December 14, 2010

Via email: director@fasb.org

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

Re: File Reference No. 1850-100 – Leases (Topic 840)

U.S. Bancorp (USB) appreciates the opportunity to comment on the Exposure Draft (ED) of the proposed Accounting Standards Update to Leases (Topic 840). USB supports the FASB’s objectives of providing a complete and understandable picture of an entity’s leasing activities. The accounting for leases is important to USB in its role as a lessee, lessor and lender as described more fully below:

- We lease many branch facilities and other bank premises, as well as office equipment.
- We offer a wide array of operating and capital lease products to our customers including, equipment leasing solutions ranging from small ticket to large ticket leasing and retail auto leasing
- We are a key user of financial statements. Our credit officers rely on financial statement information provided by businesses as part of the initial credit approval and ongoing credit monitoring processes.

Lessee Accounting

USB agrees most operating leases should be recorded on the balance sheet by lessees to reflect both the leased asset and the obligation to make the lease payments. However, we disagree with the proposed approach to measurement of these items and the proposed timing of expense recognition. We believe optional extensions of lease terms should not be recorded on the balance sheet but to enhance transparency could be disclosed in the notes to the financial statements. Likewise, we believe contingent rents should only be included when they are probable of occurring. Expense recognition related to the right-of-use asset and interest on the lease liability should utilize the same method (effective yield) and be linked together for presentation purposes to provide the most meaningful information to financial statement users. This would result in consistent expense recognition over the lease term which aligns with the pattern of the benefit received by the lessee over the lease term. In addition, this would reduce differences between book and tax accounting and avoid the creation of deferred tax items which can have regulatory implications. We believe the right-of-use asset should be
classified as a tangible asset similar to owned property or equipment but could be presented in a separate “leased assets” line on the balance sheet to add transparency.

USB also believes certain leases should not be recorded on balance sheet because they more closely resemble service contracts and the costs associated with applying the guidance to these leases would far exceed the benefits to financial statement users. For example, we have a significant number of office copier leases that would fall within this category. We believe current operating lease accounting and disclosures sufficiently address these leases and therefore believe the FASB should include short-term and de-minimis scope exceptions to the proposed rule changes.

Lessor Accounting

USB views the proposed accounting for lessors as overly theoretical, unnecessarily complex and likely confusing to financial statement users. We believe current accounting for lessors does not need revision, particularly for finance leases which are already recorded on the lessor’s balance sheet. We understand the Boards’ objective was to have symmetry between lessor and lessee accounting, however, we do not believe that goal is necessary to provide the additional information needs investors desire, and do not believe the proposed methods represent a significant improvement in accounting for lessors.

If a change in lessor accounting is warranted, we encourage the Boards to evaluate whether there is an alternative approach that may meet most of the objectives of the project and would be easier for financial statement users to understand and preparers to implement. For example, further consideration could be given to eliminating the “bright line” rule in current lessor accounting and requiring lessors to use direct financing lease accounting for all leasing activity except where certain principles-based concepts apply. USB believes lessors should continue to account for certain leases as operating leases where it is not a principal business activity (“non-core”) or where derecognition of the owned asset by the lessor would not faithfully represent the transaction. For example, real estate lease or sub-lease arrangements would likely fall into this category unless the lessor’s primary business activity is real estate management/investment.

Regardless of whether leases are currently accounted for as operating leases or direct financing leases, most leases are viewed and managed primarily as a right to receive cash flows. For nearly all of these leases, the asset will either be sold at the end of the lease term or re-leased. As a result, including the residual value of the leased asset as an integral component of the lease financing receivable would be a reasonable approach for all leases and likely easier for financial statement users to understand.

The following paragraphs further describe our comments and recommendations:

General Comments

- The changes proposed in the ED are significant and will impact long-standing business practices. We believe further analysis is required by both stakeholders and the Boards to consider the full impact of the proposed changes. Lessor accounting was originally scoped out and then later added but did not receive the same amount of consideration given to lessee accounting issues. We encourage the Boards to take the time necessary to further deliberate both lessee and lessor accounting and develop a quality standard that will be viewed as an improvement to lease accounting.

- We encourage the Boards to consider that systems, processes and conventions have been developed and business modeling has evolved around the existing U.S. lease accounting standards since 1976
(34 years ago) when FAS 13 was introduced. A material change in accounting for leases will have significant business and operational impacts. We propose an extended period of time between final issuance of a new standard and the effective date to allow lessors and lessees, software system developers and other impacted parties sufficient time to design and implement the necessary operational and system changes.

- The proposed ASU’s “simplified application” for short-term leases does not provide enough relief from the operational burden of the proposed lease accounting guidance. For many institutions, the proposed guidance will require a significant amount of data on individual leases to be gathered and analyzed not only at adoption but also on an ongoing basis. This will be operationally burdensome and the costs associated with applying the guidance to leases that closely resemble service contracts or are not essential to a company’s business model will far exceed the benefit to financial statement users. We recommend these leases continue to be accounted for as operating leases. For example, a company that is a lessee in an office copier lease should be able to continue accounting for that arrangement as an operating lease. Similarly, a company that is a lessor or sublessor in a short-term facility lease should be able to account for the arrangement as an operating lease. We believe a principles-based approach to addressing the scope of the standard is preferable to an arbitrary one-size-fits-all bright line approach. Additional or enhanced qualitative disclosures would likely be sufficient to provide users with an adequate understanding of the nature of these arrangements.

