Technical Director
File Reference No. 1850-100
FASB
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Dear Board Members and Staff:

Ruan appreciates the opportunity to respond to the proposals set out in the Exposure Draft "Leases". Ruan is a non-public transportation company with 4,200 employees headquartered in Des Moines, IA. Ruan believes the current guidelines for lease accounting need improvement as they can be subject to abuse, manipulation and unintended consequences. Additionally, we feel the proposal being considered falls short in many areas, including treatment of embedded services, contingent based rentals, optional lease terms and expense recognition.

Ruan does conceptually agree that a right of use model can provide useful information and that a standardized approach needs to be developed to include future lease obligations and right of use assets on an entity's balance sheet. Under the current proposal, lessors and lessees will encounter potentially significant earnings volatility as they periodically reassess the right of use asset and revise more likely than not assumptions relating to contingent based rents and option lease terms. Lessors and lessees will also encounter significant transitional and on-going costs as existing systems are converted or modified and staff are hired and trained to comply with the new regulations.

Question 1: Lessees
(a) Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
(b) Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

We agree conceptually that a right of use asset and a corresponding liability should be recorded for long term lease agreements. In a long term lease scenario, there is no question to us a financing component exists within the transaction. However, for short term leases, the lessee is merely paying a charge to use the asset for a given period of time. The right of use model is not appropriate for short term leases and short term leases should not be required to be capitalized.

Recognition of amortization on the right of use asset and interest on the liability to make payments seems appropriate for long term leases. For long term leases, the proposal

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creates improved consistency in the much used Earnings Before Interest Taxes Depreciation and Amortization measure. Since financing alternatives are not usually a consideration in short term rentals, it is not appropriate allocate periodic rent expense between interest and depreciation.

We also have concerns with the timing of expense recognition in the proposal and feel the interest method unfairly over burdens the early years of a lease. Instead, it is more likely the case that prepaid rent is incurred in the early years of a long term lease with straight line payments. The interest method being proposed also will create significant volatility in expense recognition as lessees renew or extent leases.
The current proposal will also produce significant unfavorable consequences during reassessment processes. If during initial assessment, optional terms are considered more likely than not to be exercised, the right of use asset will be increased by the present value of the future rents. However, if at a subsequent reassessment, a lessee determines the option periods are no longer more likely than not to be excised, there will be write-off for the gap between the value of right use asset (amortized on a straight line basis) and the remaining value for the lease obligation (amortized on the interest method).

Question 2: Lessors
(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
(b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?
(c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

We do not believe there should be two alternatives for Lessors under this proposal. A single solution will provide for more consistent reporting practices. However, we are in agreement that the underlying asset, the right to receive payments asset and the liability to make the asset available should be netted on the balance sheet and result in either a net asset or a net liability.

We take issue with proposal's requirement to include contingent rentals and lease options in the initial measurement of the right to receive payment asset and the lease liability. Instead, we would propose to use the minimum future payment concept used under current guidelines. Using the minimum future rentals concept will reduce the

variability in income statement results associated with changing assumptions for contingencies and optional terms. Additionally, we propose that the more likely than not threshold is too low and will generally result in overstating both contingencies and option periods at the time of initial measurement.

Question 3: Short-term leases
This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:
(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).
(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65).
(See also paragraphs BC41–BC46.)
Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

We do not agree the simplified requirements should be applied to short term leases. We appreciate the right of use model is appropriate for long term leases and capitalization of the lease benefits and obligations has merit. However, applying capitalization rules to short term leases is onerous and provides little benefit. We would suggest short term leases be exempt from the guidelines of the proposal and associated rental expense continue to be periodically expensed

Definition of a lease
This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). This exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

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Question 4
(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Generally we agree with the proposed definition of leases. However, the proposal is ambiguous when it comes to interpreting the impact of lease clauses allowing for substitution of vehicles. We believe a right of use asset and corresponding liability will exist in most lease transactions regardless of whether a lessor will be required to substitute leased assets under certain circumstances.

We would also ask for further guidance on how, going forward, leases considered capital leases under current requirements due to a bargain purchase will be treated. Under the proposal these capital leases would no longer be treated as a lease. How will these capital leases be governed going forward?

