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July 17, 2009

Technical Director  
File Reference No. 1680-100

Re: **Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) Discussion Paper titled “Leases: Preliminary Views” (File Reference No. 1680-100)**

The Retail Industry Leaders Association (“RILA”) and its Financial Leaders Council are pleased to respond to FASB’s and IASB’s request for comments on the Discussion Paper titled “Leases: Preliminary Views” (the “Paper”). We are submitting our comments to the Financial Accounting Standards Board and understand that they also will be shared with, and considered jointly with, the International Accounting Standards Board.

RILA is an alliance of the world’s most successful and innovative retailer and supplier companies – the leaders of the retail industry. RILA members represent more than \$1.5 trillion in sales annually and operate more than 100,000 stores, manufacturing facilities and distribution centers throughout the United States. Its member retailers and suppliers have facilities in all 50 states, as well as internationally, and employ millions of workers domestically and worldwide.

RILA has a keen interest in the development of the proposed new lease accounting standard addressed in the Paper. RILA’s retailer and supplier companies depend on significant portfolios of leased properties for the operation of their businesses. Lease accounting is an important component of RILA members’ financial statements and transitioning to a new lease accounting standard raises significant implementation issues. We provide detailed comments below.

Retailers and suppliers with significant leased property portfolios, such as our members, will incur a substantial accounting system and process burden in order to implement and comply with the new lease accounting standard. The new lease accounting standard would apply to the thousands of leases held by RILA’s retailer and supplier companies if adopted in its present form. Because each lease is different, the new lease accounting standard would require our companies to undertake a lease by lease analysis of hundreds if not thousands of leases each quarter. Implementing a new lease accounting standard would also result in significant costs to develop and implement new accounting systems which can capture the information necessary to implement the new standard. However, because of the lack of lease uniformity and the way seemingly similar leases can be impacted differently by changed circumstances, development of the necessary systems will not eliminate the need for substantial time-consuming and manual review of virtually every lease each quarter. RILA urges FASB and IASB to carefully consider this accounting system and process burden in developing the new lease accounting standard.

In the context of the ultimate goal of convergence to international financial reporting standards (“IFRS”), RILA believes that the Boards should strive to reconcile now all significant differences between SFAS 13, *Accounting for Leases*, and IAS 17, *Leases* in a manner that will limit the need for any future changes.

RILA appreciates FASB’s and IASB’s consideration of RILA’s responses to the questions in the Paper below.

## **Chapter 2: Scope of lease accounting standard**

### **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.*

RILA generally agrees with the Boards’ decision to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards.

To delineate the scope of the new lease accounting standard, RILA asks the Boards to clarify the requirements of IFRIC 4 and EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*. Additional guidance is needed, for example, to clarify the distinction between payments for the right to use a leased item and payments for services. Under existing guidance, significant uncertainty can arise when attempting to determine if an agreement for services is just an outsourcing arrangement or the right to use a specific asset.

Additionally, given that the scope of the new lease accounting standard excludes lessor accounting, RILA would appreciate the Boards issuing more guidance to clarify sublease accounting for leased locations that are no longer used or partially unused for business purposes.

### **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.*

RILA believes it would be appropriate for the new lease accounting standard to exclude short-term leases, defined as leases for a term of less than one (1) year. However, RILA believes that material short-term leases should be included in the new lease accounting standard. Excluding non-material short-term leases supports the new lease accounting standard’s objective of excluding immaterial items. Including non-material short-term leases in the standard would increase the accounting burden without providing a substantial benefit to the users of financial statements. However, RILA does believe that the Boards should issue guidance with respect to

the treatment of short-term leases that have automatic renewal provisions or leases that are reasonably assured of being renewed or extended.

RILA also believes that the new lease accounting standard should be applicable to material non-core asset leases, either on an individual or aggregate basis because they are necessary to operate a business. Including immaterial non-core asset leases under the new lease accounting standard would substantially increase the accounting burden with no significant benefit to the users of financial statements.

RILA suggests that existing accounting guidance for operating leases be followed for short-term leases and immaterial non-core asset leases.

### **Chapter 3: Approach to lessee accounting**

#### **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.*

RILA agrees with the Boards' analysis of the rights and obligations and its application of the assets and liability definitions in a simple lease contract. RILA also generally believes that all lease contracts are appropriately treated as the acquisition of a right to use the leased item for the lease term. However, RILA cautions that there are few leases over an average lease life that are and remain a simple lease contract. As a result, the proposed guidance will likely create measurement issues throughout the lease life, thereby increasing the systems and process burden for entities such as retail companies that have large leased property portfolios. .

