2013-270
Comment Letter No. 100

TRALA

TRUCK RENTING AND LEASING ASSOCIATION

September 10, 2013

Delivered Via Email

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

Re: File Reference - FASB No. 2013-270 *Leases (Topic 842): a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)*

Dear Mr. Golden:

The Truck Renting and Leasing Association ("TRALA") appreciates the opportunity to provide comments to the Financial Accounting Standards Board ("FASB" or "Board") on the proposal contained in the FASB Exposure Draft, Proposed Accounting Standards Update (Revised) Leases Topic 842 (ED).

TRALA is a voluntary, non-profit national trade association for the truck renting and leasing industry. TRALA's mission is to foster a positive legislative and regulatory climate within which companies engaged in leasing and renting vehicles and trailers, as well as related businesses, can compete without discrimination in the North American marketplace. TRALA's regular membership includes more than 550 companies employing over 100,000 people and annually generating approximately $25 billion in revenue.

TRALA members represent the vast majority of truck renting and leasing operations in the United States and Canada. Approximately 23% of commercial trucks in operation are rented or leased. TRALA members are responsible for purchasing and registering almost 40 percent of all new trucks in classes 3-8 placed into commercial service. TRALA's associate membership includes companies that supply materials, products and services such as truck and trailer manufacturers, component suppliers, tire makers, engine manufacturers, communications/technology suppliers, finance and insurance companies,

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graphics suppliers, environmental and legal consultants, and numerous others providing services to the industry. http://www.trala.org.

While the truck renting and leasing industry is large and an important factor in the US economy, the majority of its customers are smaller, private motor carriers that do not have access to public capital markets. They often depend on banks, finance companies and leasing companies to finance their businesses, to finance the acquisition of assets and to provide leases of assets and to provide services.

Small and medium sized companies, including many retailers, often choose to lease trucks under short and medium term leases averaging 3 to 5 years. These operating leases most often include vehicle maintenance agreements providing repair and replacement services nationwide. In many cases, these are services that are critical to effective interstate and intrastate commercial transportation but for which the motor carrier does not have the resources without outsourcing. For these motor carriers, leasing preserves their ability to borrow. The liquidity benefits of lower cost, fixed rate, level rent payments allow these companies to match the cost and cash outflows with the cash revenues of their business and the accounting and administration of such operating leases is currently relatively simple. The prime concerns that these lessees have are to preserve borrowing capacity, to preserve capital and to manage/minimize operational costs/cash outflows versus revenue/cash inflows.

To date, TRALA has supported the goals of the SEC and the FASB in "fixing" perceived financial reporting deficiencies regarding off balance sheet operating lease obligations so as to improve the transparency and accuracy of financial reports of lessees. TRALA members appreciate that absent empirical evidence to the contrary it ***may*** be an improvement to capitalize material lessee operating lease obligations. It is important to remember that TRALA members are also users of financial statements with the need to review the credit worthiness of customers.

TRALA noted with great interest that the American Accounting Association published the results of an independent academic study in July 2013 entitled Evidence that Market Participants Assess Recognized and Disclosed Items Similarly when Reliability is Not an Issue that provides evidence that users of financial statement process footnoted operating lease obligations as effectively as on balance sheet obligations. **TRALA believes that the Boards have to address these findings before proceeding with the total overhaul of lease accounting in the complex and, in TRALA's opinion, flawed manner proposed in the ED.**

TRALA also agrees with the European Financial Reporting Advisory Group (EFRAG) in its concern that the Boards have not made a convincing case that executory leases should be capitalized and have not done the necessary conceptual framework study of the capitalization of contracts – most importantly lease contracts. The theory that the lessor's execution is completed upon delivery of the asset to the lessee is not correct under US commercial law. Commercial law should be the basis to determine what is an asset and liability in a bankruptcy. Current GAAP in the US closely matches the legal and tax regimes and any break from those regimes should be clearly explained and justified considering all consequences. TRALA suggests that the Boards consider focusing on expanded, more accurate disclosures as an effective means of improving information regarding the financial impacts to lessees of operating leases.