- We propose a prospective transitional approach with application only to existing leases within the scope at the time of adoption and a cumulative catch-up recorded in retained earnings. The significant operational burden associated with any type of retrospective adoption would likely outweigh the benefit to financial statement users. For example, USB has over 500,000 leases in place and the “simplified retrospective approach” would add significantly more costs to the implementation. We question whether the comparative information produced under that approach is important to most financial statement users. A prospective approach would be consistent with other complex accounting standards that had the potential of bringing significant assets and liabilities onto the balance sheet.

- The transition provisions do not specifically address how sale-lease back transactions from prior periods would be treated, including any deferred gains. Given the complexity of these transactions, re-determining the gain/loss in prior periods and impact at adoption makes little practical sense. We suggest that any transactions prior to the effective date of the ED be grandfathered with enhanced disclosures required where related amounts are material.

Additional Comments on Lessee Accounting

- The ED requires lessees to measure the “right of use” (ROU) asset based on “more-likely than not” payments including contingent payments and renewal options. This is a significant departure from the “minimum lease payments” defined and disclosed under current U.S. GAAP lease accounting standards and from well established “probable” thresholds for liability recognition. We suggest the FASB further study the consequences of placing a ROU asset and a corresponding liability on the balance sheet for the “more likely than not” expected payments when there is no legal obligation to make payments related to optional renewal periods or contingent payments until the renewal options are exercised or the contingent payments are probable and estimable. We believe the proposed measurement method will overstate assets and liabilities. Incorporating projections around business decisions into the balance sheet before they are reasonably certain will reduce financial statement reliability and comparability and potentially confuse investors and other financial statement users.
Including contingent payments and non-contractual lease options would be particularly punitive to financial institutions due to (i) regulatory capital requirements based on assets levels and (ii) FDIC premium assessments which, in effect, will be based on a bank’s level of liabilities.

- We do not agree with the concept for continuous reassessment and adjustment of the ROU asset related to the probability that a lease will be extended. We believe the resulting changes in financial statement amounts without substantive changes in the contractual arrangements will be confusing and unpredictable to investors. We propose the ROU lease asset be adjusted only when impaired following the rules on impairment for long-lived assets.

- As an alternative to including the estimated impact of contingent payments and optional renewals on the ROU asset, the Boards should consider whether needs of financial statement users could be met through enhanced disclosures in the notes to the financial statements.

- The ED would require payments on the performance obligation liability to be recorded partially as an asset reduction and partially as interest expense using the effective yield method while the ROU asset would be depreciated/amortized based on usage (i.e., likely straight-line for the many leases). As a result, net expense recognition would vary over time unrelated to the benefits the lessee receives from the leased asset. Expense recognition related to the ROU asset and interest on the lease liability should utilize the same method (effective yield) and be linked together for presentation purposes to provide the most meaningful information to financial statement users. This would result in even expense recognition over the lease term which aligns with the pattern of the benefit received by the lessee over the lease term. In addition, this would likely keep book and tax accounting aligned and avoid the creation of additional deferred tax assets or liabilities. We recommend the interest expense and the related depreciation/amortization of the ROU be aggregated and presented on a single “lease expenses” line rather than embedded within interest expense and depreciation/amortization expense so financial statement users have a clear understanding of lease costs.

- Real estate leases often include incentives at the inception or renewal of a lease. The ED is silent on the accounting for such incentives. We recommend these be addressed in the final standard to promote consistency and comparability of financial statements.

Additional Comments on Lessor Accounting

- Under a derecognition model (or the direct financing model if applied to all leases), we recommend residual asset values not be separated from the related lease receivable as they are integral to the lease arrangement. Leasing businesses evaluate and view the investment in a lease based on a cash flow model which looks at the monthly payments including interest and the cash flow generated from the disposition of the residual asset. We propose the residual value continue to be included with the receivable and accreted to its future value as it is now under direct finance lease accounting.

- Financial institutions currently include interest income from lessor activities in the net interest income section of the income statement. The presentation of this income as a component of net interest margin is important to investors and analysts who follow the industry because they generally use net interest margin metrics to compare asset return results across institutions, regardless of the form of the asset (lease or loan). Under the ED’s proposed lessor performance obligation accounting method, lease income, interest income and depreciation expense would be
presented separately in the income statement and are required to be aggregated to net lease income or net lease expense. We do not believe investors would prefer this presentation over one that reflects asset return in net interest margin.

- The ED proposes to eliminate the special accounting provided for leveraged leases under U.S. GAAP. We understand the FASB decided to propose eliminating the current accounting model for these transactions because the tax attributes of the underlying asset are the same for the lessor regardless of whether the asset is financed with recourse or non-recourse debt and it believes the existence of recourse or non-recourse financing in the transaction should not change the pattern of income recognition. We recommend the FASB reconsider this position. Under the proposed ASU, the accounting by the lessor will not reflect the substance of the tri-party transaction (i.e., when the debt is non-recourse, the lessor's exposure is limited to the net investment). Instead there will be double-counting of the third party lender's portion of the lease receivable because both the lender and the lessor will be required to record that portion of the receivable on their books. Similarly, there will be double-counting of the non-recourse debt because it will be recorded on both the lessee's and the lessor's books. At a minimum, we recommend grandfathering leveraged lease transactions entered into prior to the effective date.

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USB appreciates the opportunity to submit views and would be pleased to discuss our comments with you at your convenience. Please contact me at (612) 303-5238 with questions or if you need additional information.

Sincerely,

Craig E. Giord
Controller