ELFA
EQUIPMENT LEASING AND FINANCE ASSOCIATION

August 30, 2012

Ms. Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

SUBJECT: COMMENTS RE: Final Tentative Decisions in the Lease Project

Dear Chairman Seidman and Chairman Hoogervorst:

The Equipment Leasing and Finance Association (ELFA) is the trade association representing financial services companies and manufacturers engaged in financing the utilization and investment of and in capital goods. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. Its over 550 members include independent and captive leasing and finance companies, banks, financial services corporations, broker/packagers and investment banks, as well as service providers. The equipment finance business is estimated to be a $630 billion industry in 2012. For more information, please visit http://www.elfaonline.org.

The ELFA and the Lease Accounting Project

The ELFA has consistently supported the project's principal objective of providing users of financial statements with an accounting model for leases which includes the recognition on a lessee's balance sheet of the assets and liabilities arising from lease contracts. Unfortunately, since we do not believe the Boards have appropriately resolved the question of lessee cost allocation, we are seriously considering withdrawing our support for the issuance of a final standard based upon the tentative conclusions reached in the recent redeliberations. The tentative decision that all equipment leases are purchases is fraught with difficulties. We believe

a continuation of the existing accounting standards is preferable to the model that has been proposed.

Our active engagement in the question of lease accounting extends back to 1996, and we have consistently supported the project and the goal of recording leases on a lessee's balance sheet. This long-standing support for the leases project has been principally based on the following considerations:

- The lease standard should produce a result that is representationally faithful to the economics of lease transactions;
- It should provide information to users of financial statements, both external users and management, and meaningful insights into a company's leasing activities during and at the end of a period;
- The model should be operational at the individual transaction level and not unduly complex; and
- The benefits of the new reporting model should not exceed the costs of implementation and ongoing compliance.

Unfortunately, the approach to leasing now envisioned in the project does not meet these requirements, and we believe issuance of a revised exposure draft would be ill-advised. We do not believe that reporting under the proposed model will satisfy the diverse needs of investors and will involve significant costs to implement and inappropriately raise the cost of capital.

Lessee Cost Allocation Issue

The manner in which the Boards have approached the matter of lessee cost allocation is the primary reason for our conclusion. We believe a continuation of the existing risk and reward based approach is preferable to what has been proposed. We are particularly concerned by a lessee accounting model that disregards the nature of the lease contract and instead focuses on an underlying asset the lessee may or may not control through the lease contract. Unless this question -- whether the lessee accounting model is based on the lease contract or on the asset being leased -- is resolved in a different manner, the lease model will continue to be sub optimal and will not be a meaningful improvement over what exists today.

The ELFA has similar concerns regarding the leases project to those expressed by the Investors Technical Accounting Committee (ITAC) members at their July 24, 2012 meeting with the FASB. To be useful, accounting information needs to serve the needs of investors. If the model does not serve their needs or if the change in accounting will only replace one set of deficiencies with another, it will only add costs to the financial reporting system without achieving meaningful benefits to users of financial statements.

At the July 24th meeting, ITAC member views fell into three categories:

- Leases need not be recognized on balance sheet and the cost of a lease should be shown as rent expense;

- All leases should be on balance sheet and costs allocated "as if" the asset was purchased and all debt financed; or
- Leases are a derivative, a series of forward contracts.

The proposed lease model essentially forces the Boards to choose one view of leasing over the others, due to the inherent limitations of a recognition and measurement solution to leasing. This suggests the better response to the diverse needs of users is through straight forward accounting and improved disclosures that would allow users to make the adjustments they believe are appropriate.

Consistent with other commentators, we have at times expressed the opinion that IAS 17, *Leases* and ASC Topic 840, formerly Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, without the strict numerical tests employed in that standard, could provide an appropriate framework for the accounting for leases, generally requiring only targeted modifications in the accounting for operating leases to meet the expressed information needs of users. This is a view that we would still support.

Relevant Considerations

In our view the project's goals may be achieved if:

- The lease contract is defined as the unit of account, consistent with the manner of settlement between the parties or when transfers to market participants occur;
- The model uses a principles-based approach to the accounting for lease contracts where, as in the Revenue Recognition project, the underlying asset does not affect the accounting;
- The right of use asset (ROUA) and the obligation to make lease payments from the lessee standpoint were linked for accounting purposes, mirroring the linkage that observably exists in user analysis and in fact;
- Certain contracts nominally identified as leases but inherently conditional sales agreements or loans were excluded from the ROU leasing model using, for example, the Revenue Recognition model as the first screen or providing separate guidance within the new standard similar to ASC 840 and IAS 17;
- The accounting model and financial statement presentation took into account the legal nature of the contract (e.g., an executory contract) and the economic effect of the contract, which is either a means of allocating the risks and rewards incident to ownership or a means of financing the acquisition of an asset;
- The diverse needs of users were recognized by providing a straight forward accounting model with robust disclosures to facilitate adjustments for analysis purposes;
- The proposed changes in lessor accounting faithfully portrayed the business models used by lessors in how they profit from and manage the risks of their activities;
- The assertion the proposed accounting represented a significant improvement was validated by field testing; and
- The benefits of the proposed model were confirmed through a rigorous cost-benefit analysis, including a comparative analysis with recent studies.