The guidance for distinguishing leases from service contracts under the proposed requirements may be sufficient for interpreting how to measure each component. However the cost of implementing these processes, both from a labor and a system standpoint, could be significant. As a result, we may see many entities simply capitalize both pieces and avoid the added cost associated with breaking out the components. We do not believe this is the intent of the proposal and ask that distinguishing services from leases be given a more thorough analysis.

Scope

Question 5: Scope exclusions
This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).
Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?

We believe intangible assets should be considered in the right of use asset model for a comprehensive analysis of leases.

Question 6: Contracts that contain service components and lease components
This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers*, to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5−B8 and BC47−BC54). If the service component in a contract that contains service components and lease components is not distinct:
(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
(b) The IASB proposes that:
(i) A lessee should apply the lease accounting requirements to the combined contract.
(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.
Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We believe the guidelines for distinguishing service from lease needs to be more clear. We do not agree with the proposal because it allows two very different results for basically the same transaction, i.e. under one scenario all service costs would be capitalized while under another scenario the same fundamental transaction could allow services to be periodically expensed as incurred.

Question 7: Purchase options
This exposure draft proposes that a lease contract should be considered terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).
Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

We agree that purchase options deemed to be bargains should cause the transaction to be consider a sale or a purchase rather than a lease. Accounting for other purchase options only when exercised is desirable form a practical standpoint. Assessing non bargain options for initial assessment and periodic subsequent assessments will be burdensome and expensive from a cost standpoint.

Measurement
This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:
(a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).
(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.
(c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).

Question 8: Lease term
Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We disagree with the proposal that the more likely than not longest possible term should be used to measure leased assets and corresponding lease liabilities. More likely than not is a lower threshold (approximately 50%) than our current guidance which requires a reasonably assured level of certainty. As such, leased assets and liabilities will be initially established and renewal and extension options may be included based on a more likely than not test. However, during subsequent reassessment, a very minor change in assumptions, can cause leased assets and liabilities to be significantly adjusted. These minor changes in assumptions can lead to large income statement impacts because of the front loading impact of the interest method prescribed for amortizing the lease obligation compared to the straight line amortization methodology prescribed for the lease asset. We feel the interest method overly burdens the early years of a lease with charges against an entity's income.

We believe the more likely than not threshold is too subjective and suggest moving the threshold up to a reasonably assured level. For example if a lessee had an initial five year lease term and two additional five year option terms, we would propose that in most cases only the contractually certain initial term of five years be considered as the lease term. However, if in the example the lessee made improvements to the property that had a longer life than the initial lease term, it would seem reasonably assured the

lessee would remain in the property for both lease option terms to fully get the return from its investment from the lease improvements.

Question 9: Lease payments
Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?
Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

We do not agree that contingent rentals should included in the measurement of assets and liabilities. Contingent rentals based on hours of service or volume of usage should be expensed periodically as the usage occurs. We do feel it is worthwhile to administer regular probability analyses to calculate current expected future revenue and expenses, particularly with the low threshold level of more likely than not driving assumptions. Contingent rentals which are driven by indexes can be implemented at initial measurement and included in the asset and liability amounts based on the current value of the index then in effect. Future changes to an index can be recognized as they occur and assets and liabilities can be adjusted during subsequent reassessments. We do not feel it is beneficial to attempt to estimate future index changes at the time of initial measurement.

Lease term penalties and residual value guarantees can also be recognized as they occur. For example, when it becomes reasonably assured a lessee will terminate early, a lease term penalty should be recognized. Similarly, when it becomes apparent a guarantee will be triggered because the expected market value of a leased asset will not be able to cover the guaranteed amount of the residual, the appropriate amount of the guarantee should be recognized.

Question 10: Reassessment
Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

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We believe reassessment should occur when facts and circumstances change significantly. However, because we disagree with including contingent rentals and optional terms into the lease asset and liability measurement process and encouraged raising the threshold to reasonably assured, reassessments would become much less frequent and not considered as burdensome as they would be under the current proposal.

Sale and leaseback
This exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents a sale of the underlying asset, the leaseback also would meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66−67, B31 and BC160–BC167

Question 11
Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We do not have issues or concerns with the proposed sale and leaseback proposals.

