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September 10, 2013

Mr. Russell Golden, 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

Submitted via electronic mail to director@fasb.org

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

Dear Chairman Golden and Chairman Hoogervorst:

The Equipment Leasing and Finance Association (ELFA) welcomes the opportunity to respond to the request for comments from the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) on the proposal contained in the FASB Exposure Draft (ED), *Proposed Accounting Standards Update: Leases (Topic 842).*

The Equipment Leasing and Finance Association (ELFA) is the trade association representing over 580 financial services companies and manufacturers in the $725 billion U.S. equipment finance sector. ELFA members are the driving force behind the growth in the commercial equipment leasing and finance market and contribute to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the nation's GDP; the commercial equipment finance sector contributes about 4.5 percent to the GDP. For more information, please visit http://www.elfaonline.org.

In addition to our summary comments, below, we have included in an attachment our detailed answers to the ED's Questions for Respondents.

Equipment Leasing and Finance Industry

All types of companies lease and finance equipment, but leasing is an especially significant source of financing of operating assets for small- and medium-sized (SME) companies and large non-investment grade (NIG) businesses. The SME sector is cited as the largest potential source of the job growth needed to reinvigorate the economy worldwide. Access to capital and efficient use of equipment are the major drivers for leasing, as opposed to achieving off balance sheet treatment through operating lease accounting. Based on the ELFA annual *Survey of Equipment Finance Activity*, we estimate that over 16 million equipment lease contracts are executed each year in the United States. Further, we estimate that approximately 14 million of those leases are with SME and NIG lessees. Many of those leases involve multiple assets that are included in one lease schedule. While the number of transactions is indeed large, the dollar value of individual transactions is small reflecting the nature of the items being leased. These items include various types of office and materials handling equipment, for example. As a result, the ED's complexity is a major concern. Therefore, in addition to our views on the technical merits of the proposal, much of our commentary will focus on the complexity and compliance costs associated with the proposals and the areas where the ED fails to improve the decision-usefulness of financial statements.

In addition to being lessors, our members are also users of financial statements. When determining whether to enter into a lease contract with a lessee, our member organizations analyze the ability of the lessee to meet its financial obligations according to the contractual schedule. Because SMEs and NIG companies are more prone to bankruptcy than larger investment grade organizations, our members are also concerned with bankruptcy risk, requiring information about which assets and liabilities survive bankruptcy. In making the decision to lease an asset to a lessee, lessors rely on the lessee's financial statements and, in their pricing, generally model the financial statement effects of the proposed lease investment on future periods. After lease origination, they place significant reliance on the lessee's financial statements in reassessing credit worthiness and in monitoring compliance with covenants. Accordingly, our comments involve the decision-usefulness of the proposed new accounting for leases from the perspective of both preparer and user.

Economic Nature of Equipment Leases

Leases are a legal construct recognized as distinctly different in their characteristics from secured loans for the purpose of broadening access to asset-based capital. The nature and extent of the defining characteristics of a lease contract vary considerably from jurisdiction to jurisdiction. These jurisdictional differences principally arise from differences in jurisprudence (i.e., whether substance- or form-based), in the economic environment (i.e., private or government sector centric or hybrids, the presence or absence of active secondary asset markets), and the income tax system (i.e., the significance of available government incentives tied to certain asset acquisitions and permitted transfers or sharing of such incentives between the user and the investor). U.S. equipment leases differ markedly from leases originated in non-U.S. jurisdictions, as evidenced by existence of a Uniform Commercial Code (UCC), an arduous process involving each of the 50 state legislatures. The UCC draws a clear distinction in the rights and obligations of the parties involved in leases and secured financings based on the "economic realities" of the contract (notably, whether the party designated as lessor retains a meaningful interest in the residual value of the leased asset such that it must look to the secondary market as a benchmark for recovery of its investment or in asset disposition). The U.S. income tax system provides significant tax benefits for equipment and their transferability and sharing within well-defined guidelines provided the lessor has sufficient "skin in the game."

