August 22, 2013

Russell G. Golden  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Subject: File Reference No. 2013-270

Dear Mr. Golden:

Thank you for providing the Aerospace Industries Association (AIA) an opportunity to review and comment on the proposed lease standard outlined in the Exposure Draft Leases (Topic 842), a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840) (the “Exposure Draft” or “ED”), issued by the Financial Accounting Standards Board (“FASB” or the “Board”). AIA is the premier aerospace industry trade association representing over 350 of the nation’s major manufacturers of commercial, military and business products such as aircraft, helicopters, aircraft engines, missiles, spacecraft and related components and equipment. Many of the AIA member companies are major suppliers to the U.S. Government.

Conceptually, we agree with the Board’s proposed model for lessees to recognize a right-of-use asset and a corresponding lease payment liability on the balance sheet. However, we are concerned about the level of complexity of the proposed model and the operability of a number of the proposed requirements for both lessees and lessors. Our primary concerns are as follows.

**Identification of a lease**

The definition of a lease is overly complex and difficult to apply to multiple element arrangements because it contains multiple steps to determine whether such an arrangement contains a lease. An entity may come to different accounting conclusions for economically similar contracts (for example, lease vs. service contract). Under current rules there is little pressure placed on this distinction because the accounting for an operating lease and a service contract is very similar. Although a preponderance of business arrangements substantively represent the purchase of an asset and thereby meet the definition of a lease, there continue to be arrangements that involve significant use of assets to provide a service; however the service is the fundamental purpose of the arrangement. We believe it would be helpful to articulate that consumption of the asset is a critical factor in lease determination, differentiating from the provision of a service such as energy sources. Further, we consider the point of whether the customer was involved in the design of the power plant to be inconsequential to the core of the arrangement which is to provide service. Therefore, we suggest a specific exemption of energy provision-type contracts from the scope of this proposed standard. We also suggest a clarification that when an asset and a service are not distinct within a service contract that service accounting should be applied to the entire contract unless the service element is not significant. Finally, we recommend that the proposed guidance be expanded to address certain service arrangements that would not meet the definition of a lease; similar to the existing guidance in ASC 840-10-15-10 through 15.
Lessee accounting

Cost vs. benefit

We believe that the costs to comply with the proposed requirements will exceed the resulting benefits due to the unnecessary complexity of some of the proposed requirements. We share many of the concerns about the complexity of the proposed requirements that are articulated in the Alternative Views section of the Exposure Draft. We suggest that the Board focus on a simplified model that achieves the purpose of recognizing assets and liabilities arising from leases without introducing unnecessary complexity and costs. We believe the following specific areas give rise to unnecessary complexity in the ED:

- The separation of components in lease arrangements (for example maintenance or taxes from the leased asset) would be complex and time consuming, with little or no benefit from a user’s perspective. These costs are ancillary to the lease arrangement and separate tracking and reporting will increase the ongoing compliance cost with little benefit to users. We agree with the view in paragraph BC404 of the ED that if a contract contains a lease, a lessee should include all payments to be made under the contract in the measurement of lease assets and liabilities.

- The significant judgment in the determination of Type A vs. Type B leases adds complexity and would lead to significant implementation costs and diversity in application. The dual accounting model provides for structuring opportunities for economically similar leases given the differences in cash flow and income statement presentation for Type A vs. Type B leases. Additionally, as stated in paragraph BC397 of the ED, this fails to meet the objective of a single lease model.

- The calculation of amortization of a Type B lease is complex and financial reporting systems are not currently available to calculate the lease asset amortization under this method, as the difference between the straight-line expense and the amortization of the discount on the lease liability. Because of the calculation complexity and system limitations, the implementation of Type B lease accounting will create significant costs with no benefit to users because the expense recognition will be the same as current operating lease expense recognition, that is on a straight-line basis over the term of the lease.

- The model requires an ongoing reassessment of amounts “expected to be paid” under residual value guarantees and it is unclear what threshold must be met to include amounts “expected to paid.” Establishing a liability for the residual value guarantee only when it is probable and the loss is estimable, consistent with other U.S. GAAP for loss contingencies (ASC 450, Contingencies, Loss Contingencies) could be more appropriate.

- The administrative burden of applying a complex model to a large number of small dollar leases should be considered. The proposed model seems more appropriate for material real estate leases (for example, a manufacturing facility), and will be unnecessarily costly and time consuming to apply to thousands of small dollar leases (for example, copiers) with little additional decision-useful information from a user perspective.

Recommendations

Given these complexities in applying the model in the proposed ED, we recommend the following alternatives in order of preference. These recommendations are focused on both achieving the goal of recognizing assets and liabilities arising from leases and minimizing the costs of implementation to preparers:

1. We recommend that the Board simplify the project and make only a targeted amendment to ASC 840, Leases (“ASC 840”). The amendment could be as simple as expanding disclosures to provide the desired information to users on the estimated balance sheet impact of operating leases. For example,
the Board might consider the following lessee disclosure requirement for operating leases: “An entity shall disclose the present value of remaining minimum lease payments for operating leases in order to provide an estimate of the balance sheet impact of off-balance sheet operating leases. For purposes of the present value calculation the entity should apply the current discount rate each period based on portfolios of leases with similar characteristics.” This disclosure would satisfy a significant portion of the project’s objective by providing users with a more useful estimation of the balance sheet impact of recognizing assets and liabilities related to leases, and would also minimize costs of implementation by eliminating the complexities associated with both subsequent measurement and application of the proposed dual lease accounting model to thousands of lease contracts.

