November 15, 2010

Mr. Robert Herz  
Chairman  
FASB  

Sir David Tweedie  
Chairman  
IASB  

Dear Messrs. Herz and Tweedie:

Thank you for the opportunity to comment on the Lease Exposure Draft (ED). I support the theory that operating lease obligations arising from such leases that are material should be capitalized; however, I disagree with several major elements in the ED.

The proposed approach does not resolve the following reasons why the lease accounting model is being re-written. “However, those models have been criticized for failing to meet the needs of users of financial statements because they do not provide a faithful representation of leasing transactions. In particular they omit relevant information about rights and obligations that meet the definitions of assets and liabilities in the boards’ conceptual framework. The models also lead to a lack of comparability and undue complexity because of the sharp ‘bright-line’ distinction between finance leases and operating leases. As a result, many users of financial statements adjust the amounts presented in the statement of financial position to reflect the assets and liabilities arising from operating leases."

The proposed rules (except for lessees capitalizing lease obligations that are true liabilities) distort the economic effect for both the lessor and lessee, rather than accurately presenting the effects of leases in financial statements. In particular, capitalizing estimated renewal and contingent rents result in over-capitalization and an impact to the Income Statement and Statement of Cash Flows that does not reflect the economic reality of the leases. The requirement for both the lessee and lessor to estimate payments will lead to a lack of symmetry between them in the same lease and a lack of comparability among lessors and among lessees, due to the lack of objective, reliable measures. The cited complexity in the existing rules is the one-time classification of a lease whereas the proposed rules make complexity a perpetual event, perhaps as frequent as monthly, as estimates are made, and then adjusted, in conjunction with the companies required financial reporting. Most users do in fact adjust financials for the off-balance sheet operating lease obligations, but to a lesser degree than the proposed rules. The proposed rules, in many instances, are a step backward regarding fair value. They create assets,
liabilities, non cash front-ended lease costs, deferred tax assets and deferred revenue that will be confusing for users, and certainly do not accurately reflect the economics of the transaction between the lessor and a lessee in the lease contract. This standard will create in many cases a material charge to earnings, especially on a cumulative basis for lessees.

The following is a summary of the primary issues with the ED as it relates to lessors:

<table>
<thead>
<tr>
<th>Major Issue</th>
<th>Suggested Change to ED</th>
<th>Reason(s) for Change</th>
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<tbody>
<tr>
<td>Performance obligation (PO) method inconsistent with lessee right of use (ROU) model</td>
<td>Discard the method except where the lessor performance risk is so great that it is likely the lessee will withhold rent payment</td>
<td>Derecognition is the only method that is symmetrical with the lessee ROU model in reflecting that the value of the ROU is transferred to the lessee. If the lessor has a performance obligation where the risk is so great that derecognition is not appropriate, then the lessee should not be capitalizing the lease obligation.</td>
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<tr>
<td>Lessor classification criteria are not consistent with choosing which leases have significant lessor performance obligation risks</td>
<td>Use only the criterion “does the lessor have a PO that has a real risk that the lessor may not perform and the lessee will withhold rent payment”</td>
<td>Risks and rewards analysis is inappropriate since retaining risks does not mean that a lessor performance obligation exists. The criteria and decision processes are not clear. If the value of the ROU has been transferred, and the lessor has delivered the asset, then the lessee controls the asset, and the ROU value should be derecognized.</td>
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<tr>
<td>Derecognition method does not allow residual asset to be accreted to its fair value</td>
<td>Use implicit rate in the lease to present value (PV) expected residual value and accrete residual over the term</td>
<td>Residual is an expected cash flow from the investment in the lease. It is not property, plant and equipment (PP&amp;E). Fair value gives users the best information.</td>
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**Lessor Issues:**

- The PO method does not comply with the basic premise that an ROU has been transferred and the lessee is obligated to pay rent for the estimated term of the lease. If there is a lessor performance obligation that remains unfulfilled and its risk of performance is so high that it precludes the lessor from derecognizing the value of the asset transferred, then no receivable should be recorded by the lessor. Likewise the lessee should not capitalize the lease. The proposed method seems to be merely deferring revenue recognition without basis.

- The lessor PO versus derecognition lease classification criteria as proposed are not the indicators of when a lessor has a performance obligation. A relatively short lease term or relatively high residual does not necessarily indicate the lessor has a performance obligation. The classification indicators are not clear and it is unknown how the accounting firms will interpret and apply them. There is a need for clarity.

- The derecognition or a modified derecognition method is appropriate for all leases. This is based on the basic premise that a lease transfers the value of the right to use an asset from the lessor to the lessee. The derecognition method as proposed is a step backward from the current direct finance method in that it does not account for the residual asset’s economic effects. The residual asset should be accreted.

- The residual asset is not property, plant or equipment since it is not an asset the lessor uses or intends to use in its business. The residual asset is more like a financial asset as it represents the expected cash flow from sale of the asset at lease expiration. At expiration of an equipment lease, the asset is sold or leased again to the lessee or a third party.

- Subleases should be accounted for under the derecognition method to avoid double counting of assets, and to record income where the value of the sublease rent receivable exceeds the value of the ROU asset. The principle is that the sublessor transferred something of value and the sublessee is obligated to pay rent for the term.

There will be a significant transition for both lessees and lessors. Lessors will need to re-book every lease since none of the existing models survived from current GAAP, despite the lack of evidence that there was a deficiency in the financial reporting of lessor activities. The ED does not explain how existing leases should be tested for classification between performance obligation or derecognition methods in transition. If the classification criteria are applied at the date of transition the remaining lease term is shorter versus the remaining life, and the residual is much larger as a percentage of the current book value. Thus, more leases may be classified as PO leases. If the classification criteria were limited to just whether a performance obligation exists that has a high risk of failure to perform, and then the dilemma would be solved. I suggest that current capital and finance leases be grandfathered for lessors and lessees if the reported results would not be materially different.

Lease contracts are unique and it is my hope that the Boards re-consider the overly complex rules that lead to a lack of symmetry and distort comparability among lessors and lessees due to the lack of objective measures, and instead move toward reflecting the true economic effects of leases.
Kindest regards,

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