True leases are not an accounting construct. The accounting for such leases under existing U.S. GAAP generally mirrors their classification under U.S. commercial and income tax law. Today all U.S. disciplines evaluate leases based on risks and rewards. Leases classified as capital leases are generally classified as secured financings and subject to the same rights and obligations as applicable to the parties to loans. Leases classified as operating leases are generally classified as "leases" under the UCC (Article 2A) with the tax benefits arising from the lessee's use of the property allocated to the lessor who can economically share part of these benefits in the form of lower rentals, but not otherwise and subject to certain constraints so that the nature of the transactions does not constitute the sale/purchase of such benefits. Similarly, the use of the straight-line method for rentals by lessees is commonly required under existing U.S. GAAP and the U.S. income tax laws and is implicit in U.S. commercial law in defining leases as executory contracts. Hence, we believe a faithful accounting of leases must distinguish between leases based on rights and obligations of the subject jurisdiction and their economic effects.

We believe the lessee accounting model must consider the contract the unit of account and the contract should provide the basis for the accounting for the rights and obligations arising from the lease arrangement. Where we see a major deficiency is in failing to analyze and account for the rights and obligations existing in a lease. We believe that a risks and rewards analysis consistently applied to leases of all asset types identifies the basic information required to account for both capital leases and capitalized operating leases for lessees. The balance sheet and the costs recognized in the P&L must reflect the nature of the distinctly different types of leases to satisfy the basic needs of preparers and credit analysts and lenders. The legal differences between leases are significant and impact the economics of leases. They are especially important in a bankruptcy, which is an important element of credit analysis. If the lease accounting model does not allow for equipment operating lease assets and liabilities to be broken out and clearly labeled on the balance sheet and if equipment operating leases are forced into a front-ended cost pattern where the asset amortizes at a faster pace than the liability, the nature of lease liabilities will be obscured and it will appear that the lessee has claims that exceed the value of its assets. This is not a valid depiction of lease economics for lessees.

We realize that accounting is not a science with natural laws that can have only one outcome that can be proven mathematically or strongly supported by empirical evidence, but in our opinion, commercial law and its economic implications should be a factor in determining the proper accounting for leases. It is also our opinion that there is little operating lease activity in markets where commercial law does not establish clear property rights in lease contracts, and a converged leasing standard need not be developed for systems that do not support leasing markets.

Summary Comments

We appreciate many of the changes made to the lease model since issuance of the first ED. We agree that the revised definition of the lease term and lease payments represent improvements over what was first proposed in 2010. While elements of the model in the ED before us are an improvement over its predecessor, we remain concerned that it does not reflect the economics of many equipment leases and will add complexity to financial reporting by both lessors and lessees alike. Since the proposals do not reflect the economics of many lease transactions nor appear to meet the needs of users of financial statements, we believe the significant costs associated with the proposals will exceed the incremental benefits of the proposed model. Consequently, we do not support the issuance of a final standard based upon this ED.

There are several paths forward for this project. The model needs to either be revised or the Boards should pursue a disclosure-based model in place of one based on recognition and measurement. Consistent with the corporate finance view of leasing, we believe

there is a range of lease transactions. Given this range of transactions, development of a single lease model that accurately depicts transactions within the range is not possible. We agree that for accounting purposes, the differences between leases are best reflected using a two-lease model; however, we strongly disagree with the lessee classification methodology proposed in the ED. We believe that leases should not be separated based upon the nature or type of the underlying asset, but rather on the nature of the transaction; we believe an IAS 17 model would provide a reasonable basis for this distinction.

The underlying basis for lessee accounting is not clear in the ED. At times the model refers to the lease contract and at other points it refers to the underlying asset. For example, lease cost allocation is determined by reference to the underlying asset, but initial recognition is based upon the contract. We believe the model needs to be either grounded in the accounting for the underlying asset or in the contract. Our suggestion to use IAS 17 as the basis for classifying leases into Types A or B would ground lease accounting in the accounting for the underlying asset. Alternatively, the model could be based on the contract. An example of this is the display approach, under which a lessee would recognize a lease liability and lease asset based upon the present value of remaining lease payments at each period end. The P&L would reflect rent expense. This is a straightforward model that would achieve the balance sheet recognition goal of the Boards and would be cost-effective to apply.

