

July 16, 2009

Technical Director
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**Re: Comments on FASB Discussion Paper – Leases: Preliminary Views
(File Reference No. 1680-100)**

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, submits the following comments to you regarding the above captioned release. The NYSSCPA thanks the FASB for the opportunity to comment.

The NYSSCPA's Financial Accounting Standards Committee deliberated the discussion paper and drafted the attached comments. If you would like additional discussion with us, please contact Mark Mycio, Chair of the Financial Accounting Standards Committee, at (212) 372-1421, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



David J. Moynihan
President

Attachment

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON FASB DISCUSSION PAPER –
LEASES: PRELIMINARY VIEWS**

(File Reference No. 1680-100)

July 16, 2009

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The New York State Society of Certified Public Accountants

Comments on FASB Discussion Paper – Leases: Preliminary Views

We have reviewed the Discussion Paper issued by the Financial Accounting Standards Board, *Leases: Preliminary Views*, a joint project of the Financial Accounting Standards Board and the International Accounting Standards Board (the boards) and appreciate the opportunity to provide our comments. We have the following responses to selected questions posed by the boards. Each such question is reprinted below, followed by our response.

Chapter 2: Scope of lease accounting standard

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.

Response

No. We do not believe that there should be any special exclusions or “bright lines.” Non-core assets should be included because accounting for similar items should not be based on a subjective entity perspective. In the case of short-term leases, any cost-benefit issues can be adequately addressed by the general materiality convention.

Chapter 3: Approach to lessee accounting

Question 5

The boards tentatively decided not to adopt a component 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?

Response

Yes, except contingent options should be recognized only when the contingency has occurred.

Chapter 4: Initial measurement

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 payment 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.

Response

No. We believe that the lessee's incremental borrowing rate should be used unless the implicit interest rate can be obtained. The implicit interest rate may be obtained from the lessor. Alternatively, the implicit interest rate may be determined if the lessee has knowledge of the acquisition price of the leased asset and estimated fair value of the asset at the lease expiration date (residual value). This information along with the required payments will permit the lessee to determine the implicit rate.

Chapter 5: Subsequent measurement

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.

Response

No. The fair value option would cause lack of comparability between amortized cost and fair value users. Further, fair value information on leases is not readily available. The only instance in which fair value of leases may be meaningful is if the lessee has the unrestricted right to assign or sublease leased property whose rental amounts stated in the lease are above or below market. However, that unrestricted right to assign or sublease the lease might be considered an implied embedded derivative whose accounting is governed by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Certainly, the complexity of determining fair value would increase dramatically. A fair value approach to leases would be inconsistent with the amortized cost approach favored by the boards.

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.

Response

No. Resetting the interest rate (implicit or incremental borrowing rate) would be inconsistent with the amortized cost approach advocated by the boards. The resetting of interest rates is inconsistent with the nature of the leasing activity which is to provide the right to use property at a cost determined at the inception of the lease

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rents. 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.

Response

Consistent with our response to Question 10, we do not believe the lease liability should be adjusted for any changes in interest rates. We believe that our response is consistent with the accounting for liabilities under the vast majority of U.S. GAAP.

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.

Response

Yes, for all leases, because that is the nature of the expense. The activity is a rental activity and the expense should be described as rent.

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.

Response

No. We believe that current lease term should establish the lease liability. The “most likely” criterion is too subjective and in many cases would be speculative and can result in misstated financial statements. The only criterion for extending the lease term is if it is virtually certain that the lease term will be extended. This level of certainty can be achieved with a lease amendment or a signed letter of intent to the lessor. If the renewal rent is at market, how is this rent estimated at the inception of a long term lease? There is a presumption that if a lease has an option to renew it is not likely to be exercised; otherwise the longer lease term would have been selected originally. Generally renewal options are exercised when the lease approaches its expiration date because the lessee is in a better position to determine how his interest will be best served.

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.

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

Response

We do not support the proposed approach because estimates to renew a lease are subject to error or manipulation. See our answer to Question 13. The proposed approach also introduces increased complexity and inefficiency to the process. One of the intended objectives of this new standard is to decrease its complexity.

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.

Response

We disagree, in part for the reasons stated in paragraph 6.58 which states, “These board members would include in the exercise price of a purchase option in the measurement of the obligation to pay rentals only if the purchase option was priced to provide a significant incentive to exercise the option.” Current U.S. GAAP (FASB Statement No.

