



greatamerica.com

December 15, 2010

Technical Director
Financial Accounting Standards Board ("FASB")
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Re: File Reference Number 1850-100

To Whom It May Concern:

We appreciate the opportunity to be able to comment on the "Leases" exposure draft. It's our understanding that the primary driver for proposing changes to the current lease accounting guidance is the "bright-line" distinction between capital leases and operating leases, which can lead to economically similar transactions being accounted for differently. Not only are these transactions (capital leases and operating leases) accounted for differently, but operating leases are also off-balance sheet transactions, which may not provide a complete picture of an entity's financial condition.

GreatAmerica Leasing Corporation ("GreatAmerica") is an independent small-ticket lessor, with an active portfolio of more than 115,000 lease contracts, and an outstanding net investment in leases of approximately \$1.1 billion. In addition to GreatAmerica's interest in the proposed lessor accounting guidance, it also has an interest in the proposed lessee accounting guidance as it is a user of lessee financial information for making credit decisions. Further, GreatAmerica is also a lessee, primarily under leases for office space from which it operates.

In our opinion, the exposure draft goes far beyond addressing the primary need for change. Certain provisions within the exposure draft are overly complex, and may actually distort the economic effects of leasing, rather than providing a faithful representation of leasing on a lessor's and/or lessee's financial condition. We will try to address all of our concerns by answering the questions posed to respondents in the exposure draft. Our responses are as follows...

Question 1:

- (a) Yes, however, we disagree with the proposed measurement of the right-of-use asset and the liability to make lease payments (see responses to Questions 8 and 9 below for additional details). The proposed measurement is based on definitions of lease term and lease payments that are not liabilities at the inception of the lease. The FASB should consider maintaining the current definitions of lease term and minimum lease payments to measure the right-of-use asset and liability to make lease payments. The current definitions are more objectively measurable, and promote comparability and symmetry in financial statements.

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(b) No, the exposure draft proposes treating the asset and liability as independent items for subsequent accounting, even though the proposed model links the asset and liability at the inception of the lease. We believe that the unit of account in a leasing transaction should be the lease contract, and that this unit of measurement should be used at both the inception of the lease, as well as for subsequent measurements. We further believe that the amortization of the asset and liability need to be considered together so that the pattern of amortization and interest expense in the income statement does not exceed the amount of the rental charge associated with the lease contract. As a financial statement user, we do not believe that the proposed income statement presentation provides decision useful information, and that by accounting for the asset and liability separately, as proposed, misstates the cost of a lease transaction.

Question 2:

It appears that the primary reason for proposing a change to lessor accounting, is to ensure that the lessor model is consistent with the proposed lessee model. We believe that the current lessor model should be left in place, as it does provide a complete picture of a lessor's financial condition, and is an accurate economic representation of the underlying lease transactions. We're not convinced that a change is necessary, simply to have a "consistent" model between the lessee and lessor. It's widely accepted that lessees and lessors may have different information at the inception of a lease transaction (the rate charged by the lessor versus the lessee's incremental borrowing rate, for instance), which further supports the notion that the models don't have to be consistent. In practice, the information used by lessees and lessors is not consistent under existing guidance, and will still not be consistent under the proposed guidance.

To address the proposed models, we do not agree that a lessor should apply the performance obligation ("PO") approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term for several reasons. First, the PO approach is not consistent with the proposed lessee model. Accordingly, the PO approach does not meet the FASB's objective for proposing changes to the lessor model. In addition, a risk and benefits analysis may not be appropriate, because retaining significant risks or benefits does not necessarily suggest that a performance obligation exists. For instance, leases originated by GreatAmerica include provisions that provide for the lessee to have "quiet enjoyment" once it takes delivery and control of the use of the underlying asset. Therefore, the performance obligation is extinguished at the time the lessee takes delivery and control of the use of the underlying asset. Lastly, we believe that the PO approach should be discarded, except in circumstances where the performance obligation is so great that it is likely that the lessee will withhold the lease payment. In these instances, we do not believe that these transactions would meet the definition of a lease, therefore, derecognition is not appropriate, and the lessor should not record a receivable and the lessee should not capitalize the lease obligation.

