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July 17, 2009

Technical Director
Financial Accounting Standards Board

RE: File Reference Number 1680-100

Dear Director:

Foreword:

We are submitting the following comments on behalf of the 4,000 members of the American Rental Association (ARA) who reside in the United States. ARA members rent equipment, tools, and party and event equipment to the public and other businesses. A common term for our members' business activity is *rent-to-rent*.

ARA has reviewed the Discussion Paper *Leases: Preliminary Views* dated March 19, 2009. The equipment rental industry has significant concerns about the potential effects the proposals put forth in the Discussion Paper could have on our industry and our customers and recommends that short term rental agreements are excluded from the scope of this action.

Industry Perspective:

The Discussion Paper issued by the joint boards of the Financial Accounting Standards Board (the Board) and the International Accounting Standards Board could potentially have an overwhelming impact on the equipment rental industry without providing a meaningful benefit to financial statement users. The equipment rental industry generated revenues from renting equipment in 2008 in excess of \$35 billion. It is estimated that our industry contributed more than \$96 billion to the U.S. economy in 2008.

The existing accounting model for leases is governed by FAS 13 and IAS 17 as either operating or financing leases. The new proposal is to eliminate the operating lease model and account for all leases in the same manner. In theory, this sounds like a more straightforward approach but in actuality, it is more complex than the current model.

The Discussion Paper does not include a view on short-term leases, rentals or non-core assets and has asked for input in these areas. In addition, the Discussion Paper does not specifically discuss short-term rental. Short-term rental is an item that greatly affects the equipment rental industry and will have a major impact on individual rent versus buy decisions. If somehow the Board construed short-term rental and short-term leasing as the same activity, the requirement to record a short term rental on a company's balance sheet would be tedious and complex and the benefit would not outweigh the cost. The revenue from short term rental arrangements should continue to be accounted for on a straight-line basis, consistent with the provisions of SAB 104.

Non-core assets are assets that are not vital to the company's operations and therefore the capitalization of these items would not provide information of value to users of the financial statements. The cost of recording these items is not justified by the value of the information that will be provided. Non-core assets should also continue to be accounted for as operating leases with required disclosures.

Short-term equipment rentals are *at will* agreements whereby a renter receives equipment in exchange for a payment that is the value of the time the equipment will be used. The renter does not gain any benefits of ownership from this transaction. Accounting for short-term rentals on a straight-line basis, and not as leases, reflects the underlying economics of the transaction.

The economic impact of the requirement to capitalize all lease transactions will definitely impact all our member companies with all size rental revenues, from an independent small rental business with one location through national rental companies with multiple locations. The recording of these transactions will affect financial ratios which could affect existing loan covenants as well as approval for new financing. The equity ratios would decrease which may be a deterrent to new investors who do not understand the impact of this new standard. As a capital intensive industry that requires capital investment to replace equipment, we are dependent upon accurate financial ratios to obtain or maintain access to financing.

We speculate the thought for change in the standard is due to off balance sheet financing that occurs, but do not believe that this is the solution. The current standard provides opportunity to structure leases as operating versus financing to avoid recording on the balance sheet. The proposed method also includes that opportunity with individuals estimating the lease time period and options. In good economic times they will favor renewal and in tougher economic times, lead to shorter time period estimates. This new method may record the lease on the books but it cannot insure that the estimates are accurate. The result is balance sheets become more volatile without achieving a goal of better comparability.

The complexity of this proposal is inevitably going to cause confusion within both recording and understanding the accounting for leases. Not only is the initial recording complex, but the need to reassess the values at each reporting date adds to the technicality. This may also lend itself to adaptation of values to fit the current economic situation of the company. A majority of our member companies do not possess the skilled staff to record these transactions and will be required to hire professional accountants at additional cost. This puts an added accounting burden on small and medium size companies and larger companies will have increased complexity to deal within multiple locations.

The fact that the boards have decided to split the issue of accounting for lessors and lessees only further complicates the matter. Investors will have trouble understanding that the lessors record the transaction one way and the lessees record it another way. This does not achieve the goal of increased comparability of financial statements.