TRALA has several specific areas of concern in the ED and they are substantially the same as in our previous comment letters regarding the Leases Project. They are as follows:

Cost/Benefit

The benefit capitalizing all material operating leases, as proposed in the ED, has not been met satisfactorily for the majority of users. The Investors Technical Advisory Board (ITAC) highlights this in its objection to capital lease and operating leases being combined on the balance sheet. In addition, the costs and consequences of complying with this proposed standard are unnecessarily high for both lessors and lessees. TRALA believes that a reasonable cost/benefit analysis of the overall proposal should be required, especially in light of reports cited in this letter that conclude the markets are functioning effectively under the current lease accounting GAAP.

Lessee Materiality and Complexity

The vast majority of truck lessees are small to medium sized companies that are unlikely to have the accounting resources to adapt to the significant complex changes and reporting requirements proposed in the ED. These companies will turn to the lessor for help, adding significant customer support costs in helping lessees analyze terms, rates and estimates and how to account for them.

TRALA commends the Boards for their changes in the definition of the lease term, only capitalizing variable rents based on a rate or index and the requirement to include as a payment the amount expected to be paid under residual guarantees. These changes are a good start at reducing unnecessary complexity. However, the real issues of complexity and materiality are in the lessee P&L methods, the complexity of re-booking resulting

from re-assessments and the need to have market observable pricing to bifurcate bundled full service lease payments.

The relatively short-terms and low dollar amounts involved in truck and trailer leasing further minimize the cost effectiveness of the complex accounting and reassessment requirements and will not result in meaningful adjustment amounts. TRALA recommends that right-to-use equipment leases with expected lease terms of 60 months or less and less than $250,000 in equipment costs should continue to be accounted for as operating leases. Readers of financial statements understand operating lease accounting and could benefit from increased disclosures for leases that continue to be accounted for as operating leases. TRALA would support requiring lessees to provide an accurate Present Value (PV) of the remaining rent obligations and the weighted average incremental borrowing rate used to value operating lease obligations.

Form over Substance

TRALA agrees with the Board's recognition that there are leases where the rights are ownership rights (Type A) rather than just rights of use (Type B) and that the two should have different accounting treatment. However, TRALA strongly disagrees with the classification tests for equipment leases that are drastically different than current GAAP and also different from the tests for real estate leases. All leases that are executory in nature should be treated the same – according to their substance. Attempting to simplify lease classification by forcing them into an appearance of comparability is misleading to users who need the breakdowns provided by current GAAP based on the legal nature of the lease for their credit decision making.

P&L and Balance Sheet Presentation

The vast majority of leases utilized in the truck leasing industry are right-of-use leases where the lessee has the temporary right to use the asset for a specified period of time and is obligated to return the asset at the end of the lease term. Under the Type A/I&A model proposed in the ED, in a capitalized right-of-use lease, the asset would be presented separately but within Property, Plant and Equipment (PP&E) and would be amortized straight line over the lease term. The ED treats the capitalized lease obligation as a loan with imputed interest. TRALA's position is that under a capitalized right-of-use lease (executory contract), the profit and loss (P&L) pattern should be straight line, reflecting the operating expense nature of the lease.

Also executory contract leases will be mixed with capital leases through the Type A classification tests that do not treat equipment leases using a risks and rewards regime that matches the US legal and tax regimes. If the boards decide they must be capitalized, the value of the asset and the liability related to an executory lease, absent impairment, are the same over time and equal to the present value of future payments. In that case, TRALA recommends that the current GAAP for accruing the average rent be maintained and the current PV of rents be merely put on the balance sheet on each reporting date. In other words keep current GAAP but take what is in the footnotes and put it on the balance sheet as a separate and clearly labeled ROU asset and non-debt executory lease liability. This also avoids the need for significant deferred tax accounting impacts that result from the accelerated lease cost pattern proposed in the ED.

The right-to-use asset should have a separate classification within PP&E on financial statements so that users understand that the lease is only a temporary right to use the asset. The lease liability would be separately presented and labeled as a non-debt obligation. Rather than inventing a whole new standard, TRALA proposes using the existing FAS 13/IAS 17 as the basis for the new lease accounting standard, modified to capitalize former operating leases but leaving P&L accounting and cash flow treatment as-is and leaving capital lease accounting as-is.

