CB RICHARD ELLIS
ENTERPRISE NOTES

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Highlights from CBRE's Comment Letter to the FASB/IASB Regarding Proposed Changes to Lease Accounting

This fall, Enterprise Notes featured a series of articles addressing upcoming changes in lease accounting as proposed in the Exposure Drafts of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). In response to the Exposure Drafts, CBRE (along with more than 700 others) filed a formal comment letter addressing our concerns regarding the proposed changes. Click here to review the comment letter in its entirety.

Following are the highlights of the CBRE comment letter as they relate to several of the more concerning aspects of the Exposure Drafts. (Note: For purposes of gaining a better understanding of the background and context of the topics being referenced, please click here to review the consolidated version of the series of articles previously published.)

General

We believe the FASB and IASB should give additional consideration to:

- The significant judgment and subjectivity that will be required initially and on an on-going basis.
- The costs of additional staffing, systems modifications and consulting fees needed for both initial and on-going compliance.
- The impact the proposed standard will have on the ability of companies to comply with credit agreement covenants.
- The potential that the standard could drive companies toward short-term leases with no options, which may not be in the best economic interests of the companies and their shareholders.

Lessee Accounting

- We are not in agreement with the prescribed approach requiring the amortization of the right-of-use asset and the recognition of interest expense relating to the liability based upon the effective interest method, which results in an acceleration, or front-loading, of interest expense into the earlier periods of the lease term.
- We believe the right-of–use asset should be amortized in a manner which results in the straight-line recognition of total amortization and interest expense over the lease period.

Lessor Accounting

- We do not believe the issues and complexities relative to commercial property leases have been fully vetted and are not convinced the combination of the performance obligation approach and the derecognition approach represents the best solution.
- It is our understanding the FASB intends to issue an Exposure Draft in the first quarter of 2011 addressing whether entities should be given the option (or be required) to measure an investment property at fair value. We recommend that the final standards for both lease accounting and fair value accounting should be issued simultaneously.

Lease Term

- We are concerned that the new standard, as proposed, will lead to leasing decisions being made based primarily on accounting rules rather than economics.
- We believe it is a more accurate representation of a company's true obligations and commitments to only use the initial lease term stated in the lease, as well as any bargain renewal option periods, for the determination of the right-of-use asset and the liability to make lease payments unless it has been officially noticed that a lease is going to be terminated prematurely or extended through the exercise of an option.

Contingent Rentals

- We do not agree with the proposal to include contingent rentals (i.e., percentage rent, CPI rent increases, etc.) in the measurement of the right-of-use asset and the liability to make lease payments as this is not consistent with the definition of a present obligation of the lessee and therefore should not be treated as a contractual liability.
- The requirement to include contingent rentals in the measurement of the asset and liability would impose an extreme administrative burden on companies and require a level of forecasting that in many cases would border on pure conjecture.

Executory Costs (i.e., Operating Expenses)

- It is our recommendation that executory costs related to real property leases should not be included in the determination of the right-of-use asset or the liability to make lease payments.

Reassessment

- We believe the current language in the Exposure Draft is very broad and allows for too much subjectivity and judgment regarding when to reassess, which will cause inconsistency in application.
- The requirement for continuous reassessment, to determine if significant changes have occurred, will require companies to actively monitor a number of lease inputs (i.e., likelihood of exercising options, sales growth projections, etc.), which would be a significant administrative burden with limited, if any benefit.

In addition to reviewing the CBRE comment letter, you are invited to access the recording of a recent CBRE Global In-Sights presentation on the lease accounting issue entitled "FAS-Talking 3: Unintended Consequences," featuring Ray Torto, Jeff Beatty, Todd Anderson and Nick Tansey. Click here to access the recording.

The CB Richard Ellis Task Force on Lease Accounting Changes is comprised of the following team members:

- Jeff Beatty, Financial Consulting Group (Task Force Director)
- Todd Anderson, Global Corporate Services
- Judy Dahlke, Client Accounting Services
- Steve Latkovic, Investment Properties
- Mike Nelson, Strategic Consulting
- Jennifer Pazzia, Global Financial Reporting
- Andrew Steinberg, Global Financial Reporting
- Nick Tansey, Portfolio Administration Services