Short-Term Rental Transactions:

In order to frame our comments properly, we will provide a brief description of the typical transaction that is at the core of the equipment rental industry.

Equipment rental contracts are first and foremost <u>at will</u> contracts. By this we mean that equipment rental contracts; 1) have no specified term; 2) do not convey any aspect of ownership to the renter; 3) can be terminated by either party to the contract with no notice or penalty. Similar to the example in <u>Section 3</u> of the Discussion Paper, we will present an example of a rental transaction and then provide several additional cases that frequently occur while a piece of equipment is being rented.



Example

A customer contacts a rental company and asks for a backhoe for use in digging trenches that must be at least 12 inches wide and 14 feet deep. The rental company recommends a machine unit with the appropriate specifications that will enable the customer to successfully undertake and complete the job. The customer tells the rental company that they expect the job to take about a week and the rental company quotes the customer a weekly rate for the equipment. If the equipment is to be delivered to the job site, there is an additional charge to the customer.

Fact 1: The rental company only provides a machine within a product category; they do not provide a specific make, model or year. The machine is most likely not new.

Fact 2: The rental company has not conveyed any aspect of ownership to the person or company renting the machine.

Fact 3: The renter has been given a weekly rate, but it is understood that they can return the machine when they have completed the job, or they may keep it for additional time at the same rate if they require the machine for additional work.

Exploring this example and the accompanying facts will illustrate several points that make ARA believe these transactions which are typical to our industry are not and should not be included within the scope of the lease accounting changes being proposed in the Discussion Paper.

First, the machine specified in our example is not a specific brand or model. The machine is unlikely to be new. Any similar type machine in a rental company's fleet is interchangeable with the machine that is sent on this particular rental. Moreover, if one machine is sent on the rental order in the example and subsequently has a mechanical problem and must be repaired, the rental company is responsible for retrieving the machine and replacing it with another machine in that product category that is capable of performing the required work.

The interchangeability of equipment is an important aspect in the equipment rental industry. A typical rental fleet averages between 30 and 60 months in age depending on economic conditions. Rental fleets tend to age in a slow economy and be more recently purchased when economic growth is robust. If a fleet is four years old on average there are likely to be nine model years of equipment represented in the fleet. That is because equipment is replaced such that the fleet has a uniform distribution with just as many new machines and machines of the same type that are eight years old. Therefore when a renter requests a machine by signing a rental contract, he does not know if he is getting a new machine or one that is four, or six or eight years old.

These two points are critical because they are not addressed in the Discussion Paper. The value of a lease is determined by the cost of the equipment, the interest rate, and the term of the lease. A rental is based on the value of the time the equipment is used and the type of equipment. A backhoe that costs \$60,000 does not rent for a higher rate than one that costs \$50,000 ceteris paribus. Moreover, interest rates do not play any direct role in the determination of rental rates. Rental companies borrow funds and finance equipment purchases for their fleet, but the machine that is paid in full rents for the same rate as the machine on which payment is still being made. Interest rates are an expense just like labor, maintenance or facility rent, which adds to costs. Rates are set so that the rental revenue from equipment covers costs.

Renting is purchasing time in a very specific way that is also quite different from a lease. In most cases a rental rate reflects an 8-hour day. When rental companies rent machines they record the hours on the hour meter and they check those hours when the machine is returned. If the machine is rented for seven days but has 168 hours of use recorded on the hour meter, the customer will be billed for three weeks of use. In fact it is quite common for companies that rent pumps and generators to use GPS to determine how many hours the units are being utilized not only so they can keep billing current, but so they can perform scheduled maintenance on the equipment at the job site.



Renting equipment is all about flexibility. When companies lease equipment they are bound by the terms of the contract. With the exception of certain issues with insurance and liability, rental contracts do not bind the parties to a rigid time period with specified payments that are calculated so that the payment over time includes an appropriate reflection of interest. Leases also transfer the title of ownership under lease agreements; they are liable for property taxes on the machine, maintenance, transportation, licensing if required, and many other attributes of ownership. Rental transactions have none of these attributes. The rental company retains full ownership rights, is responsible for maintenance, licensing, transportation, storage, taxes and all other responsibilities of ownership. Thus rental transactions are not leases and should not be accounted for as such.

