



July 8, 2009

Financial Accounting Standards Board  
Attn: Technical Director—File Reference 1680-100  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1680-100  
Discussion Paper “Leases: Preliminary Views”

Dear Technical Director, Board Members and Staff:

The Accounting and Auditing Committee of The Ohio Society of Certified Public Accountants is pleased to express its views on the discussion paper, “Leases: Preliminary Views”.

In general, we concur with the tentative views expressed by the Financial Accounting Standards Board with exceptions as noted in our responses to the questions as outlined below:

### **Question 1**

*The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?*

*If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.*

We concur that beginning with the existing lease standard is a sufficient place to start. While there are deficiencies with the current standard; it is our opinion that there are more provisions that work than do not. The main problem with the current standard lies in the fact that “loop holes” are exploited. Attempts should be made to tighten the exceptions rather than “blowing the whole standard up” and starting again.

## Question 2

*Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.*

*Please explain how you would define those leases to be excluded from the scope of the proposed new standard.*

We concur with the discussion points raised in section 2.15. While it would seem appropriate to exclude certain “non-core” assets, we agree that making a determination of “core” versus “non-core assets” would be subjective. Furthermore, creating a clear cut definition of these asset types would be extremely difficult. Generally when a scope exception is difficult to measure or define, “loop-holes” are created. This subjectivity is the primary concern with the current lease accounting standards.

The board makes note that certain short-term leases “may” be excluded from this provision due to materiality. We concur with the board’s opinion on this. We would like to emphasize that “materiality” must be the main driver behind a scope exclusion. Nature of the lease, duration of the lease or any other determining factor will most likely result in additional complexity and subjectivity, unless the Financial Accounting Standards Board specific exclusion guidelines within the right-of-use asset/obligation accounting requirements.

## Question 3

*Do you agree with the boards’ analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.*

This topic does have numerous facts to consider. Ultimately, we do concur with the conclusion that there are several basic lessee rights and lessee obligations. The rights and obligations listed by the board appear to capture the basic elements when broken down to the most simplified terms.

In our opinion, where it becomes much more difficult to identify the proper accounting treatment is with the determination of assets and liabilities arising from a lease contract.

## Question 4

*The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognize:*

- (a) an asset representing its right to use the leased item for the lease term (the right-of use asset)*
- (b) a liability for its obligation to pay rentals.*

*Appendix C describes some possible accounting approaches that were rejected by the boards. Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.*

We concur with the board's preliminary view that the right to use a leased item meets the definition of an asset and should be included on the balance sheet.

We concur with the board's preliminary view that the obligation to pay rentals meets the definition of a liability and should be included on the balance sheet.

The board's preliminary view that the "obligation to return a leased item at the end of the lease term is NOT a liability" warrants additional discussion. The board discusses two main criteria for determining whether the obligation to return a leased item at the conclusion of the lease term meets the definition of a liability.

1. Present obligation/Past event- Section 3.22 describes this scenario. While the discussion does make some sense, an obligation to return a leased item still exists (assuming the contract states so). In our opinion, the obligation began at the moment the contract was signed and was merely "enforceable" at the time the lease expired. In any event, an obligation still existed to return the leased item at some point in time.
2. Outflow of economic benefits-
  - a. While we agree that the lessee has no right to economic benefits and no obligation to make "lease" payments at the conclusion of the lease term, the obligation to meet the requirements of the lease contract will still be in effect. In the event that the lease contract stipulates that the leased item be returned to the lessor in an "acceptable condition" (generally taking into consideration routine wear and tear) and it is not, there most likely will be an "outflow of economic benefits". In this case, the lessor most likely would request that the leased item be returned, replaced or the equivalent economic value be transferred from the lessee to the lessor.
  - b. In addition, the board takes the approach that the obligation to return the leased item is similar to that of an "asset custodian". While this conclusion does make sense, whose obligation is it to replace the asset in the event that it is damaged, lost or stolen while in the "custody" of the asset custodian? Generally, a contract between parties will determine this in the terms and conditions of the contract.

In our opinion, a liability to return a leased item does exist in some form. At a minimum, detailed footnote disclosure of the company's obligation to return leased items at the conclusion of the lease term should be presented. When a 'right to return' liability becomes probable for the lessee on a right-of-use asset, it should be accrued and the offsetting charge should be directly against period expense for the lessee at that time.