TRALA's recommendation for a straight line P&L with capitalization through putting the PV of the payments on the balance sheet can be simply accomplished by using an Excel spread sheet. However, the proposed Type A and Type B accounting require complex IT systems to handle the imputed interest and the re booking when assumptions change. Under TRALA's recommendation, the incremental borrowing rate and future payments for each lease can be captured in a column on an Excel spread sheet. The average rent expense accrual and the PV of the rents would be easily calculated automatically. As there are changes in assumptions they could be added to the future rents and the new PV and new average rent expense would be easily calculated for the monthly journal entries. This simple approach for all executory leases would save the huge IT system costs associated with complying with the EDs proposed methods.

The balance sheet presentation of leases broken down and classified by their legal regimes is important to TRALA's customers and their lenders. Capital leases and executory leases have significantly different economic effects and legal and tax treatment. The classification tests required by the ED proposals will force lessees to still maintain records under the FAS 13 classification methodology for tax compliance and to give potential lenders the information they need to assess the impact of a possible bankruptcy. This need for information for bankruptcy analysis was clearly pointed out to the FASB at a meeting with the ITAC. The cost of maintaining two sets of records as a

result of the changes proposed by the ED should be specifically addressed by the Boards. This added cost could be avoided if the current GAAP classification tests are maintained rather than the drastically altered tests as proposed in the ED.

Bundled Executory Contracts

Many truck leases are "full-service" leases that incorporate non-fixed costs including vehicle maintenance costs, tax and regulatory compliance costs, and other executory costs bundled into the lease rate. All the services are distinct but the billing is on a bundled basis. Unbundling these costs would present significant administrative costs for lessee customers and competitive concerns for truck lessors. However, capitalizing any of these costs would misrepresent the real value of the leased asset and would detract from the accuracy and clarity in financial statements sought by the FASB.

Customers view the entire amount of full service lease costs as operating costs. This a new concern as current GAAP treats the operating lease cost and executory/service costs the same – that is they are "off balance sheet" and generally recognized on a straight line basis or as incurred. The ED's requirement to default to capitalizing the full bundled lease payment if the lessee cannot find market pricing for the lease and service portions of the payment is unreasonable and onerous. A lessee should be allowed to use a reasonable estimate of the lease and service components if it can't get more precise observable market information, especially when the amounts are not material.

Something similar to the "more likely than not" estimating method could be acceptable. TRALA notes that the AAA commentary on the G4+1 special report advised the FASB that lease contracts are frequently tailored to the desires of the parties to the lease so it can be difficult or even infeasible to identify similar lease contracts. Each vehicle has a different cost due to features and components that are added to customize the truck to the lessee's business needs. As an example, many trucks are sold as a cab with a bed and the trucks body is added to suit the lessee's needs. A cherry picker or a refrigerated box are only 2 common examples of such configurations. The same goes for the services portion of the full service lease. Service contracts are designed based on the truck's configuration and use and as a result, are not a static commodity. As such, finding identical service contracts in the market is unlikely.

Sale Leasebacks

Sale leasebacks are common in the normal every day course of the equipment leasing business. Companies order equipment and are sometimes involved in the chain of ownership before they decide if they want to own or lease the assets. The proposed rules

for sale treatment in a sale leaseback with a purchase option of any amount less than the purchase price would negate sale treatment for many leases that would be sales under current GAAP. Again, TRALA raises the issue that current GAAP for a sale leaseback with a non bargain purchase option is in line with the risks and rewards based US tax and legal systems. The proposal in the ED breaks this useful alignment. This is another form over substance issue. Because of the form of the transaction – a momentary involvement in the chain of ownership – sale treatment may be negated.

Lessor Accounting

TRALA believes that lessor and lessee accounting should not be symmetrical but rather the lessor's business model should drive the lessor accounting. The proposed lessor R&R method is only cosmetically different than the current GAAP direct finance lease accounting method. TRALA suggests no change from current GAAP. The proposed change will result in high IT costs for no apparent benefit. Comparing the R&R and DFL methods, the balance sheet values and the earnings recognized are exactly the same absent sales type profit, if a gross profit is present. The Boards should clearly explain the benefit/need to replace the DFL method with the Type A/R&R method considering the cost to lessors to make the change.