Presentation
This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position
(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143−BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?
(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor

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should disclose this information in the notes instead? What alternative presentation do you propose and why?
(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

We believe the decision to lease a long term asset is primarily a financial decision for a lessee and generally may be tax driven. We do not feel it is beneficial to separately classify a leased asset separately from a similar asset that is financed either by conventional debt, capital lease obligations or a company's own operating capital. Similarly, we do not feel it necessary to create separate line items on the face of a balance sheet to show lease obligations separately from other long term obligations. These breakouts may however be appropriate within the notes to a financial statement.

We agree that a lessors balance sheet may be best presented using the net leased asset or net lease liability approach. Distinguishing assets and liabilities arising under sublease agreements may be useful for detailed tracking purposes, but we do not believe an entity's balance sheet need be cluttered up with these details. Sub lease assets and liabilities should be combined and netted with the underlying asset and the primary lease asset and liabilities.

Question 13: Income statement
Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We do not believe it is necessary to separately present lease income and lease expense on the face of the income statement. The Board may be able to provide examples of appropriate note disclosures to enable consistent reporting and common interpretation amongst entities.

Question 14: Statement of cash flows
Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153

and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

For lessees, we agree that it may be meaningful to show the change in lease payment obligation as a financing cash flow. The lease activity can be treated in a parallel why with how financing cash flows are treated for conventional debt, i.e. two separate line items, one for new financing and one for payments. The interest component of expense and amortization of the lease asset will be components of operating cash flows. We do not believe it is appropriate to break out separate lines in the operating section of the cash flow statement for lease activities.

For lessors we also believe it is not necessary to break out separately the cash flows generated from the lease asset.

Disclosure

Question 15
Do you agree that lessees and lessors should disclose quantitative and qualitative information that:
(a) identifies and explains the amounts recognized in the financial statements arising from leases; and
(b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows? (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

The proposals relating to disclosures appear reasonable.

Transition

Question 16
(a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We agree with the proposal to adopt a simplified retrospective approach for initial application. The simplified approach will be costly to implement but pales in comparison to the costs associated with a possible full retrospective approach where

every lease would need to walked forward from its initial application date using the new guidance.

We would suggest the Board consider not requiring adjustment of opening equity amounts to account for differences resulting from retrospective application of the proposal. Instead, we encourage use of a line item titled "transitional adjustment for adoption of new accounting policies" within the equity section of the comparative prior year statements.

Benefits and costs

Question 17
Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

There will be significant costs associated with adopting this proposal. New software systems will need to be developed to comply with these new complex requirements. While it may be an economic stimulus for software companies, lessees and lessors will be carrying the burden of paying for the entire conversion. In addition to software development costs, companies that engage in leasing transactions to meet their business needs will incur significantly increased costs to retrospectively restate existing leases at transition, periodically reassess asset and liability values, and continually conduct probability analyses to establish future predictions related to contingent rentals and term options. The new proposal also extends the scope of lease accounting to cover many service contracts not previously considered as a lease.

We agree with the intention of establishing a balance sheet liability for the future lease obligations. However, we feel it can be more effectively accomplished by the following:

1. Remove short term leases from the requirements of the proposal
2. Eliminate from the lease term all non contractually binding option periods, or option periods where there is not reasonable assurance that renewal will occur
3. Eliminate contingent rentals from the proposal and consider using future minimum lease payments as defined under current guidance when establishing the lease asset and lease payment liability.
4. Increase the threshold the proposal uses as a basis for assumptions from "more likely than not" to "reasonably assured".

Question 18
Do you have any other comments on the proposals?

We feel the proposal should be delayed for a period long enough to allow computer system developers to bring new systems to the market place, or develop upgrades to

existing systems to help companies manage through the conversion. This may take several years and we would think four years might be a good approximation. The delay in implementation will also allow companies to begin restating their existing leases and be better prepared for the conversion.

Non-public entities

Question 19
Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

We agree that non public companies should comply with the proposal. However, the Board should consider delaying implementation for non-public and not-for-profit entities. Delaying implementation for non-public entities will let the large public companies be the beta site for software development and allow efficient audit procedures to trickle down to the smaller firms often used by the non-public sector.

Thank you for considering our comments. If you have any questions or wish to discuss this letter, please feel free to contact me at (515) 245-2794 or by email at rambrozi@ruan.com.

Sincerely,

Randy Ambrozic
Vice President – Controller
Ruan Transportation Management Systems, Inc.