#### **Question 4**

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

- (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.*

RILA believes that it is generally appropriate to recognize both the right-of-use asset and the liability for the obligation to pay rentals. This is similar to the current treatment of capital leases under SFAS 13, *Accounting for Leases*.

**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 recognises:*

- (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?*

RILA generally supports the Boards' approach not to adopt a components approach to lease contracts. A components approach is difficult to apply and, when separate components could be measured on different bases, creates the potential for leases to be structured to reduce the amount recognized for the lessee's obligation to pay rentals.

**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 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.*

RILA agrees that the present value of the lease payments discounted at the lessee's incremental borrowing rate would be a reasonable approximation of the fair value of the lessee's obligation to pay rentals. For most companies, this approach would be simpler to apply than a requirement to measure the obligation to pay rentals at fair value; however, RILA would also support permitting, but not mandating, lessees to adopt a fair value approach to their obligation to pay rentals. RILA strongly recommends that the lessee's incremental borrowing rate be fixed at the inception of the lease. Fixing the incremental borrowing rate at the inception of the lease is appropriate because the obligation to pay rentals is akin to the obligation to pay fixed rate debt. However, even if the Boards were to adopt a fixed initial incremental borrowing rate approach, retailers and suppliers with a significant leased property portfolio would incur a substantial accounting system and process burden in implementing this new measurement of the obligation to pay rentals.

**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.*

RILA agrees that the lessee's right-of-use asset should be measured at cost. Such treatment would be consistent with the initial measurement of other non-financial assets, would be simpler to apply than requiring fair value measurement, and cost basis, measured by the present value of the lease payments, represents a reasonable approximation to fair value at the inception of the lease. However, RILA cautions again that entities such as retail companies with significant leased property portfolios will still incur a substantial accounting system and process burden in implementing this new measurement of the right-of-use asset at cost.

**Chapter 5: Subsequent Measurement**

**Question 8**

*The boards tentatively decided to adopt an amortised 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 favour and why.*

RILA generally agrees with the Boards' tentative decision to adopt an amortized cost-based approach because this approach is consistent with the way many other non-derivative financial liabilities (e.g., debt used to purchase equipment) are measured. Furthermore, an amortized cost-based approach is simpler and less costly to apply than a fair value approach.

However, RILA currently has significant unanswered questions which RILA hopes will be resolved by the Boards. For example, will the asset amortization method be the same or different from the liability amortization method?

**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.*

RILA generally prefers that the new lease accounting standard not permit a lessee to elect to measure its obligation to pay rentals at fair value. Permitting fair value measurement could lead to inconsistency because companies could apply fair values techniques and assumptions differently. Permitting fair value measurement would also add unnecessary complexity, cost, and volatility to the accounting standard because of the requirement to subsequently update fair value measurements using the expected cash flows and market interest rates at the time of remeasurement.

**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.*

RILA strongly believes that lessees should not be required to revise their obligations to pay rentals to reflect changes in their incremental borrowing rate. Requiring revisions to the obligation to pay rentals to reflect changes in the incremental borrowing rate is inconsistent with the approach used for subsequent measurement of many other non-derivative financial liabilities, in particular the amortised cost-based approach. RILA believes that the incremental borrowing rate should be fixed at the lessee's incremental borrowing rate at the time the lessee decided to procure the lease, because this incremental borrowing rate was the basis for the lessee's decision to obtain the right-of-use asset and incur the liability to pay rentals. For lessees with hundreds or thousands of leases, the accounting system and process burdens that would result due to (1) the complexity of determining the current market interest rates for lease obligations and (2) the sheer number of man-hours that would be required to review each lease each reporting period, would greatly outweigh the limited benefit that this information would provide to users of financial statements. Recognizing, however, that the Boards may mandate that changes to the incremental borrowing rate be made, RILA believes that if this course were pursued, any such changes should only be required when there is a significant change in estimated cash flows.

**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.*

RILA agrees with the Boards' proposed approach. Specific guidance on accounting for the obligation to pay rentals is necessary given the unique features and complexity of lease accounting.