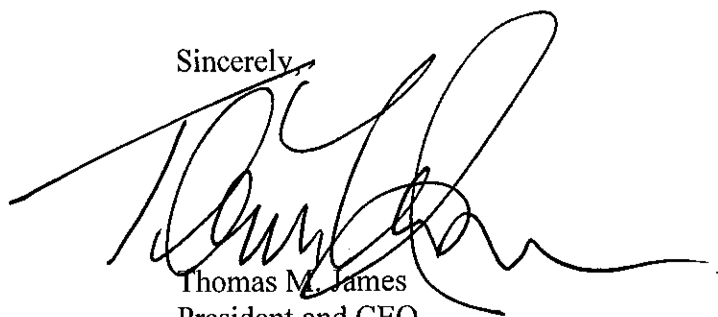
All insured or guaranteed residuals should be financial assets for the lessor as they are under current GAAP. The Boards should clearly explain why they are changing current GAAP for lessor minimum lease payments if there have been no alterations in the environment to warrant a change.

Some lessors in our industry use leveraged leases to finance the assets in their lease portfolios to reduce funding costs as tax benefits reduce the lease pricing. If leveraged lease accounting is eliminated their cost of funding will increase. TRALA suggests that leveraged lease accounting was not adequately debated and is unique to the US market. The Board in place when FAS 13 was written did extensive analysis that led to devising the leveraged lease model and there should be clear justification presented to eliminate it as the environment has not changed.

Mr. Russell Golden, Chairman
September 10, 2013

TRALA very much appreciates the opportunity to comment on the proposals contained in the ED. TRALA also stands ready to offer its services in the event the Boards need any further information on the truck renting and leasing industry. TRALA remains committed to helping the Boards produce accounting standards that are simple, workable and reflect the substance of transactions in the financial statements of TRALA members and their customers for the benefit of their lenders and investors.

Sincerely,



Thomas M. James
President and CEO
Attachment

ED Questions for Respondents and Answers:

Question 1: Identifying a Lease
TRALA agrees with the definition except that lease contracts also transfer rights of ownership in addition to rights of use (capital leases). In the US there are 2 kinds of leases – capital leases and operating eases (executory contracts/ROU or rights of use leases). They have distinctly different economics and the accounting for the 2 should be different .TRALA does not see the need for a change as the change proposed does not reflect the substance and legal nature of leases.

Question 2: Lessee Accounting
TRALA believes that current GAAP works well in terms of classifying leases and accounting for capital leases and operating leases differently. TRALA agrees with the recommendations of the AAA commentary on the G4+1 paper and does not believe that the nature of the leased asset should be a factor in lease classification or accounting.

TRALA agrees with lease asset and lease liability initial measurement as being the present value of the minimum lease payments as defined in the ED. Capital leases represent tangible assets and "true" debt that survive bankruptcy as opposed to the asset and liability in a capitalized operating lease/executory contract (an intangible asset that disappears in bankruptcy and the liability is a non-debt liability that also disappears in bankruptcy). This is important information for potential lenders and credit analysts. It is also important so that debt limit covenants are not breached due to a technicality instead of a change in reality.

Subsequent measurement should be different for capital leases and capitalized executory contracts. TRALA outlines its recommendations in the body of its comment letter.

Question 3: Lessor Accounting
Lessor classification should be based on business model. Financial lessors should use the current GAAP DFL method. Operating lessors should use the operating lease method. As a result, users of their financial statements would have the best information on the nature of their business.

Question 4: Classification of Leases
Unless a risks and rewards based lessee classification system is maintained, there will be a break from the current legal/tax alignment and there will be costly unintended consequences as TRALA discusses in the body of its comment letter.

Question 5: Lease Term

TRALA agrees with the ED definition of lease term, except that it seems to echo what is already in current GAAP only using different words – "significant economic incentive" - to describe a bargain option or an option that must be exercised to avoid a penalty for failure to exercise the option. Why the need to change?

Question 6: Variable Lease Payments
TRALA agrees with the treatment of variable lease payments.

Question 7: Transition
Lessee transition for Type A I&A leases is far too complex, including the front loading of costs. Most truck and trailer leases are small in dollar value and they are numerous, yet they will be subject to the highly complex transition on a lease by lease basis. This could be avoided if the classification tests are changed as recommend in the body of TRALA's comment letter.

Question 8: Disclosure
TRALA does not agree that a lessee in a lease with services needs to disclose future non lease components. The same disclosure is not required for other service contracts not connected to a lease.

Questions 9, 10, 11, 12
No comments