Rental vs. Leasing in Context of the Discussion Paper:

In this section we will link some of the broad points made in the previous section to specific issues brought forth in the Discussion Paper. We will conclude that the Discussion Paper does not capture the fundamental nature of rental transactions in and of its presentations and that no elements of the Discussion Paper could be altered to appropriately define short-term rental transactions as leases.

<u>Section 1.3</u> defines *financial leases* as "...those leases that transfer to the lessee substantially all of the risks and rewards incidental to ownership of the leased asset." The thrust of the proposal outlined in the Discussion Paper is to make all leases financial leases. We agree with this definition of a financial lease; however we argue that the requirement that the lease convey the risks and rewards of ownership is not descriptive of a short-term rental transaction.

<u>Sections 2.18 and 2.19</u> pertain to *short-term leases*. However, the definition of a lease is not altered from that provided in <u>Section 1.3</u>. We conclude that a short-term lease is not equivalent to a short-term rental transaction.

<u>Section 3.2</u> discussed the rights and obligations of the lessee. Under the approach outlined in this section the lessee would recognize (a) an asset representing its right to use the leased item for the lease term (b) a liability for its obligation to pay for the right to use the leased item. There is no lease term in a short-term equipment rental contract. The obligation to pay is settled at the time of the transaction. If additional time is taken under the flexibility of the rental contract the obligation to pay is once more settled. Failure to pay for additional rental time is considered criminal *Theft of Rental Services* in many states.

Example 1 in the Discussion Paper describes a lease that establishes a lease term of five years and stipulates a machine life of 10 years along with other requirements associated with delivery and payment schedules. Short-term rental contracts and rental rates are not based on lease terms, of stipulated salvage values. Payment for equipment rental services are the simple calculation of payment = rate x time.

<u>Section 3.8</u> says the Board considered *only those rights and obligations that exist after the leased item is delivered to the lessee.* In a short-term rental agreement the renter has only one right and that is to use the rented item for the amount of time he has paid for. His only obligation is to return the item and pay for any additional time that has accrued beyond his initial payment at the time he initially rented the item.

<u>Section 3.10</u> discusses the non-cancellation clause in Example 1 in the Discussion Paper. Rental companies retain ownership and therefore the right to take possession of their equipment at any time for any reason. At the same time, renters may, with the consent of the rental company, extend the amount of time they retain possession of the equipment by making or agreeing to make payment for that additional time at the applicable rate.



In <u>Section 3.16</u> the board identifies the right to use the leased item as *the lessee controls the right to use the leased item during the lease term because the lessor is unable to recover or have access to the resource without the consent of the lessee (or breach of contract). This statement is at odds with the form and function of the short-term rental agreement. In fact the rental company often exercises their right of access to the rented item so that they can perform periodic maintenance.*

The obligation to *pay rents* in <u>Section 3.18</u> is conditional in the rental contract. If the renter is not provided with the item requested there is no obligation to pay rentals because there has been no transaction.

<u>Section 3.26</u> outlines the new approach being proposed by the board. Specifically that all lease contracts will be treated as an acquisition of the *right to use the leased item for the lease term.* We believe that short-term rental contracts that do not have a specified term and which do not confer the rights of ownership on the renter are not leases and should not be subject to these proposed accounting procedures.

<u>Section 4.8</u> discusses the relevant interest rate to be used to determine the value of discounted cash flows. Short-term rentals are not paid over time, they are paid on a cash basis at the time of rental and with subsequent renewals that may or may not occur. This discussion continues in <u>Section 4.15</u> with the initial decision by the board to measure a lessee's obligation to pay rents at the present value of lease payments discounted by the lessee's incremental borrowing rate.

<u>Section 4.19</u> has a similar discussion of measurements of the right to use an asset. While having obvious application to the lease situation, these calculations would not be useful in evaluating the value of a rental transaction. This is particularly true with respect to later discussions in <u>Chapter 7</u> that look at the effect of residual value on the valuation of assets and obligations. Residual value is particularly inappropriate in the valuation of short-term equipment rentals because the renter would only know the age and condition of the equipment he is renting when it is delivered to him. Moreover, that equipment may change at any time during the rental because of maintenance, failure, or other unforeseen factors.

