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Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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CoBank, ACB (CoBank) is a cooperatively-owned bank providing a diversified range of financial solutions to agribusinesses and rural power, water and communications companies. CoBank is a member of the Farm Credit System, a federally-chartered network of borrower-owned lending institutions. We offer leasing services through our wholly-owned subsidiary, Farm Credit Leasing Services Corporation (FCL). FCL supports nearly 7,500 customers nationwide with lease financing for a broad range of vehicles, equipment, machinery, and facilities. We appreciate the opportunity to comment on the issues being considered by the Board in the Exposure Draft document as lease accounting standards are reviewed and re-written.

The changes contemplated in the Exposure Draft document would likely have a significant impact on FCL's customers, many of whom are cooperatives and other businesses that support vital industries throughout rural America. These changes include a gross-up of balance sheets, changes in earnings, impacts to debt covenants, increases to required capital levels, the restructuring of lease arrangements, potential increases in certain taxes and increased accounting and financial reporting burden. From a lessor perspective, the impact to FCL's accounting and operations are equally significant, and include the costs associated with implementing changes to information systems.

In summary, we support the overall concept in the Exposure Draft which requires material off-balance sheet obligations to be recorded on the balance sheet. However, we disagree with certain aspects of the Exposure Draft, as more fully described below.

The Exposure Draft prescribes two different lessor accounting models (performance obligation and derecognition) depending on whether the lessor retains exposure to

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significant risks or benefits associated with the underlying asset during or after the estimated lease term. We believe the Board should consider simplifying the lessor accounting requirements to a single approach - a derecognition model which includes an estimated fair value of any residual asset. This approach is appropriate for several reasons. First, we feel that the Board has not appropriately defined what constitutes retaining exposure to significant risk or benefits. In the Exposure Draft, the Board provides certain facts and circumstances to be considered in the “ retains exposure” evaluation including: significant contingent rentals, options to extend or terminate the lease, duration of the lease term relative to the useful life of the underlying assets, and the effect of any residual value guarantees. However, the Board also states “the existence of one or more of the indicators is not conclusive in determining whether the lessor retains exposure”. This highly subjective approach could lead to varied judgments and conclusions regarding whether to apply the derecognition or performance obligation model for economically similar leases. Second, we believe the derecognition model for lessor accounting is more compatible with the right to use model prescribed for lessee accounting. Under this approach, a liability/receivable relationship exists between the lessee and the lessor, which is based on the present value of the payment stream and differs only by the interest rate applied to discount the liability/receivable. Third, as the Board proposed eliminating a two-model approach for lessee accounting (capital and operating) in the Exposure Draft in favor of a single right-to-use model, it seems contradictory for the Board to prescribe a two-model approach for lessor accounting. One of the largest criticisms of the historical accounting by lessees was that multiple models produced inconsistent accounting and reporting. By allowing two models for lessor accounting, the same situation is likely to result, thereby reducing the comparability of financial statements.

We also believe that certain elements of the proposals surrounding lessee accounting should be modified. The proposed approach would have lessees estimate and re-estimate the period over which they expect to exercise renewal options. We suggest that a better approach would be to have the lessee record its true legal obligation, including any penalties required for not exercising renewal obligations. In addition, by front-loading expense, we believe the proposed pattern of lessee expense recognition distorts the periodic usage costs associated with leased assets. A more intuitive approach would be

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to match the expense recognition related to the asset use with the amortization of the underlying obligation.

Finally, the transition requirements in the Exposure Draft require recognition and measurement of all contracts within scope of the guidance as of the beginning of the first comparative period presented in the financial statements in which the entity applies the guidance (the "simplified retrospective approach"). To comply with the Board's transition requirements, FCL will be required to significantly modify its operations and accounting systems and expend significant time to determine the financial impact of a change in lessor accounting for all of its active leases as of the earliest date presented in the financial statements. To reduce a portion of the cost and time involved, we suggest a modified transition approach that requires full capitalization of what were formerly operating leases as of the earliest period presented, and a prospective transition to what were formerly sales and direct financing leases. We believe this approach would adequately address capitalizing operating leases, which is arguably the single largest shortcoming of the historical lease accounting model, without requiring the operational burden, cost and time of restating the sales and direct financing lease accounting in all previous periods presented.

Please feel free to contact me with any questions.

Sincerely,

Mike Vestal
Vice President and Controller
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