13) states, “A provision allowing the lessee, at [the lessee’s] option, to purchase the leased property for a price that is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable, that exercise of the option appears, at the inception of the lease, to be reasonably assured.” We strongly support continuance of this principle.

Chapter 7: Contingent rentals and residual value guarantees

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?

Response

No. Many contingent rent amounts that will be incurred during the term of the lease such as percentage sales rent are not readily determinable at the inception of the lease. Consequently, estimating rent payments that may never occur or occur infrequently would serve to over or understate the lease asset and related obligation. We recommend that contingent rent be accounted for in accordance with current U.S. GAAP and be expensed when incurred. Unlike minimum rent payments, the lessee has no liability for contingent rentals until the contingency has been incurred. Therefore, there is no compelling reason to recognize that liability.

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.

Response

We do not support either approach because we do not agree with the inclusion of contingent rentals. See our response to Question 16.

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.

Response

Yes, because the index rate is readily determinable.

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.

Response

We do not support either approach because we believe that contingent rentals should be expensed when incurred for the reasons stated in our response to Question 16.

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.

Response

We do not support either approach. See response to Question 16.

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?

Response

No. See our answer to Question 16. We believe residual guarantees are contingent payments. This view is consistent with conclusions reached in paragraphs 7.42 and 7.43 of the Discussion Paper.

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?

Response

Yes, this will result in greater transparency. We recommend that there should be note disclosures similar to the type of disclosures currently required under U.S. GAAP for capital leases.

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?

What additional disclosures (if any) do you think are necessary under each of the approaches?

Response

We agree with the boards that leased assets should be presented in the statement of financial position based on the nature of the item (*i.e.*, classes of property). We also agree with the FASB that "in-substance purchases" should be presented separately from other leased assets.

As previously stated in our response to Question 22, we recommend that there should be note disclosures similar to the type of disclosures currently required under U.S. GAAP for capital leases. In addition, substance purchases should be separately disclosed showing the amount of the bargain purchase option or, where applicable, date title is transferred.

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.

Response

Yes. Initial direct costs to acquire a lease appear to exclude landlord funded tenant/leasehold improvements. This tenant improvement (TI) subsidy is usually specified in the lease. This discussion memorandum does not address the accounting for this subsidy, which is quite common in commercial real estate leases. The boards should specify whether a TI subsidy would reduce the amount of minimum lease payments that will be capitalized. The boards should address the accounting for other lease incentives.

The boards should address and clarify whether executory costs are excluded in determining capitalizable rent, *i.e.*, real estate tax reimbursements to the lessor, *etc.* Capitalizable rent should be defined to include all payments to the lessor, such as minimum rents that are not defined as contingent rents.

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.

Response

Yes, because it is a legally enforceable obligation established by the lease contract. This position is consistent with the boards' position with respect to liability recognition by the lessees.

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.

Response

We support (b), recognition of a performance obligation by the lessor, because the leased asset continues to belong to the lessor and has the effect of deferred rent which should be recognized over the term of the lease. Title to the leased asset has not been transferred and when the lease expires the lessor has an unrestricted right to use the leased asset. Further, during the term of the lease the lessor has a right to mortgage or sell the leased asset- very common in real estate. The presence of an existing lease with the lessee does not prevent the sale or refinancing of the leased asset.

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.

Response

No. In many cases the lessor continues to render services to the lessee throughout the term of the lease by assuring that the rented space continues to be available to the lessee. The lessor's failure to meet the debt service requirements of a mortgage, maintain the leased asset, provide utilities *etc.*, would interfere with the lessor's ability to provide the unfettered use of the leased asset to the lessee. The lessee has the legal right to withhold rent in the event adequate service is not provided to him. This is highlighted in the real estate industry in which the property has to be maintained by the lessor and debt service requirements have to be met. Even in triple net leases in which the lessee pays all operating expenses, the mortgagee can in many cases cancel all leases if the leased property is foreclosed. The operating business model for the real estate industry emphasizes periodic cash flow which provides for cash to meet periodic operating expenses and provide for sufficient money to pay debt service. Consequently, recognizing all the rental income at the inception of the lease does not recognize the continued responsibilities and services of the lessor and does not provide financial information that is useful to owners and creditors.

Question 28

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

Response

Yes, all leased properties are investments.

Question 29

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

Response

Yes.

1. Tenant improvement allowances, lease incentives, and other lease acquisition costs in real estate leases provided by the lessor to the lessee should be addressed.
2. Executory costs, *i.e.*, sales taxes, reimbursement to lessor for real estate taxes, proportionate share of operating expenses should also be addressed.