

13 December 2010

International Accounting Standards Board 30 Cannon Street London EC4M6XH United Kingdom

Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Dear Madam/Sir,

Thank you for the opportunity to offer comments on the proposed changes to the financial recording of leases contained in the FASB/IASB Lease Exposure Draft (ED).

The Institute of International Container Lessors, Ltd. (IICL) is a trade association, organized in 1971, representing the majority of lessors of maritime containers and intermodal chassis. Its member companies<sup>1</sup> both own and manage approximately 90 percent of the global leased container fleet, representing nearly half of the world container fleet and approximately half of the U.S. chassis fleet operated by ocean carriers, railroads, and other companies.

The majority of container and chassis (equipment) leasing activity is conducted on a long-term operating lease basis. Equipment is usually returned to lessors at the end of the lease. Revenue is represented by a string of lease payments, with container damage and location displacement costs treated separately. Such annuitized and predictable earnings streams have been viewed as one of the key characteristics of leasing companies, which has afforded them access to capital for future growth.

Equipment leases are primarily a supply of goods rather than a financial service. They are consummated on a global basis and the financial information is viewed accordingly. It is essential to have simple, clear and concise rules for the treatment of leases on the financial statements of lessors and lessees to increase the relevance of the information that is available to readers of the statements, and is reflective of the industry's sound leasing practices.

Beacon Intermodal Leasing, LLC; CAI International, Inc.; Cronos Ltd.; Flexi-Van Leasing, Inc.; Florens Container Services Company Ltd.; GE SeaCO Services Ltd.; Gold Container Corporation; SeaCube Containers LLC; TAL International Container Corporation; Textainer Equipment Management (U.S.) Ltd.; TRAC Intermodal; Triton Container International Limited



The following comments are offered for your consideration:

## Rules Must be Simple: The Complexity of Reporting and Investor Analysis is Potentially Confusing and Counterproductive

The proposed lessor accounting rules do not add any significant new information that is not already covered by existing disclosures to their financial statements. Instead, the proposed new balance sheet line items add complexity and create a compliance burden without providing a major improvement in the level of lessor information available. Additionally, the proposed rules of the ED will make financial statements less meaningful to readers and subject them to much more judgmental valuations by lessees and lessors. The costs and complexity of audits will be burdensome and create additional friction between issuers and auditors.

The proposed rules do not reflect the cash flows of a lease or recognize that the benefits of a lease are constant for its entirety.

Contingent rents are not true liabilities and therefore more clarity will remain if the current accounting rules are left in place.

It is recommended that the current definitions of lease term and minimum lease payments be left in place for lessors and lessees. We view the existing definitions to be more objectively measurable, therefore promoting greater comparability and symmetry.

The proposed rules will result in divergent effects on lessor and lessee income statements, especially in the first year of the new rules implementation. This would inevitably lead to a lack of comparability amongst lessors and lessees. Lessors will recognize accelerated earnings, unrelated to cash flows. Lessees will experience significant increases in expense recognition as the requirement to include estimates of possible, but uncertain, future lease extension options will front-load expenses that are not aligned with actual lease payments. This will confuse analysts, potentially establish high barriers to sound leasing activities and result in counterproductive results.

Furthermore, it is believed that optional lease extension outcomes are difficult to determine at the beginning of a lease and therefore only contractual obligations should be reported. The valuation of lease continuation options would be subjective and arbitrary. Estimates would have to be reviewed and adjusted at each reporting date within the lease period, which would increase workloads significantly with little visible benefit. The use of estimates on lease renewals would significantly overstate assets and liabilities. By significantly increasing the amount of debt recorded, there is a risk that loan covenants may be violated despite the fact that there will have been no actual change in financial condition. This could result in restrictions on how much a company is able to borrow, which in turn will have a negative impact on its ability to conduct its business.



If the proposed changes are implemented, it is likely that discussions of optional lease extensions will migrate from the inception of a lease to the end of a lease. This may actually add greater risk and uncertainty for lessors and lessees, and less information available for readers of financial statements.

#### **Uncertainty Exists for the Urgent Need to Change**

There are no major deficiencies in the current financial reporting of lessor activities. It is understood that the objective of the review of lease accounting was to increase transparency, primarily by addressing how lessees account for leases. The ED far exceeds this objective. The extent and complexity of the proposed changes to lessor accounting in particular is very surprising as there were no indications of a single major deficiency in the financial reporting of lessor activities.

