards' preliminary views, and we fail to understand why a probability-weighted estimate of amounts payable provides a more meaningful or investor-useful result for residual value guarantees than a payment amount developed under a most-likely payment approach.

6. Presentation

Regarding the presentation of the lessee's obligation to pay rentals, the IASB tentatively decided that the obligation should *not* be presented separately in the statement of financial position, while the FASB tentatively decided that the obligation should be presented separately. The ITAC favors the FASB approach on the grounds that it imparts more information to users about the nature of a firm's liabilities at the first level of information being presented. We understand that the distinction of lease obligations versus financing obligations could be made in the notes as well, but we believe investors will generally benefit more from finding information on the face of a financial statement than having to find it later in footnotes.

The Boards developed three approaches to presentation of the right-of-use asset in the statement of financial position: 1) according to the <u>nature of the underlying leased item</u>, 2) as an <u>intangible asset</u>, and 3) on the <u>basis of the lease classification</u>. Of the three approaches, the ITAC supports the first. We believe that investors would understand better the nature of a firm's operations if leased assets are identified as they would be reported if they were purchased, such as land, buildings, equipment, and the like. We would prefer to see leased assets categorized by their nature, but reported separately from assets actually owned in order to give investors a view into the particular asset-intensiveness of a business, while providing a view into the assets' financing at the same time.

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In conclusion, we reiterate our satisfaction in seeing the Boards address this long-standing financial reporting deficiency. We thank you for considering our comments. If you wish to discuss any of them or if you have any questions, please feel free to contact the undersigned or any ITAC member.

Sincerely,

Jack Ciesielski

Jack T. Ciesielski