These suggestions are consistent with the comments we have made as the project has progressed, and we continue to believe they provide the basis for the development of an accounting standard on leasing that will stand the test of time.

Alternative Approaches

While one general model for leases based upon the concept the unit of account is the lease is preferred, we do concur with the Boards' tentative approach to differentiate between leases that are purchases of an asset and leases that only represent a temporary transfer of the right of use. There are many ways to achieve this end in a cost effective, yet improved, framework. We offer the following alternatives to summarize and clarify our previous recommendations:

- Use the Revenue Recognition standard as a filter

  Revenue Recognition's control concept provides the basis for separation (or classification) test, since it already defines when a contract is a sale. All other contracts would be evaluated as right of use contracts. The standard setting advantages include consistency within the standards and in judgments to be made. This approach allows for all relevant factors to be considered in determining the nature of a contract. The principal disadvantage of using control instead of risks and rewards for classification purposes is that it can result in a diverging conclusion from the one reached under commercial law, including bankruptcy law, and income tax law, notably with respect to the analysis of purchase options. Any divergence would add to the cost of adoption and ongoing compliance.

- Make targeted modifications but use existing lease accounting standards as the filter

  This approach would use a risks and rewards framework, consistent with existing GAAP and other regulatory regimes (generally, commercial law, income tax law, sales and property tax law) in distinguishing leases from purchases. The ROU assets and ROU obligations would still be recorded. The idea proposed by some that the lease be capitalized on an undiscounted basis could also be explored, notably for intermediate term leases or private company reporting purposes.

- Expand footnote disclosures

  Leave the recognition and measurement provisions of existing GAAP in place to distinguish in-substance purchases of assets from leases, but expand lease disclosures. For example, it would be possible to set forth a method for lessees to calculate the liability equivalent of its operating leases and the imputed interest component of cash paid under operating leases. The principal advantages include the disclosures would contain new information requested by all users without biasing its use to serve some users over others in financial statement measurement, little or no divergence with the legal and tax regimes would result, and preparer cost would be clearly commensurate with user benefits. The disadvantage is operating leases would remain off balance sheet although users as represented by ITAC did not seem overly concerned by this.

> As one member of ITAC stated "if you ***must*** balloon the balance sheet . . .", indicating ambivalence to on balance sheet capitalization of lease assets and obligation within financial reporting.

Given the significant diversity in user needs discussed above, we believe a disclosure alternative is the approach that has the greatest chance for issuance of a revised leasing standard that improves financial reporting.

Other Matters

We continue to believe the Boards have not properly addressed tax-advantaged leases. These leases involve the transfer of tax benefits arising from the lessee's use of the leased asset to the lessor in exchange for reduced lease payments. Unlike other investment products, a lessor observably earns a significant portion of its investment return from tax deferral or tax credits or a cash grant equivalent. We believe the Boards' proposals for lessor accounting inappropriately consider taxes to be a by-product of the accounting by lessors, rather than the central component that they are. A lessor model that does not consider this will always be deficient to a significant degree.

Conclusion

We acknowledge the development of a leasing model is a complex undertaking with difficult trade-offs to be made. We believe, however, a lease model finalized in the form described by the Boards would not be an improvement over current accounting and will not stand the test of time. We are also concerned the desire to complete the project will work against the development of a high quality leasing standard. Over the years while the Boards have considered leasing, much has been learned. Leasing is a difficult subject, and we commend the Boards for the efforts they have taken and how far the Boards' thinking has come over the course of the project. We also commend the Boards for the efforts they have taken to address the concerns raised during the comment letter and outreach processes. Still, the model which has been proposed does not meet the four key considerations set forth in the beginning of this letter. It does not reflect the economics of a lease contract, it does not provide incremental information beneficial to a cross section of users, and it involves costly and complex accounting analysis and calculations which we do not believe are commensurate with the benefits to users of financial statements.

On the lessee side, as ITAC so clearly pointed out, the cost allocation question remains the most significant issue outstanding. To best meet user needs, the lessee's balance sheet, P&L and cash flow statements for leases should reflect the nature of the contract and the consideration tendered, i.e., an executory contract where payment is made for future use and where non-payment results in loss of the right to use. On the lessor side, the business model instead of the nature of the underlying asset should drive the accounting and reporting. In addition, the accounting for tax benefits should be addressed so that the accounting faithfully reports the economic bargain between the parties.

We remain available as a resource to the Boards in finalizing the Leases project to meet the expressed needs of users on an effective cost-benefit basis. Thank you for your consideration of these views.

Sincerely,

William G. Sutton
President and CEO
Equipment Leasing and Finance Association