While the need to address some of the structural abuses that may have occurred under current rules is appreciated, it is believed that the ED introduces other highly subjective criteria, particularly in the areas of lease term determination (upon renewals) and contingent rental payments that have the potential to cause similar disharmony among parties to a leasing arrangement. With regard to these areas, it is believed that expanded disclosure can be used to supply the reader with information not currently provided under existing GAAP.

#### **Exposure Draft is too Complicated and Excessively Burdensome**

The proposed rules are too theoretical and are not practical. Equipment operating lease payments are an operating expense. It also does not appear that any cost benefit study was conducted prior to developing the ED. A simple and effective solution is to amend IAS 17/FAS 13 to capitalize operating leases and leave expense straight line.

It is believed that amounts pertaining to possible renewal options or contingent rentals should not be recorded as assets/liabilities. Only contractual obligations should be recorded as such (with few exceptions). Renewal periods extending beyond a reasonable amount of time, e.g. five years, are prone to error and can introduce significant volatility in earnings upon subsequent analysis.

Small (non-core) assets, such as office copiers, vehicles and postal machines that exist in nearly all businesses, and for which there doesn't appear to be confusion among financial statement readers, should be excluded.

Overall, it is believed that the initial and on-going costs of implementing the ED, particularly for small and medium-sized companies, will be disproportionate to the benefits perceived by the financial statement readers. Expenses will invariably increase in the areas of internal personnel, outside consultants, external auditor fees and systems enhancements.



With regard to lessor accounting, it is not believed the alleged abuses noted on the lessee side carry over to the lessor. For a company whose principal operations involve leasing assets, existing GAAP appears to address the most critical aspects of financial reporting. The "hybrid" model proposed in the ED, under the performance obligation criteria, would serve to unnecessarily gross-up the balance sheet, while maintaining the asset on the company's books. This situation is exacerbated in a sub-lease arrangement, whereby the lessor would be required to gross up the asset/liability (as lessee), while potentially having to gross up the balance sheet a second time under the performance obligation criteria (as lessor).

It is recommended that the exclusion of contracts from the requirements of the ED be extended to three years.

From an operating performance perspective, rent expense is believed to be a logical and well-understood operating expense category. Substituting amortization and interest expense for rent expense does not add to one's understanding of the underlying performance of a company's operations. Rather, it is likely that confusion will be created, as EBITDA will change under the ED.

A "grandfathering" provision should be included considering the impracticality of analyzing the provisions of the ED for all years presented in the financial statements. Certain loan covenants may be in technical default as a result of grossing up a company's balance sheet (affecting leverage ratios) and changing the definition of EBITDA (affecting net worth covenants) as required under the ED. A technical default has numerous (costly) implications to a company beginning with having to assess its ability to continue as a "going concern" to having to renegotiate new covenants with its banking partner taking into account all of the unknowns required by the ED. Even if a company is successful in renegotiating its covenants, banks typically charge significant fees to reset covenants, resulting in a typically expensive exercise.

The ED represents a significant hardship for lessors that rely on lenders to finance growth in their businesses. Unnecessary staff reductions could result if adequate cash for working capital becomes too expensive for small to medium-sized companies.

#### **Unintended Impact on Operating Practices**

The objective of accounting disclosures should be to increase transparency and comparability, not to change how a customer conducts its business. However, the proposed changes could have a material impact in how our customers conduct their business. The reporting burden would be significant. Shorter-term leases may be favored. Lessees may be motivated to buy rather than lease. This in turn has potential implications for the container and chassis leasing business including access to capital.



Most leasing companies have more than 70% of their fleets on long term operating leases, which has provided them with enormous protection during market down cycles and has as opened up the debt capital markets to them. Any shift back to a short term master lease model, driven only by accounting rules, could have negative implications on the industry, in terms of the additional risk which lessors would assume, as well as impact on its general access to capital.

It is hoped that these comments are found to be informative and constructive, as the changes proposed in the Exposure Draft are significant and could have a profound impact on many industries and an impact on economies around the world.

Please contact me if you require any clarification or have any questions, which I will be happy to address.

Sincerely yours,

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Steven R. Blust

President