If the PO approach is not discarded, the FASB needs to better clarify when each approach would be applied. The exposure draft suggests that the lessor's business model would be an indicator of which model to apply, yet, the exposure draft suggests that the analysis should be done on a lease-by-lease basis. We've heard others who would interpret the guidance to suggest that the PO approach would be applied if the leases under current guidance would have been classified as operating leases, and that the derecognition approach would be applied if the leases under current guidance would have been classified as either direct financing leases, or sales-type leases. However, based on our understanding of the exposure draft, even though GreatAmerica has a single business model (small-

ticket lessor where the profits of the business are derived from interest income and the principal risk associated with the business is credit risk), and has historically originated virtually all of its leases as direct financing leases, the fact that the analysis is to be made on a lease-by-lease basis could lead to GreatAmerica accounting for leases under both approaches based on varying residual positions. We believe that accounting for our leases under both approaches would be misleading to our financial statement users, as using both approaches would suggest that we operate under multiple business models.

The derecognition approach does match the concepts in the lessee model, and appears to better represent the economics of the lease transaction to the lessor. There are a couple of areas that may require further analysis, however. First, the exposure draft suggests that the residual asset should be classified as PP&E. To a small-ticket lessor such as GreatAmerica, the residual asset is an expected cash flow from the investment in the lease, and should be reported as part of the net investment in the transaction. These assets are not used, nor are they intended to be used in the lessor's business, so to suggest that the residual asset is a fixed asset of the lessor is a clear misrepresentation of the lessor's interest in the asset. In addition, the residual asset should be accreted to the estimated fair value at the end of the lease. Failure to accrete the residual asset understates profitability over the lease term, and by catching up income at the end of the lease (i.e., at the time the asset is sold), does not properly match when the revenue was earned. Other provisions under this approach which should be reconsidered, including the lessor's lease term and lease payments, are discussed in more detail below (see Questions 8 and 9).

Lastly, we didn't realize that the intent of the exposure draft was to also change the scope of the current lease guidance. Under current accounting guidance (ASC 840-10-25-1), leases that either transfer ownership of the asset to the lessee at the end of the lease term, or that contain a bargain purchase option, are still classified, and accounted for as leases. Based on our understanding of the exposure draft, these "leases" would no longer be classified or accounted for as leases; but rather, would be accounted for as a purchase (lessee) or sale (lessor). From a lessor's perspective, the net result of the amounts reported in the financial statements for these transactions as a lease versus loan would be very similar. However, the economics of a "lease" are quite different from a loan. One of the primary differences is that a lease requires the lessee to make a specified number of payments, and the obligation cannot be prepaid for a "principal" amount. For instance, a lease for a \$3,100 piece of equipment, with payment terms of 36 payments of \$100 would require a minimum payment of \$3,600, and could not be prepaid for \$3,100. From a presentation perspective, this would appear on our statement of financial position as two separate line items (minimum lease payments receivable in the amount of \$3,600, and unearned income in the amount of \$500), rather than a single line item in the amount of \$3,100. We believe that the current guidance/presentation provides better transparency to our financial statement users, and to change the accounting for and presentation of these transactions as proposed could be misleading to our financial statement users. Further, this proposed change to the scope would require lessors to modify accounting systems, or invest in new systems to properly account for these transactions as loans, even though the economic substance is not the same as a loan. Since the accounting is so similar, the cost of modifying or investing in new accounting systems would outweigh any potential benefits of this change in scope. The change is also not consistent with the underlying economics of these transactions, which could mislead financial statement users.

Question 3:

No, we believe that short-term leases, from a lessee's perspective, should use an approach consistent with an operating lease under current guidance. Short-term leases are generally not material, and the disclosure of the amounts of such leases in the footnotes to the financial statements will provide an adequate amount of data for a financial statement user to effectively evaluate the financial condition of an entity. The cost of establishing systems to track short-term leases will far outweigh the benefits. We also reject the assertion that this will lead to structuring opportunities, due to market dynamics that will generally prevent these opportunities (see the example provided below in Question 8).

