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Financial Computer Systems has been providing lease accounting services and software to corporations throughout the United States and Canada since the promulgation of FAS 13 in 1976 (and the Canadian equivalent, CICA 3065). We have focused on assisting lessees with their reporting requirements (with limited work for lessors, primarily those that are also lessees). We have been concerned for many years about the structuring many lessees do to avoid reporting substantial transactions on the balance sheet, and we applaud the boards for finally taking the steps needed to correct this situation.

We have chosen to respond to only some of the questions, either considering others to be well decided by the boards and not needing further comment, or considering that we have nothing further to add to their discussion.

Question 2: FAS 13 has effectively excluded leases with an initial term of 12 months or less. We believe that attempting to capitalize leases of such short duration (down to overnight rentals of hotel rooms) is an exercise that offers little benefit to financial statement users at considerable cost, and we believe such short-term leases should be excluded from the new standard. Such an exclusion should not apply to a lease with options to renew that, when reviewed under the new standard's criteria, would extend the lease beyond 12 months. We consider it unlikely that even large numbers of such short-term leases would truly result in material assets and liabilities. A 12-month expected useful life threshold is commonly used to differentiate purchases that are capitalized from those that are expensed, so we consider excluding shorter leases (expensing the rent as incurred) to be consistent with accounting treatment of other asset purchases.

We strongly oppose excluding "non-core asset" leases; we believe that such an exclusion would provide significant potential for abusive treatment, and whether an asset is core or non-core makes no difference in the entity's obligation to make the payments stated.

Question 4: We believe that the right to use model is a good one which will greatly enhance comparability and transparency for financial statement presentation. The removal of bright lines from US GAAP and of the inherent incomparability of capital and operating leases, whether the line drawn is based on rules or on principles, will encourage the lease vs. buy decision to be based on true economics (and the other intangible factors that affect the decision), not on how creative accountants can be and what can be squeezed past the auditor, a situation that penalizes those trying to be conscientious and honest. And recent events have proven the danger of allowing companies to hide real obligations off the balance sheet.

Question 6: A disadvantage of always using the incremental borrowing rate, with no limitation on the asset/obligation value to the fair value of the underlying asset, is that it can hide how costly a transaction is from statement users. (We have seen equipment leases with implicit interest rates in excess of 50%.) The asset is then overstated, and amortization expense is

overstated relative to interest expense. Yet we have found also that often determining a fair value is a difficult process, particularly for real estate leases.

We recommend retaining the FAS 13/IAS 17 limitation on the original lease obligation & asset value to the underlying asset's fair value when the underlying asset is equipment, because we believe this will provide more comparability between lease and purchase asset acquisitions. It is usually relatively simple to determine that fair value (equipment is almost always available for purchase as well as for lease) and equipment seems most prone to being leased at effective interest rates well in excess of a lessee's incremental borrowing rate. This is not the same as using the implicit interest rate, in that it does not require knowledge of the lessor's unguaranteed residual.

One of our main areas of concern is the recommended changes to recognition of contingent rentals, and therefore we respond to each of the questions on that topic:

Question 16: We agree with the boards' conclusion that estimated contingent rents should be included in the initial lease obligation.

Question 17: We believe that a probability-weighted approach, particularly when combined with the requirement to adjust at each reporting period, will result in an excessive amount of time and expense for preparers. It should be remembered that these numbers can never be anything other than estimates, and therefore precision is inherently elusive. We believe that a "most likely" approach will be less onerous and will yield results that are well within the range of reasonableness. This is also consistent with the methodology chosen for determining the lease term.

Question 18: We agree with the FASB's position. However, one issue with contingent rents which we believe should be more clearly spelled out is how inflation adjustments should be recognized (particularly if the FASB's preferred "most likely rental payments" approach is used). We are aware of a variance in current practice between those who consider the CPI an index and those who consider the change in CPI a rate. This means that some companies currently treat all inflation adjustments as contingent rent (setting up a lease using its initial rent as the minimum rent for the entire life of the lease), while others estimate that the current inflation rate will continue through the life of the lease and treat the increases based on the current rate as part of the minimum lease payments, with only the difference (positive or negative) between that estimate and the eventual actual rent treated as contingent rent. The terminology of "changes in an index or rate" is open to both interpretations, since the Consumer Price Index is, as its name indicates, an index, though most focus is on the rate of change in the index from one year to the next. Since this is a common feature of real estate leases, we believe comparability would be served by the boards clarifying how an inflation adjustment should be recognized. We believe it is most consistent with the concept of "most likely" to treat CPI (or equivalent inflation measures in other countries) as a rate, and to estimate future rents based on the current rate of inflation.

