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Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
File Reference No.: 2013-270

Re: “Leases (Topic 842): a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)”

Dear Director:

On behalf of the Banks of the Farm Credit System (FCS or the System), we welcome the opportunity to express the FCS’s views with respect to the FASB proposed Accounting Standards Update, **“Leases (Topic 842): a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840).”**

Background Information about the Farm Credit System

The Farm Credit System is a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. Through its four Banks and 82 Associations, the FCS provides sound and dependable credit to American farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and farm-related businesses. The Associations are cooperatives owned by their borrowers, and the Banks are cooperatives owned by their affiliated Associations or principally owned by cooperatives and other eligible borrowers. As of June 30, 2013, the FCS's combined assets totaled \$248.5 billion, with \$192.8 billion of the assets consisting of net loans, and liabilities of \$207.9 billion, with \$199.0 billion of the liabilities being Systemwide debt obligations that are publicly traded. The System also had \$3.6 billion in lease receivables at June 30, 2013.

The comments that follow are the result of consideration of issues related to the accounting changes proposed by the FASB. Some FCS institutions may be submitting comments separate from this letter in order to address specific issues not discussed or to clarify or emphasize positions expressed herein.

General Comments

One of our greatest concerns is related to the complexity of certain items in the lease exposure draft and the impact it will have on our customer lessees. Many of our lessees are small, independent agricultural entities and agricultural producers that do not have the accounting and/or systems capability to implement sophisticated and complex accounting rules. Additionally, most of our lease volume is small ticket, lower risk and generally not long term (3-5 years). This proposal would cause a significant amount of work for our lessees with minimal benefit. The inability to account for leases under the new methodology could have an adverse business impact on many

smaller entities that rely on leasing to operate their business. As a user of financial statements for purposes of extending credit in many cases, we do not see a significant added benefit of utilizing the matrix of accounting treatment for different scenarios. We are concerned about the effect to working capital, ratios and debt covenants to our existing borrowers as currently structured. On this same note, we point out that the cash flow available to pay debt will remain the same.

It appears the main focus of the proposal is to capitalize all lessee operating leases (or at least recognize the present value of the operating lease) in both the assets and liabilities of the financials.

As a result, both the lessee and lessor would potentially have a lease asset reflected on their balance sheet. Income and expense recognition is determined based on the nature of the leased asset and the lessee's consumption of that asset, and therefore the recognition method could vary.

Lessee and lessor recognition would likely not be symmetrical or truly represent the economics of their leasing transactions. In addition, for financial institutions, there is uncertainty with regard to how regulators would treat this additional asset for risk weighting for capital ratio purposes. These issues should be addressed in a final standard.

In addition, the differentiation between Type A (Personal Property) and Type B (Real Property) and the different rules that impact each also seems unduly complex. Further, the requirement to continually re-assess the lease term is a significant change from current practice. This will require judgment and detailed systems and processes to be able to monitor the need to re-assess.

Lastly, we would propose not changing any of the rules for lessor accounting at this time. The lease exposure draft has addressed the most pressing issue – bringing operating leases onto the balance sheet – and there is no compelling reason to change lessor accounting.

Questions for Respondents

The following are answers to the questions we believe are applicable to the System.

Question 1: Identifying a Lease

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease?

The System generally agrees with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

The System would request the Board provide additional guidance around what is considered "insignificant" if the lease exposure draft remains unchanged. The System believes the treatment of leases should be based on the classification as either a capital lease (based on ownership of asset) or an operating lease (based on right to use the asset) and not based on whether it is property or real estate (Type A or Type B, respectively). We believe the nature of the lease (capital versus operating) should dictate the accounting and that the separate accounting for Type A and Type B adds unnecessary complexity in terms of the amortization and the

determination of the discount/interest. More guidance should be provided on how to assess the appropriate discount rate. Additionally, treating all leases the same would have negative consequences for many lessees (e.g. cost basis, debt covenants) and would not give analysts and investors the transparency that is required, particularly as it relates to bankruptcy. If the intent of this lease exposure draft is to capitalize operating leases on the lessee's balance sheet at present value, that is achieved with the guidance in the draft. However, the income impact should reflect the economics of the operating lease, which is straight-line over the life of the lease.