Question 4:

(b) No, we believe that this changes the scope of the lease guidance. As described above, this change will require lessors to modify accounting systems, or invest in new systems to properly account for this change in scope, and will actually lead to less transparency for financial statement users. Since this change does not yield a materially different accounting treatment compared to current lease accounting guidance, and may mislead financial statement users, the benefits of scoping these transactions out of the lease guidance would outweigh the costs. In addition, this change is not consistent with the underlying economics of a lease transaction.

Question 8:

No, from a lessor's perspective, GreatAmerica originates leases with renewal options that are a unilateral right of the lessee. GreatAmerica, as the lessor, would never be able to determine the lessee's intent. In addition, we agree with Mr. Stephen Cooper's alternative view that this would overstate the contractual receivable which would imply exposure to credit risk, when the reality is that it's an exposure to the underlying asset risk. Setting aside the theoretical flaws with the FASB's proposal, there are also several practical issues that this would raise for our company. For instance, this definition of lease term would require GreatAmerica to track multiple lease terms, one for accounting purposes, and one for contractual purposes. GreatAmerica is an active participant in the securitization markets, and we don't believe that a lender would lend against a contract beyond its contractual term. Therefore, GreatAmerica would always need to track the contractual terms of the underlying contract for borrowing purposes. The exposure draft also suggests that this evaluation needs to occur on a lease-by-lease basis. As a small-ticket lessor with a portfolio of more than 115,000 leases, this just isn't practical. Further, GreatAmerica's renewal terms are generally on a month-to-month basis, so the amounts on a lease-by-lease basis (GreatAmerica originates transactions with an average term of approximately 50 months) likely aren't material. Given all of the above factors, we believe the costs would far outweigh the benefits of using this definition of lease term.

No, from a lessee's perspective, a renewal option that is solely reliant on business conditions, should not be included in the lease term. We agree with Mr. Stephen Cooper's alternative view that optional renewal periods should only be included in the measurement of assets and liabilities when an agreement includes an incentive to extend the lease. We also believe that the threshold should be higher than "more likely than not", in order for an optional renewal period to be included in the lease term, even when the agreement includes an incentive to extend the lease. If these criteria are not met, the renewal option would not meet the definition of a "liability" under the conceptual framework. In the basis for conclusion, the FASB also suggests that factors such as the lessee's intentions and/or past practices should factor into this determination. We disagree with this conclusion, as neither of these factors can be supported by contractual obligations. We also agree

with Mr. Stephen Cooper's alternative view that options to cancel and extend leases provide a lessee flexibility when reacting to changing business circumstances, and accordingly, these features reduce risk for lessees. If all of these optional lease periods are included in the measurement of the right-of-use asset, then the resulting liability would overstate a lessee's financial leverage. As a financial statement user, we believe that the proposed treatment of renewal options will provide less transparency, and will likely mislead the financial statement user when evaluating the lessee's financial position. Lastly, we reject the assertion that not making renewal options part of the lease term will lead to structuring opportunities. We believe that market dynamics will generally prevent this type of abuse. For instance, let's assume that GreatAmerica originates a 60 month lease. Business conditions would not allow GreatAmerica to originate a 1 year lease with four 12 month renewal options, because our lenders would only lend against the contractual term, which is 1 year. If GreatAmerica, or a lessor, cannot borrow against the entire lease stream, it would change the economic viability of the lessor's business model. This market dynamic exists throughout the leasing industry, and is not limited to GreatAmerica's business model.

GreatAmerica would propose leaving the definition of lease term as it is under current guidance. The current definition is more objectively measurable, is more aligned with the conceptual framework, provides better transparency to financial statement users, and promotes comparability and symmetry in the financial statements.

Question 9:

No, contingent rentals should not be included in the measurement of assets and liabilities, for either the lessee or lessor. We would question whether a contingent rental meets the definition of a liability under the conceptual framework, since an entity would not have a contractual obligation until the contingency is met. To prevent structuring opportunities, principles should be established for identifying where contingent rentals lack economic substance and represent disguised minimum lease payments. We believe that lease payments should be determined based on the current definition of minimum lease payments. The current definition is more objectively measurable, and promotes comparability and symmetry in the financial statements.