2. If the Board does not feel that a targeted disclosure-only approach sufficiently meets the project objective, then we recommend that the Board consider a single model for all leases. We recommend the following single simplified model for lessee accounting, as follows:

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<tr>
<th>Initial balance sheet measurement</th>
<th>Subsequent balance sheet measurement</th>
<th>Expense recognition</th>
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<td>Initial measurement of the right-of-use asset and lease liability at present value as described in the ED, however, would also include ancillary lease costs (e.g., maintenance, taxes) to eliminate complexity in application.</td>
<td>Subsequent measurement would recognize that the right-of-use asset and lease liability are directly related and inextricably linked, such that the resulting amortization of the right-of-use asset would offset the lease liability rather than as an expense. Amortization would be recorded on a straight-line basis unless another method provides information that is more useful. Amounts would only be re-measured when a lease is modified.</td>
<td>Straight line expense recognition consistent with current operating lease accounting with a separate “prepaid rent” asset or “deferred rent” liability recognized to achieve straight-line expense recognition. This methodology would ensure that the total lease asset or liability is not overstated or understated in relation to the lease contract (for example, in the case of a rent holiday, the contractual liability has not changed and, therefore, the “deferred rent” liability would offset the decrease in lease liability due to amortization).</td>
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This approach would simplify the accounting for leases by lessees, while also providing users with recognition of the assets and liabilities associated with a lease contract. Additionally, if the Board adopts this model we recommend that the Board clarifies the scope such that in-substance purchases (for example, title transfers at the end of the term) should be accounted for under other GAAP, such as, ASC 605, Revenue Recognition and ASC 360, Property, Plant, and Equipment.

3. We recognize that a limitation of suggestion #2 above is that no leases would be presented as financing leases (in the income and cash flow statements), as some leases are today under a capital lease model. If the Board wishes to retain financing lease presentation for some leases, we recommend that the Board retain the current ASC 840 / International Accounting Standard 17, Leases (“IAS 17”) guidance on determining operating and capital leases. Capital leases would continue to
follow the accounting outlined in ASC 840 / IAS 17 while those meeting operating lease criteria would follow the accounting outlined in our suggestion #2 above. The main benefit of this approach is it retains the well-understood rules that exist currently for determining whether a lease should be classified as financing and requires recognition of assets and liabilities related to leases on the balance sheet.

**Lessor accounting**

Similar to our thoughts above on Lessee accounting, we believe that the costs to comply with the proposed lessor requirements will exceed the potential benefits as the current lessor accounting model meets the needs of and is well understood by management, investors and regulators. We do not agree that a lessor should apply a different accounting approach based on whether the lessee is expected to consume more than an insignificant portion of the economic benefits of the underlying asset (Type A/B categorization in the ED). Rather, we believe that the business model, underlying economics and credit health of the lessee are more appropriate bases for determining the accounting approach.

For example, if a lessor has not transferred substantially all of the risks and benefits relating to the underlying asset because the underlying asset doesn’t transfer to the lessee at the end of the lease term or the lessor is subject to the lessee’s credit risk, we believe an operating lease accounting model should be used as it best depicts the economics of the arrangement. In our industry, it is not unusual for leases that would ordinarily be accounted for as capital leases to be accounted for as operating leases when there are significant concerns regarding collectability of amounts due from the lessee. We do not believe a receivable and residual approach for leases where there is significant credit risk is appropriate as the lessor retains risk of loss related to both financing receivable and residual asset.

Our preference is the Board retains the current accounting guidance for lessors as we believe it most appropriately reflects the substance and overall economics of our lease transactions and meets the needs of management and investors. However, we would support removal of the current U.S. GAAP bright line tests in favor of an IAS 17 model whereby the accounting is dependent upon the substance of the transaction rather than the form of the transaction. Furthermore, we do not believe that symmetry between lessee and lessor accounting is an appropriate goal for a new lease model. Ultimately, the principal attributes relevant to lessor accounting are balance sheet presentation and income recognition, in contrast with issues of cost recognition and allocation for lessees.

**Disclosure and transition**

*Disclosure*

While we understand the need for greater transparency in reporting the obligations and assets associated with lease arrangements, we believe the proposed disclosure requirements continue to be onerous. It places unnecessary burden on the reporting entity to provide extensive and detailed disclosures that have little apparent correlation to the objective of enabling users to understand the amount, timing and uncertainty of cash flows arising from leases.