Question 3: *Lessor Accounting*

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Again, should the lease exposure draft remain unchanged, the System would request the Board provide additional guidance around what is considered "insignificant". We also do not agree with the matrix of accounting treatment, due to the limited benefits and high cost of navigating the matrix.

Question 4: *Classification of Leases*

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

In general, the theory of the approach to mirror the lessee's expected consumption of the economic benefits embedded in the underlying asset seems reasonable. However, this approach is overly burdensome and is not consistent with the accounting for other financing receivables (both current and proposed guidance). The guidance should allow for reasonable aggregation of similar leased assets.

When identifying the classification of a lease, paragraph 842-10-25-6 allows an exception for Type A non-property leases when the lease term is for an 'insignificant part of the total economic life of the underlying asset.' Based on the illustration in 842-10-55-63, an 'insignificant' part of the total economic life is less than 16%. The FASB should consider more clearly defining 'insignificant' to encourage consistency in application across entities.

Question 5: *Lease Term*

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

The requirement to perform an ongoing reassessment and re-measurement of lease assets and liabilities coupled with the requirement to account for each lease component as a separate lease (842-10-15-18) is overly burdensome. The proposed guidance does not identify the timing of when a lease should be reassessed – at the time the lessee/lessor becomes aware of a plan that may change the economic benefit of the asset (commitment to perform leasehold improvements, for example) or at the time actions are taken to change the economic

benefit of the asset (date of renovation commencement).

Additionally, the requirements in 842-20-35-5-d and 842-30-35-4-c to reassess lease payments when there is a 'change in index or a rate used to determine lease payments during the reporting period' should only be necessary when a change in rates was not considered in the initial determination of the lease liability or lease receivable, respectively. Other reasonable factors for reassessment would be when there is a change in contract or a significant change in factors not considered at the commencement date. However, a change in factors not considered at the commencement date should only be performed annually, not constantly for every quarterly reporting period.

The exception for short-term leases allowed under 842-10-25-14 and 842-10-25-15 at its face may seem to alleviate some of the burden; however, under the illustration in 842-10-55-68 and 842-10-55-69, a lease is precluded from being defined as a short-term lease because the maximum possible term under the contract is longer than 12 months even though the lessee does not have a significant economic incentive to exercise the option to extend beyond 12 months. If the lessee does not have significant economic incentive to exercise an option to extend beyond 12 months, the accounting is overly complex when all income would run through the financial statements within a one-year period. The FASB should consider the impact this guidance may have on leases as a business practice. Contracts may limit terms for 12 months with no option to extend, but in practice, continue leasing the same asset year after year to avoid overly burdensome accounting treatment.

Question 6: *Variable Lease Payments*

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

See comments above in Question 5. Also, as it relates to remeasurement, the System is concerned with the concept of recognizing cumulative changes in the net present value through the current year income statement. The current period financial results should not benefit or be penalized for benefits used in future periods. Measurement each reporting period will be extremely burdensome, especially for entities that have a large number of these type leases. Required audit evidence and review for these frequent adjustments will be resource intense and costly. In addition, it is unclear how decision useful this will make the information presented.

A change in the consumer price index (CPI) is a representation of the effects of inflation. The term structure of interest rates is commonly seen as including a premium that follows inflation, though there can be periodic disconnects. If this is the case, then an increase in the CPI would generally result in an increase in the discount rate that should be used to discount the increased future lease payments, resulting in insignificant adjustments to the liability amount. This is a circular exercise which provides no decision useful information to the user.

Question 7: *Transition*

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

It is our hope that the Board will consider grandfathering existing leases or at least those that have less than 12 months remaining. Significant historic information on existing leases will be needed as the lease exposure draft is currently written so we would suggest the Board provide more clarity and ease the transition regarding existing leases. As noted above, we have concerns over whether some of our smaller leasing customers will be able to comply. The System is concerned about the lessor changes for leases previously recognized as operating leases. It seems that the balance sheet would be misleading to readers to derecognize an asset; adjust it for previously recognized payments; and show a lease receivable for the remaining lease payments. The reclassification from PP&E to lease receivable at the present value may not align initially nor reflect the actual ownership of the underlying asset.