SUMMARY AND CONCLUSIONS:

ARA concludes that the methods and procedures presented in the Discussion Paper do not pertain to short-term equipment rental agreements that are typical customers within the rent-to-rent industry. Short-term rental agreements do not convey ownership to the renter; all aspects coincidental to ownership remain with the rental company including maintenance, taxes, transportation and storage. Rental payments are made specifically for the use of time as it is needed. Short-term rental contracts are at will contracts that do not have a specified term and rental rates are not calculated based on explicit interest or discount rates.

The ARA asks that in the next communication related to this action, the Board clearly states that short-term equipment rental agreements are excluded from the scope of this action.

Sincerely,

The American Rental Association

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December 15, 2010

Technical Director
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Dear Director:

This letter provides further comments to the action referenced above by the American Rental Association (ARA) on behalf of our members. ARA has provided comments to previous requests on the issues raised in the Discussion Paper on March 19, 2009. We are attaching those comments dated July 17, 2009, to this letter for your continued reference. ARA has reviewed the Exposure Draft issued August 17, 2010, and we continue to have significant concerns about the definition of short-term leases and how that definition affects what we to believe is a fundamentally different transaction; the <u>short-term rental of personal property</u> such as equipment.

Notwithstanding our request for a scope exclusion for short-term rental transactions, we believe the election available to lessors under paragraph 65 of the exposure draft to not recognize an asset with an offsetting liability or a derecognized asset for short-term leases is warranted. We also believe it is imperative that any final guidance retain this key provision. Unfortunately, the guidance in the Exposure Draft does not provide the same election to lessees thereby creating an inconsistent application among parties to the same lease agreement. Most ARA members function primarily as a lessor, however many of these companies rent a considerable amount of equipment from other rental competitors, which is in turn rented to customers under what is known as a re-rent transactions. In almost all instances re-rent agreements do not specify a term and can be called off rent at any time without penalty to the customer. As the Exposure Draft is currently written, rental companies would be required to establish a liability for each and every re-rent item on rent from a competitor which depending on the size of the business could amount to several thousand items at a given time. Because lease terms are not specified, a separate estimate of the expected lease term on an asset by asset basis would be required for every re-rent item. This would create a significant burden in terms of cost and effort resulting in a benefit that does not outweigh the cost. As such, we strongly believe the same election made available to lessors to not recognize liabilities for short-term rental obligations should also be made available to lessees. For leases less than one-year, both lessees and lessors should be permitted to continue recognizing these transactions as executory contracts in accordance with existing accounting literature. For leases greater than one-year, we understand the risk of "off balance-sheet arrangements" and do not have any objections to the proposed standard.

Based on definitions provided in the Exposure Document, it is our understanding that typical short-term rental transactions are not included in the scope of the Exposure Document. We have reached that conclusion because the specific type of rent-to-rent transaction described in detail in ARA's attached comments to the Discussion Paper has not been included as either part of the scope of the Exposure Document or as part of the definition of Short-term Lease. Our letter of July 17, 2009 clearly stated:

ARA concludes that the methods and procedures presented in the Discussion Paper do not pertain to short-term equipment rental agreements that are typical for customers within the rent-to-rent industry. Short-term rental agreements do not convey ownership to the renter; all aspects coincidental to ownership remain with the rental company including maintenance, taxes, transportation and storage. Rental payments are made specifically for the use of time as it is needed. Short-term rental contracts are at will contracts that do not have a specified term and rental rates are not calculated based on explicit interest or discount rates.

The ARA asks that in the next communication related to this action, the Board clearly states that short-term equipment rental agreements are excluded from the scope of this action.

Once again, we believe the specific scope exclusion that we requested in our letter of July 17, 2009 should be clearly stated or that other clarifying language with regard to short-term rental agreements be forthcoming from the Board.

Respectfully submitted,

John W. McClelland, Ph.D.