Of particular concern is the proposed requirement for a lessee to provide a reconciliation of opening and closing balances of the lease liability separately for Type A leases and Type B leases. We consider the reconciliation components as cited in paragraph 842.20-50-4 of the ED, to closely resemble detailed information that one would expect to find in the underlying financial records of a company and appear incongruous with the Board’s allowance of aggregate disclosures. Further, we consider the requirement to disclose option provisions to be redundant of the requirement to include such options in the initial measurement of the lease agreement. Therefore, we suggest the Board places greater emphasis on the lessee’s discretion in determining meaningful and relevant lease disclosure, whereby what are currently proposed requirements should be recast as suggested example disclosures and dispense with the
reconciliation and options disclosure requirements.

Transition

We support the changes to the proposed transition guidance, however, believe the guidance could be further refined to lessen the cumbersome implementation with respect to existing operating leases. We encourage the Board to reconsider the grandfathering concept as an alternative to its modified retrospective approach.

Providing preparers the option of employing a fresh start approach to lease arrangements entered into as of the effective date would allow preparers adequate time and resources to effect proper application of the proposed standard going forward. We see no real advantage to the users of the financial statements in recasting financial results that were previously reported and understood by the investor community as a whole, rather, we are of the view that a prospective approach will satisfy the overarching objective of providing users with current, relevant financial information regarding the economic benefits and obligations of lease arrangements.

Other considerations unique to our industry

Interest rate

We believe that our industry is unique, and our contracts and regulations embody many different complexities that simply do not exist in many other industries, such as our requirements to comply with the Cost Accounting Standards ("CAS") and the Federal Acquisition Regulation ("FAR"). While we agree that the lease liability and right-of-use asset should be recorded at present value, we believe there are other appropriate alternatives for establishing the discount rate in addition to the two options suggested in the Exposure Draft. It is common business practice in our industry to enter into leases exclusively to support various U.S. Government contracts. In those cases, where they qualify as capital leases, we are explicitly reimbursed by our customer using a predetermined rate referred to as the “cost of money.” In essence, the customer is financing our procurement of these assets for the performance of our contracts with that customer. Under these conditions, we believe it is appropriate to use this contractual cost of money rate as the discount rate in establishing our lease liabilities and right-of-use assets.

To use any rate other than that specified under CAS, on which our contract reimbursements are based, would distort the economic link between our contractual arrangements and the resulting lease transactions and reduce the decision-usefulness of our reported results. In many cases, the customer explicitly directs us to enter into a lease, and as noted above, acts as the financier for these leases whether the requirement to enter the lease was explicit or implicit. The use of one rate for financial reporting purposes and another for our contractual arrangements would result in an accounting difference that affects our reported results but has no economic substance.

To prevent this potential distortion of contractors’ reported results, we recommend that the Application of Discount Rate in sections 842-20-55-1 to 842-20-55-4 of the ED be modified to include, “If the cost of the leased asset is directly reimbursed by the lessee’s customer and if it can be readily determined, the rate the customer reimburses for the lease.”

Additional issues will arise due to lack of alignment with the Federal Acquisition Regulations (FAR)

The proposed standard also uses the term “interest expense.” We suggest that this term not be used, as it represents a specific term of art (i.e., the amount paid to lenders under contractual borrowing arrangements). We believe the term should be characterized more along the lines of “imputed lease obligation costs” and disclosed as such in the financial statements.

Clarification with the Proposed Revenue Recognition Standard
As U.S. Government contractors, we are frequently required to enter into leases on behalf of our customers. Currently, these leases are considered and accounted for as contract costs. In these instances, based on the terms of the contract, the leased asset is one component of an overall complex solution driven by specifications determined by the customer. In many cases, these lease costs are fully paid for by the contract, included in the bid price of our contract and required to be paid for if the contract is terminated for convenience. As a result, we currently do not believe these leased assets meet the Exposure Draft's definition of “right-of-use assets.” We think the Board should consider the following indicators in determining whether these arrangements should be considered within the scope of the Exposure Draft or as contract costs under the proposed guidance in the Exposure Draft entitled, Revenue Recognition (Topic 605), Revenue from Contracts with Customers:

- Is the leased asset required to perform under a single contract and is it either fully consumed in the performance of the contract, or will the lease terminate upon completion of the contract?
- Does the customer of the company have significant input with respect to the specific asset being leased to fulfill a contract, or does the company retain significant latitude in determining how to fulfill the contract?
- Is the cost of the lease fully recoverable under the terms of a contract with a customer?

This clarification could reduce future potential diversity in practice.

**Administrative matter**

For future exposure drafts, we think it would be helpful if the Board also provides the “traditional” format of the Proposed Standard during the comment period for review. The format provided for this exposure draft (as Amendments to the FASB Accounting Standards Codification) can be confusing, making it more difficult and time consuming to follow and understand the proposed implications to our financial reporting process. We also request the “traditional” format at the time of issuance of final standards (for major projects) for ease of implementation.

We appreciate the opportunity to present our views on this subject and welcome the opportunity to review them with you either in person or by telephone. Thank you for your attention and consideration of our comments.

Best regards,

Terence Regis Marcinko
Director Finance & Accounting
Aerospace Industries Association