Question 8: *Disclosure*

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

The System is supportive of the ability to aggregate and disaggregate disclosures so useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics, as stated in 842-20-50-2. This allows the disclosing entity to include more or less detail in the financial statements based on the lease portfolio as well as the significance of the lease portfolio in comparison to an entity's total asset mix.

However, the expansive disclosure requirements do not provide decision-useful information to the user of the financial statements. More specifically, the reconciliations of amounts recognized in the statement of financial position do not provide significant benefit to the user, but would be overly burdensome and require a significant amount of data to be collected at a transaction level for the reporting entity.

The reconciliation of the undiscounted cash flows to the lease liability recognized in the statement of financial position (paragraph 842-20-50-8) is essentially the discount related to the time value of money. This one line item reconciliation does not seem useful and could easily be calculated by other data disclosed in the financial statements should the user want this data-point.

In addition to the extensive disclosures required by this exposure draft, substantial disclosures will be required under existing authoritative guidance. By altering the requirement for on-balance sheet presentation for leases, nearly all non-property leases will be scoped into the expansive disclosure requirements for financing

receivables as these leases would now meet the definition of a financing receivable (310-10-55-14-e). Additionally, the requirement in 842-30-45-1 to display lease assets separately from other assets in the statement of financial position would not result in consistent presentation when defined as a financing receivable for financial institutions when all financing receivables held to maturity are aggregated on the statement of financial position.

The disclosure requirements will be very burdensome for smaller, less sophisticated lessees and may produce results that are not in line with what the Board is envisioning. The disclosures detailed in paragraph 842-20-50-3 will result in generic information due to the fact that many lessees are involved in a wide array of lease transactions. The reconciliation required for both Type A and Type B in paragraph 842-20-50-4 for public entities is very complex and could result in too much information that will not be utilized by readers and investors.

The System believes the existing footnote disclosures on minimum lease payments provide sufficient information for analysis of commitments.

Question 9: Nonpublic Entities (FASB Only)

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

This will be a significant help to non-public entities.

Question 10: (FASB Only)

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

The System believes the treatment of leases should be based on the classification as either a capital lease (based on ownership of asset) or an operating lease (based on use of lease asset). If more information is desired for related party leases, we believe that should be included as a disclosure only.

Question 11: (FASB Only)

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

The System does not feel it is necessary to provide additional disclosures. If there is a material related party lease, it would be included in an entity's related party footnote.

Other: *Observable Prices*

The System disagrees with the requirement in 842-10-15-21 where an observable price is defined as the price that either the lessor or similar suppliers charge for similar lease, good, or service components on a standalone basis. This guidance seems to require additional research outside of the lease contract to identify observable prices as illustrated in 842-10-55-46. A materiality threshold should be used to determine whether identification of prices outside the stated contract are necessary rather than combining non-specified components as allowed under 842-10-15-20-b-2.

Other: *Impairment of Lease Receivable*

Paragraph 842-30-35-10 requires recognition of impairment in accordance with Topic 310. While leases would meet the definition of financing receivables under paragraph 310-10-55-14-e, would they not have to be assessed for loss contingencies as described in Topic 450-20? Additionally, if the exposed guidance for the Current Expected Credit Loss model is adopted, this would require Day 1 recognition of losses. The FASB should clarify whether these Day 1 losses be considered in the evaluation of the discount rate and related income stream as the lessor should not expect to derive economic benefits from the portion of the receivable that exceeds the carrying value of the asset.

Other: *Return of the Underlying Asset*

Paragraph 842-30-55-46 illustrates the leased asset is repossessed and booked as a new asset, but only for the amount equal to the book value of the lease receivable and residual asset, not fair value less costs to sell. This is inconsistent with 360-10-35-43: 'A long-lived asset classified as held for sale shall be measured at the lower of its carrying amount or fair value less cost to sell. If the asset is newly acquired the carrying amount of the asset shall be established based on its fair value less cost to sell at the acquisition date.' The FASB should consider clarifying in the proposed example that repossessed assets under a lease should follow similar treatment as a long-lived asset held for sale or a long-lived asset held and used.

We appreciate this opportunity to respond and hope our comments prove useful to the Board. If you have any questions with respect to the contents of this response, please call me at (201) 200-8081.

Respectfully,



Karen R. Brenner
Managing Director –
Financial Management Division