## Question 5

*The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognizes:*

- (a) a single right-of-use asset that includes rights acquired under options*
- (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.*

*Do you support this proposed approach? If not, why?*

We concur with the board's approach for not adopting a components approach to lease contracts. It seems that this would "open up a can of worms" with respect to companies attempting to circumvent the lease accounting standards. It is already difficult to design standards that seek to make a level playing field. We believe when you throw in an unlimited number of "wild cards" (which you will experience with lease components) that the lease accounting will be even more diluted than it currently is.

## Question 6

*Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate? If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.*

We concur using the incremental borrowing rate for the lessee may offer the best opportunity to estimate fair value for the rights acquired under many lease agreements, due to the lessee's lack of or knowledge of the alternative cash purchase price for asset rights and/or residual value on such assets. Such information would be critical in order to reasonably estimate fair value.

The accounting objective should be to provide the most accurate view of the fair value of the right-of-use acquired and to measure the underlying financing cost incurred in acquiring these rights over the time frame entailed under the lease agreement.

We believe with some leases (financing type leases, for example), the lessee may have enough information to establish a clear view of assumed residual value and be aware of cash purchase price options relevant on those assets. Under these circumstances, we believe use of that information leads to a more accurate view of the financing cost associated with acquiring rights over a period of time.

Where such information is available to a lessee, accounting standards should require use of such information in estimating fair value of right-of-use acquired and to measure financing costs. Where the lessee does not reasonably have access to such

information, only then should the alternative use of the lease's incremental borrowing rate be permitted.

### **Question 7**

*Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost? If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.*

We concur with the Board's decision to initially measure a right-of-use asset at cost. This approach provides comparable financial information between companies that might purchase versus those that might alternatively choose to lease assets. We also concur that this approach is easier and less costly to apply than fair value measurements on a repetitive basis.

This approach effectively treats a right-of-use asset in the same manner as a non-financial asset. Such assets typically are used on a continuous basis and are not normally subject to market conditions where such assets are readily sold or bought in the normal course of business. Accordingly, we do not believe a fair value measurement from year to year for such assets is meaningful or realistic.

### **Chapter 5: Subsequent measurement**

#### **Question 8**

*The boards tentatively decided to adopt an amortized cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach? If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favor and why.*

We concur with the tentative decision to adopt the amortized cost-based approach to subsequent measurement of the lease obligation and the right-of-use asset. This approach will enhance comparability between companies that may use a debt approach to purchase assets and those companies that choose to use leasing as an alternative financing route to acquire rights to similar assets.

Alternative methods that might require specific differentiation between types of leases or which may ignore the interest element inherent in a lease agreement serve only to result in a much more complex and costly approach in applying accounting standards, continue the same definition problems and issues that exist in practice today (between capital and operating leases) and weaken comparability of financial statements between companies.

## Question 9

*Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.*

We believe underlying lease obligations are similar to other non-derivative type financial obligations with a key exception. Lease obligations in the normal course of business have limited capabilities (through sublease provisions) for transfer of the liability to other parties. Typically, lease agreements do not permit the lessee to prepay, replace and refinance those obligations as may exist with other types of non-derivative type debt. Therefore, fair value reflecting current market conditions is an unrealistic manner to view lease debt obligations.

Accordingly, we do not support any election by a lessee to measure its related lease obligation at fair value. This election option would weaken financial statement comparability and potentially introduce accounting measurements that may be misleading to the user of financial statements.

## Question 10

*Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons. If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.*

We support the decision not to require reassessment of the lessee's incremental borrowing rate. Requiring annual reassessment of an incremental borrowing rate is inconsistent with existing accounting for non-derivative financial liabilities and is too complex and costly for many preparers of financial statements

Once a lease transaction has been entered into, the basic facts leading to the initial valuation of the right-of-use asset acquired for the lessee (and conversely for the lessor) and the related lease debt obligation are established...including the effective financing costs in effect at the time the transaction was entered into. Since lease agreements typically are fixed and not contingent on any subsequent change in credit status or incremental borrowing cost of the lessee, it doesn't make sense to impose an accounting approach that assumes there is such impact from subsequent changes in lessee incremental borrowing cost. To do so would impose artificial results in accounting for a lease not based on economic reality for an entity.

Financial statements should reflect the economic status of the business based on the assets, liabilities and equity as they realistically exist. Where assets and obligations can readily be sold, prepaid and created anew in an existing marketplace, fair value may have some relevance to a financial statement user. Where that condition does not

exist, imposing fair value methodology can lead to misleading valuations and related information in financial statements.