If the Boards are not able to develop a model that is more representationally faithful and that meets the needs of users of financial statements, we believe a disclosure-based alternative should be pursued. While this would not achieve the goal of recognizing lease liabilities, it would serve the needs of users of financial statements in a cost-effective manner. Groups of financial statement users have advised the Boards they are able to process the existing lease disclosures to make rational investment decisions. These views are also supported in recently published academic research. In "Evidence that Market Participants Assess Recognized and Disclosed Items Similarly When Reliability is Not an Issue" [1], the authors note the following:

- *… The FASB or any other accounting standard-setter should not be primarily concerned that investors and creditors will underweight or ignore altogether disclosed information that meets sufficiently high reliability, accessibility, and interpretability thresholds.*
- *These results support the view that creditors do not appear to price lease obligations differently based on recognition versus disclosure.*

The goal of financial reporting is to provide users with decision-useful information and it is important that the goal be met on a cost- effective basis. These goals should not be

[1] THE ACCOUNTING REVIEW Vol. 88, No. 4 DOI: 10.2308/accr-50421 July 2013 pp. 1179–1210.

sacrificed in order to develop accounting constructs that, while achieving certain goals, do so at an unacceptably high cost.

The Boards have generally expressed a preference for a recognition and measurement model over a disclosure-based model, and some have commented that the question of recognition versus disclosure of lease transactions is no different than the recognition debates that surrounded pension and stock option accounting. We believe that lease accounting represents a separate and distinct set of issues. Both pension and stock option accounting were concerned with basic recognition questions. In stock option accounting, the question was whether any compensation expense should be recognized at all. In pensions, it was a question of a minimum liability and how to account for future obligations that were potentially significantly greater than current expenditures. In current leasing standards, there is a recognition system, lease obligations that are not recorded are disclosed, and current rent expense is closely associated with the cash flows that will occur in future periods. Therefore, there is no relevant comparison of leasing to these other accounting debates.

Lessor Accounting

The Boards have made a number of improvements to lessor accounting over what was proposed in the first ED. While the model is improved, we are of the opinion that lessor accounting generally functions well under current GAAP and that a classification approach based upon the type of underlying asset will generally not produce a presentation that will better reflect a lessor's position in the leased asset and lease contract. The existing classification model, which determines lessor accounting based upon the lessor's position with respect to the lease contract and leased asset, produces a more faithful depiction. As the Boards move forward, it will be important that they approach lessor and lessee accounting from different perspectives. Lessor accounting is concerned with presenting the lessor's position in the lease and leased asset as well as with lessor income. Lessee accounting is concerned with the recognition of lease assets and lease obligations and with the allocation of costs arising from a lease contract. Knowing how the lease impacts the parties is important, but these are separate and distinct areas of concern. Therefore, symmetry is not required and should not be a preferred outcome.

If the Boards proceed with the model proposed in the ED, we believe lessors should have the ability to base their financial accounting presentation on their business model, as that is what users desire. Equipment operating lessors share many of the attributes of lessors of property and therefore should be able to use the operating lease method. Conversely, the direct finance lease method is the preferred approach for financial lessors, whose

position is generally closer to that of a creditor. The result would be balance sheet and P&L presentations that satisfy users' needs as they reflect the substance of the respective lessors' businesses.

We also believe that, similar to current GAAP, any residual guarantee or residual insurance changes the nature of a residual from a physical asset to a financial asset, as the risk is transformed into credit risk. This is important for securitization purposes as financial assets are typically securitized. It would also better reflect the risks transferred when accounting for gross profit, which is inherent in some leases. It is also an area where we believe change in the current approach is unnecessary.