**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 amortisation or depreciation in the income statement.*

*Would you support this approach? If so, for which leases? Please explain your reasons.*

RILA does not support this approach. The decrease in value of the right-of-use asset should be reported as a depreciable or amortizable asset in order to remain consistent with the current practice for capital leases. RILA would also support requiring disclosure of the depreciation or amortization of the right-of-use asset similar to the disclosure required for the depreciation or amortization of other tangible and intangible assets, because this information would be meaningful for the users of financial statements.

**Chapter 6: Leases with options**

**Question 13**

*The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie 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.*

RILA agrees that the lease term should be the most likely lease term. However, RILA disagrees that the lessee should not be able to consider its intentions and past practice in determining the most likely lease term, along with the contractual factors, non-contractual financial factors, and business factors identified in the Paper. RILA acknowledges the Boards' concern that basing the lease term solely on the lessee's stated intention could be open to abuse and potentially significant true-ups at the end of the lease term. However, RILA's members consider their intentions and past practice as the primary factor in determining the most likely lease term. Excluding entirely intentions and past practice from the determination of the most likely lease term would not result in the most accurate financial statements for such companies. RILA recommends that intentions and past practice, although not necessarily determinative, both be permitted as factors to consider.

**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 recognised 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.*

RILA supports requiring reassessment of the lease term only on the basis of a persuasive change in material facts or circumstances, such as the renegotiation of a lease during the average lease life. RILA does not support requiring reassessment of each lease term at each reporting date. Retailers and suppliers with a significant leased property portfolio will incur a substantial accounting system and process burden if reassessment of each lease term is required at each reporting date. Furthermore, in the absence of a persuasive change in material facts or circumstances, requiring reassessment of each lease term at each reporting date would not provide users of financial statements with more relevant information.

RILA agrees that when reassessment is in fact triggered by a persuasive change in material facts or circumstances, then changes in the obligation to pay rentals should be recognized as an adjustment to the carrying amount of the right-of-use asset.

#### **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.*

RILA generally agrees with the Boards' approach. However, RILA also agrees with the subset of Board members who would include 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. In other words, purchase options should only be included if the exercise of the purchase option is reasonably assured.

### **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?*

RILA questions whether all types of contingent rentals meet the definition of a "liability" as defined by FASB Concept Statement No. 6. Assuming that contingent rentals are in fact liabilities, RILA would generally support the Boards' approach. In this regard, RILA agrees with the subset of Board members who believes that the treatment of contingent rental payments should depend on the nature of the contingency to which the payment is linked. If the

contingency depends on an index, then RILA agrees that the contingency should be included in the obligation to pay rentals.

On the other hand, contingent rentals that are subject to performance of the lessee, such as percentage of sales over a certain breakpoint, should be excluded from the obligation to pay rentals. Performance-related contingency amounts do not exist until the event occurs and are difficult to estimate over the course of an average lease life. In this current economic environment, RILA's retailers have increased difficulty in estimating performance-related contingency amounts such as percentage of sales which are a component of rental payments under many retail leases. Accordingly, performance-related contingency amounts should be recorded as rent expense and be matched to the lessee's economic activity rather than amortized over the lease term in some other fashion not directly related to economic activity.

### **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.*

RILA prefers the FASB's approach to measure contingent rentals on the basis of the most likely rental payment, excluding performance-related contingency amounts for the reasons in our response to Question 16. The most likely rental payment is simpler to apply than the probability-weighted approach and choosing this approach would reduce the accounting burden if periodic reassessments were required.

### **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.*

RILA supports FASB's approach to require lessees to measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

**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.*

RILA believes it is appropriate to require remeasurement for material changes in the lease's contractual cash flow, such as changes in index-related contingencies. However, as explained in RILA's response to Question 16 above, RILA would exclude performance-related contingencies from the obligation to pay rentals and also from remeasurement requirements.

If the Boards were to decide to include performance-related contingencies in the obligation to pay rentals, however, RILA suggests that the Boards consider the very onerous and costly burden to lessees in requiring remeasurement of performance-related contingencies. Each of RILA's retailer and supplier companies may have hundreds or thousands of leases with performance-related contingencies, and requiring ongoing remeasurement of these leases would consume very significant accounting system and process resources. Furthermore, requiring remeasurement of performance-related contingencies would likely be of limited benefit for users of financial statements because the standard for remeasurement would likely become very complex and result in significant discrepancies in application from lessee to lessee unless clear and comprehensive guidance were provided with respect to determining which performance-related contingencies are significant, which performance-related contingencies are immaterial, and how performance-related contingencies should be measured.