### **Question 11**

*In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities. Do you agree with the proposed approach taken by the boards? If you disagree, please explain why.*

We concur with the boards' approach to specify the required accounting for the obligation to pay rentals in lease contracts. Because the right to use and the corresponding liability are matched under the lease contract, no separate market exists for the liabilities. Therefore using the existing guidance for financial liabilities would not likely lead to better estimates for the obligation to pay rentals. Further, the lessee may not have the requisite knowledge assumed in existing guidance (e.g. the rate implicit in the lease) to provide accurate measurements.

### **Question 12**

*Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortization or depreciation in the income statement. Would you support this approach? If so, for which leases? Please explain your reasons.*

We do not support the introducing alternative approaches to account for the decrease in value of the right to use asset. An important component of the proposed standard is the assumption (conclusion?) that every lease represents both the acquisition of a right to use asset and funds this acquisition with an obligation to pay rentals. Allowing differential treatments for some leases increases the possibility of manipulation and potentially decreases comparability among companies.

We believe the diminishment of the right-of-use asset should be described consistently as either rent expense or as depreciation expense for all leases. It is not obvious a bright line definition exists to support selective use of either description for leases. Because cash flow and expense recognition occur over time under a lease, we understand the potential logical argument for supporting the use of "rent expense" for the consumption of the right-of-use asset. However, we believe the right-of-use asset is similar to owned tangible or intangible assets, and that its consumption is more properly described as depreciation/amortization, and that the offsetting liability is more properly viewed as a debt obligation for the entity.

## Chapter 6: Leases with options

### Question 13

*The boards tentatively decided that the lessee should recognize an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

We concur with the boards' approach to specify that the lease term used to compute obligations to pay rentals is the most likely lease term. This approach is the most straight-forward and guarantees a realistic computation (i.e. a computation based on a possible outcome, 10 or 15 years).

### Question 14

*The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognized as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

We concur with the requirement to reassess the lease term at each reporting date and recognition of changes in the obligation to pay rentals as an adjustment to the carrying amount of the right-to-use assets. The reassessment means that the lessee has acquired an additional right-of-use asset (more time) and a corresponding liability. A question arises at the time of reassessment, however, about the appropriate incremental borrowing rate used to measure the additional obligation. Presumably, the lessee makes the reassessment based upon information available at the time. Part of the decision to exercise (or not to exercise) a renewal option is likely based on the current economic conditions which include the lessee's incremental borrowing rate. Therefore, the boards should consider measuring the additional obligation using the lessee's incremental borrowing rate at the time of the reassessment.

Another key question is whether this change should be accounted for as an expense adjustment in the period when the change is made, or whether it should be accounted for as a change in the underlying value of the right-of-use asset. We believe such a change (except when it is associated with an accrual of a 'right of return' obligation for the lessee) should be accounted for as a change in value of the right-of-use asset, which is consistent with the views of the International Accounting Standard Board in this area. The alternative direct expense treatment for lease adjustments seems to turn on a punitive approach based on a presumption that management judgment will be biased towards minimizing lease terms, and that subsequent direct expensing will

reinforce better recognition judgments at lease inception. Treating any lease term adjustments as a change in right-of-use asset value better supports matching the expense of the consumption of such an asset with the periods benefited through its use.

*Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.*

Yes. Reassessment of the lease terms and changes to both the right-to-use asset and obligations for rental payments permit the user to see changes in management plans and/or expectations. This is especially important for changes in leases of core assets.

### **Question 15**

*The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

We concur with the proposed approach. The purchase option is an extension of the life of a right-to-use asset. Unless the purchase option is really a bargain purchase, the lessee will likely wait until close to the end of the lease to make a determination whether to exercise it. Since in this case there is no commitment to purchase, it will be excluded from the computation of obligations for rental payments. Disclosure of the existence of the option should provide statement users with sufficient information.

### **Contingent rentals**

### **Question 16**

*The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach? If you disagree with the proposed approach, what alternative approach would you recommend and why?*

We agree a lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements for certain types of contingent rentals where a reasonable estimate can be made by management based on the facts and circumstances at the measurement date and management believes it is probable the contingent rental will be paid.

### **Question 17**

*The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the*

*basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.*

*Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.*

We support the FASB tentative approach to measure the lessee's obligation to pay rentals using a most likely rental payment of contingent rentals payable because the benefit of using the more complex probability weighted model doesn't outweigh the cost the implementation. Additionally, the difficulty and subjectivity for the lessee to determine the probability of each of the possible outcomes makes the probability weighted method more complex for users to understand and less relevant than the best estimate method.