Question 10:

No, if the changes described above are made, there would be no need to remeasure the assets and liabilities arising under a lease, since all of the components would be based on contractual obligations, rather than estimates. Alternatively, if the proposed exposure draft is adopted, this will add a significant burden on lessees/lessors to re-evaluate each lease, each reporting period. We understand that only a "significant change" would require remeasurement, however, to determine whether or not a significant change has occurred, each lease would need to be evaluated each reporting period.

Question 12:

(c) No, we do not agree that a lessor applying the derecognition approach should present the residual assets separately within property, plant and equipment. As discussed above in Question 8, the residual asset is an expected cash flow from the investment in the lease, and should be reported as part of the net investment in the transaction, not as PP&E. Since these assets are not used, nor are they intended to be used in the lessor's business, we believe that classifying them as PP&E misrepresents the lessor's interest in the asset.

Question 16:

No, we do not believe that the transition proposals are appropriate. To reiterate, existing lessor accounting is not “broken”. To require transition adjustments from a lessor’s perspective would be an overwhelming burden with little, if any, benefit. In addition, if the final guidance includes the changes that are proposed above, the transition proposal would not be necessary for lessors since the “modified” derecognition approach would not yield materially different accounting results from existing lessor accounting. Accordingly, existing transactions could be grandfathered in under transition.

Question 17:

No, we disagree that the FASB’s assessment that the benefits of the proposals would outweigh the costs. As documented above, this assessment is not correct when considering the PO approach (i.e., this approach may lead to misleading financial information for GreatAmerica’s financial statement users, so any cost associated with adopting this approach would far outweigh any perceived benefit), lease versus loan (purchase/sale accounting) classification (see Question 2 above), short-term leases (see Question 3 above), lease term (see Question 8 above), the remeasurement provisions (see Question 10 above) and transition (see Question 16 above).

To summarize, the most critical issues, as they relate to GreatAmerica, would include the following:

- Lessee approach: As a financial statement user, we do not believe that the proposed lessee guidance provides decision useful information, and misstates the cost of a lease. We believe that the amortization of the asset and liability need to be considered together so that the pattern of amortization and interest expense in the income statement does not exceed the amount of the rental charge associated with the contract.
- Lessor approach: We do not believe that there is an adequate case for change to the existing lessor guidance. To the extent that the FASB continues to work towards changing the lessor guidance, we believe that the PO approach should be discarded altogether.
- Residual asset: The residual asset, as it relates to a small-ticket leasing transaction, is an expected cash flow from the investment in the lease, and should therefore be classified as a component of the net investment in leases, rather than PP&E. In addition, the residual asset should be accreted to the estimated fair value at the end of the lease to properly match when the revenue was earned.
- Scope of “Leases” guidance: Leases that either transfer ownership of the asset to the lessee at the end of the lease term, or that contain a bargain purchase option, should still be classified and accounted for as leases, rather than being accounted for as a purchase (lessee) or sale (lessor).
- Lease term: The lease term should not be changed from the definition used under current guidance, which fairly represents the contractual obligation.
- Transition: The proposed transition rules would impose an overwhelming burden with little, if any, benefit.
- Costs and benefits: As documented throughout our comment letter, we believe that the costs to implement many of the proposed changes far outweigh the benefits.

In closing, we would like to reiterate that it appears that the exposure draft reaches far beyond the primary need for change. We believe that a simplified standard would accomplish the original objectives of the proposed changes (i.e., removing the “bright line” distinction between capital and operating lease, and off-balance sheet transactions), and would provide reliable measurements and comparability among lessors and lessees. We’ve been pleased to see the amount of “out-reach” that the FASB has engaged in related to the “Leases” project, and hope that the FASB will re-evaluate the proposal, and arrive at final guidance that better supports the economic substance of leasing transactions as well as the original need for change. If you



have any questions regarding GreatAmerica's comments, or would like to discuss our responses further, please contact our Controller, Brett Steffen, at 319-261-4029.

Sincerely,

A handwritten signature in blue ink that reads "A Golobic". The signature is fluid and cursive, with the first letter "A" being particularly large and stylized.

Anton Golobic, Chairman and CEO

A handwritten signature in blue ink that reads "Brett Steffen". The signature is fluid and cursive, with the first letter "B" being particularly large and stylized.

Brett Steffen, Controller