**Question 20**

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

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

*(b) recognise 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.*

RILA supports option B. Any change in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments should be recognized as an adjustment to the carrying amount 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?*

RILA agrees with the Boards' approach. Contingent rentals and residual value guarantees are similar in concept and applying the same recognition and measurement requirements seems appropriate.

## **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?*

RILA believes that financial presentation should be based on the facts and circumstances specific to the individual lessee and therefore financial presentation should not be prescriptive. Therefore, the new lease accounting standard should allow, but not require, separate presentation.

For example, separate presentation may be appropriate for lease obligations that are material in the judgment of the individual preparer. Separate presentation may also be helpful for users of financial statements to distinguish between right-of-use assets and owned long term assets, such as in the context of assets which are no longer required for future business activities. Finally, separate presentation of the obligation to pay rentals from long term debt obligations more accurately reflects the differences between a lessee's obligation to pay rentals and a debtor's long term debt obligation.

### **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?*

RILA believes that financial presentation should be based on the facts and circumstances specific to the individual lessee and therefore financial presentation should not be prescriptive.

The individual lessee should make additional disclosures if such disclosures would benefit the users of the financial statements by enhancing their understanding of the lessee's material matters and contingencies. Such material matters and contingencies could include, for example, the renewal of leases for material right-of-use assets and situations when control of a material right-of-use asset is not held by the lessee.

## **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.*

RILA would appreciate the expansion of the new lease accounting standard project to address the following issues:

- The need to clarify the requirements of IFRIC 4 and EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*, and best define what is a lease agreement that falls under the scope of the new lease accounting standard;
- What precise arrangements constitutes a new lease under the new lease accounting standard;
- Confirmation that given the Boards' decisions expressed in the Paper, the final new leasing accounting standard formally nullify the consensus reached in EITF 97-10, *The Effect of Lessee Involvement in Asset Construction*;
- The relationship between the new lease accounting standard and FAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, and FAS 143, *Accounting for Asset Retirement Obligations*;
- Clarity on whether the same method should be used to amortize the obligation to pay rentals and the right-of-use asset;
- How to determine impairment of a right-of-use asset and any effects of such impairment on the obligation to pay rentals for the asset;
- More guidance on the definitions and differing treatments of core and non-core leases;
- Accounting for subleases of leased right-of-use assets;
- Accounting for temporary lease changes such as co-tenancy agreements;
- The treatment of executory costs;
- Whether amendments to leases during the lease term should be accounted for using the catch-up or prospective approach;
- Explicit consideration of implementation issues in the context of the conversion to IFRS and the accounting system and process burden for companies with significant leased property portfolios; and
- Clarification of timing for initial recognition of the right-to-use asset.

## **Chapter 10: Lessor Accounting**

RILA's members are retailers and suppliers who are primarily lessees. Therefore, our comments on the Paper focus on the lessee accounting questions and we take no position at this time on the lessor accounting questions.

## **Concluding Remarks**

RILA appreciates the opportunity to comment on the Paper. RILA generally supports FASB's and IASB's development of a proposed new lease accounting standard. However, FASB and IASB should appreciate that the current proposals will result in considerable implementation issues and costs for retailers, suppliers, and other companies with significant leased property portfolios. To minimize these issues, RILA believes that the Boards should take a holistic approach to revising the leasing standards and make the effective date of any new standard for lessees coextensive with the effective date of a lessor standard. This will allow the Boards to finalize the lessee standard after ensuring that no additional issues are raised through their efforts on the lessor side of the same transactions. Moreover, every effort should be made to reconcile the divergent views that currently exist in the Paper and, failing that, every effort should be made to minimize any further changes to the lease accounting standard in the context of an overall IFRS convergence project. In any event, given all of the implementation issues and burdens for companies with substantial numbers of leases, a significant amount of time will be needed to implement any new lease accounting standard.

Thank you for taking RILA's comments under consideration. We would be pleased to further discuss RILA's views with you at your convenience.

Respectfully submitted,

A handwritten signature in cursive script that reads "Sandra L. Kennedy".

Sandra L. Kennedy  
President  
Retail Industry Leaders Association