### **Question 18**

*The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.*

*Do you support the proposed approach? Please explain your reasons.*

We agree the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease because this will reduce complexity and cost of the application of the lease accounting standard changes. Determining the change in index or prime interests rate is not a cost effective approach between the cost of implementation and the benefit to users.

### **Question 19**

*The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments.*

*Do you support the proposed approach? If not, please explain why.*

We support the proposed approach because as new facts and circumstances come to light, management should update their assumptions to the contingent rental value to provide useful and timely information to the users.

### **Question 20**

*The boards discussed two possible approaches to recognizing all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:*

- (a) recognize any change in the liability in profit or loss*

(b) recognize any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

*Which of these two approaches do you support? Please explain your reasons.*

*If you support neither approach, please describe any alternative approach you would prefer and why.*

**We support the recognition of any changes in the estimated contingent rental payments in profit or loss because such changes do not appear to increase or decrease the value of the right-of-use asset.**

## **Residual value guarantees**

### **Question 21**

*The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives.*

*Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?*

**We agree not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives because contingent rentals and residual value guarantees are often related and dependent on each other and therefore should be treated the same.**

## **Chapter 8: Presentation**

### **Question 22**

*Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?*

**We concur with the FASB that the obligation be presented separately in the statement of financial position. Since the lessee's obligation differs from other financial liabilities, the user of the financial statements will be able to quickly identify the type of liability on the statement of financial position, in addition to having the information disclosed in the footnotes.**

### **Question 23**

*This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position. How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons. What additional disclosures (if any) do you think are necessary under each of the approaches?*

We agree that the right-of-use asset be presented according to the nature of the underlying leased item. It is consistent with the way in which the lessee uses the right-of-use asset in its normal course of business. It also simplifies the reporting since the guidance on differentiating in substance purchases from other leases has not been defined. Also, the difference between leased assets and owned assets could be presented in the notes to the financial statements.

We do feel that the difference between leased assets and owned assets be required to be disclosed in the notes to the financial statements if this method of presentation is approved.

## **Chapter 9: Other lessee issues**

### **Question 24**

*Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.*

We believe that “short term” leases should be excluded from the scope of this requirement, and they should be treated as direct expense as incurred leases. Imposing a minimum lease term for which the accounting requirements associated with a right-of-use asset would commence ensures that effective cost-benefits associated with accounting for the lease are achieved and complexity is balanced with value for financial statement users. This exclusion definition should be evaluated further by the Financial Accounting Standards Board, but we would suggest, for example, any lease terms of less than two years should be considered for exclusion by definition. For these exclusions, we suggest additional footnote disclosures be required to enable the financial statement user to identify such exclusions made for defined short term leases.

## **Chapter 10: Lessor accounting**

### **Question 25**

*Do you think that a lessor’s right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.*

We believe that the lessor’s right to receive rentals under a lease meets the definition of an asset because the transaction of delivering the leased item gives rise to future economic benefits, and the lessor controls the right to receive the future payments.

### **Question 26**

*This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor. Which of these two approaches do you support? Please explain your reasons.*

We support the derecognition approach on the leased item by the lessor. In this approach, the lessor has sold the right to use the leased item (control) to a lessee in exchange for an amount as outlined in the lease agreement. This in turn creates a residual interest in the underlying asset. We believe this approach better reflects the actual transaction that takes place, rather than creating new assets and obligations.

#### **Question 27**

*Should the boards explore when it would be appropriate for a lessor to recognize income at the inception of the lease? Please explain your reasons.*

We believe that the boards should outline when it would be appropriate for a lessor to recognize income at the inception of the lease. This would provide for more consistent reporting between entities if that was clearly outlined.

#### **Question 28**

*Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.*

We believe it should be addressed within the scope of the new standard. It would help clarify requirements specifically for investment properties and provide guidance on whether investment properties are carried at cost or fair market value.

#### **Question 29**

*Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.*

It appears as if most all of the issues have been covered by this discussion paper.

We appreciate the opportunity to provide feedback to this discussion paper and welcome any additional opportunities to further discuss or otherwise support the efforts of the Financial Accounting Standards Board in this area.

Phillip L. Wilson, CPA  
Chairman, Accounting and Auditing Committee  
The Ohio Society of CPAs  
E-mail: pwilson@hbkcpa.com

Joel R. Karg, CPA  
Member, Accounting and Auditing Committee  
The Ohio Society of CPAs  
E-mail: jkarg@columbus.rr.com