Question 19: We are concerned that continual remeasurement of contingent rental liabilities will significantly increase the complexity of reporting. Contingent rental agreements tend to be unique to each lease (different percentages of rent per store; minimums, maximums, or fractions of CPI changes; etc.). Therefore, companies with hundreds or thousands of leases potentially face burdensome recalculation requirements. A company with a fleet of vehicles, for instance, potentially would need to review the mileage of each vehicle at each reporting period to check for excess mileage. A retail chain might need to recalculate 20 or 30 years worth of future rents for each store. We question whether the greater putative precision is worth the cost. The need to recalculate means that the anticipated future rents, and therefore the lease obligations, would be constantly changing, which will potentially make it more difficult to compare past and present financial reports.

We believe that the requirement that contingent rents be estimated at inception protects against the current problem of substantial rent obligations being hidden from reporting by being characterized as contingent, and that allowing the difference between estimated and actual contingent rent to be expensed as incurred, with no change to the future obligation, will provide sufficiently accurate information to fairly represent the lease to financial statement users, perhaps with the proviso that if the lease term is changed due to option/cancellation clause reassessment (or a renegotiation of the lease), the contingent rental estimates should be updated at that time.

Question 20: We disagree with the FASB's decision to recognize changes in contingent rent in profit or loss. Since many long-lived real estate leases include inflation adjustments, and inflation is always changing, companies with a large real estate lease portfolio face constant fluctuations, potentially large, in their lease obligations each reporting period. For instance, a 20-year lease with \$10,000 monthly rent (in advance), an incremental borrowing rate of 5%, and annual CPI increases would have a present value of \$1,947,145 at a 3% inflation rate. With a drop in inflation to 0% (as happened this past year), the present value would drop to \$1,521,567; if inflation rose to 5%, the present value would rise to \$2,321,506. Under the FASB's preferred methodology, these large changes would be taken immediately to profit or loss, which means that the lease could result in profit or loss swings from year to year that are several times the size of the actual rent payments. We doubt that these swings will help users of financial statements understand the economics of the lease transaction and the associated business. Since the actual change in rents will be recognized over many years, we consider it more appropriate to adjust the carrying amount of the right-to-use asset, as the IASB prefers, so that the change in asset will be amortized over the full life of the change. (And since the rate may later move in the opposite direction, only a portion of the first change would need to be recognized at all, which would be consistent with the actual rent outlay.) This is also consistent with the adjustments required when expected cash flows on leases change due to reassessing options (chapter 6).

Question 24: We were concerned that the DP did not include any ideas about how the new regime would be implemented. We note the boards' decision at their June meetings to set up all leases at the implementation date with equal asset and obligation, based on the present value of the remaining rents. We agree with that decision; we consider it in general the least disruptive and most effective in enabling comparability between reporting entities. However, this decision does not address the closing out of current lease assets and liabilities, under both capital and operating leases (where the latter have deferred liabilities due to scheduled rent increases). In

almost all cases, lessees would book a gain on closing their existing leases, since for a capital lease depreciated on a straight-line basis over the lease term, the asset is always less than the obligation during the lease term, and operating leases with scheduled rent increases result in deferred liabilities. This gain either could be booked directly to retained earnings, could flow through the income statement, or could be recognized over the remaining life of the lease.

- Booking directly to retained earnings means that the removal of excess expense which was previously recognized is not shown in the income statement, which over the life of the lease overstates the expense of the lease.
- An immediate recognition of the gain in the income statement means that an accounting change results in income that could be substantial for some lessees, particularly those with many long-lived real estate leases. This may obscure the true economics of the lease and the entity.
- Amortizing the gain over the remaining life of the lease is, in our opinion, the most appropriate, as it is consistent with how the benefits would have been recognized without the change in accounting method, and reflects that the benefit truly applies to the entire life of the lease. For simple capital leases whose accounting may be virtually unchanged under the new standard, this will result in the least discontinuity between old and new regimes.

We appreciate the effort the boards and their staffs have taken to resolve the serious issues in lease accounting that have resulted in financial statements that do not fully reflect obligations lessees have undertaken. While there will always be individuals and companies that try to game the system, we believe the fundamental approach significantly limits the impact of such attempts and will provide a much fairer and more comparable presentation of the economic reality of reporting entities. We urge the boards in reviewing comments to keep in place the fundamental principles enumerated in the discussion paper and to keep the process on schedule for promulgation in 2011, presumably with implementation planned for 2012. We stand ready to assist corporations and other reporting entities in implementing the new standard, as we have assisted them with implementing the current standard.

Sincerely,

A handwritten signature in black ink that reads "Kelvin Smith". The signature is written in a cursive, flowing style.

Kelvin Smith
Vice President