Finally, there should be a place in the proposed lease model for leveraged lease accounting. It is not appropriate to eliminate an accounting method that has been in existence for over fifty years simply because the accounting method no longer fits into contemporary accounting thought. The netting of lease receivables and nonrecourse debt is in line with the rules for the right of offset, as it is a three-party agreement where the parties agree that the rent is to be paid to the lender and cash flows will settle on that basis. Presenting rent and debt on a gross basis gives a false perception of the amount of assets and claims that exist in a bankruptcy analysis. We also believe that the MISF yield revenue recognition treats tax credits as revenue and recognizes that timing differences reduce the net funded position in an investment. Consequently, revenue is recognized to match the interest cost to fund the net investment. The leveraged lease structure may be unique to the U.S. as it has a mature capital markets and it has a tax regime that incents investors to acquire assets via tax credits and accelerated write-off of basis. The accounting accurately reflects the economic effects. The decision to eliminate the structure may be useful to gain worldwide accounting convergence but it is a setback for accounting in the U.S. and those businesses that have come to rely on its benefits. The loss of leveraged lease accounting will increase the pricing for large value leased assets, especially those with favorable tax attributes, such as tax credits that are designed to promote new alternative energy projects.

Cost Versus Benefit Considerations

It is our view that, on balance, the ED does not produce true benefits to the financial reporting system. There is some perceived benefit from the reporting of lease obligations in a lessee's balance sheet, but the usefulness of the recognized value is uncertain. It is difficult to describe the benefit to users as more accurate reporting of lessee obligations when there are differences between the accounting definition of a liability and the differing needs of investment grade debt, high-yield debt and equity analysts. The lease

obligation produced may be more precise and comparable across companies, but it is not more accurate.

The compliance costs and unintended consequences of the proposed approach are significant. These unacceptable costs would be significantly reduced if the core framework of current GAAP is maintained and lease classification based upon a risks and rewards model employed for the Type A/Type B separation. We believe there has not been an assessment of less costly alternative approaches that would still achieve the goal of improving transparency of lessee and lessor financial statements. Further, we do not believe that there has been an adequate assessment of the technology costs involved in systems requirements for both lessees and lessors that involve transition, implementation and ongoing compliance.

There are several aspects of the ED that add complexity and cost, but do not significantly improve the lease model. First, the proposed rules for both the lessee and lessor in equipment leases must be executed on a leased-asset by leased-asset basis. This is a major issue as it will add complexity in implementation and ongoing compliance, especially since this is an element of the model that does not correspond to the needs of any group of financial statement users.

In addition, many leases are routinely entered into on a sale leaseback basis for administrative purposes; a lessee will take delivery of a series of low value assets and then convert to a sale and leaseback. This is possible under current GAAP, but in transition, *every* lease will need to be evaluated to determine if it was executed using a sale and leaseback, and every sale will need to be reviewed. This evaluation will need to be done by the lessee and the lessor as the proposals impact both parties in a lease. The control criteria should be revisited for sale and leaseback transactions, and, at a minimum, existing sale and leaseback transactions should be grandfathered at transition.

Another feature of the ED that will add unacceptable costs are the new definitions and factors to consider when assessing the term of a lease. While the Boards intent is to bring the factors to be considered in line with existing requirements, the definition introduces new terms and concepts. This will result in the expenditure of significant resources as the new terms are studied, analyzed, implemented and audited. If the Boards' intent is to maintain existing requirements, the most cost-effective method would be simply extracting the key concepts and descriptions from existing GAAP.

The changes to lessor accounting for Type A leases is another area where changes are being proposed that will alter the way certain leases are accounted for but not to a significant or meaningful extent. The changes in the recognition and subsequent measurement of residuals in what were sales-type leases in current GAAP and the

manner in which income is recognized for all Type A lease receivables and residuals represent minor changes to GAAP. In simpler terms, the receivable and residual method is only cosmetically different than current Direct Finance Lease accounting. The changes will, however, cause lessors to incur costs to revise systems and reporting routines.

Finally, the provisions that require active reassessment of lease terms and certain variable lease payments will add costs to financial reporting. The impact of these changes may not be very significant, but they will require significant investments in systems and revisions of reporting routines. If a simpler approach as recommended above is adopted, it would eliminate a portion of the reassessment accounting complexity. Lessors and lessees, however, will still need to review each and every lease contract to identify in their accounting systems the leases that require reassessment. This process will be very time intensive, but will probably have limited impact on the amount of liability recognized.

The Boards should also weigh the cost versus benefit analysis in direct costs, other than the systems and process changes that will be borne by preparers. SME and NIG companies are the heaviest users of equipment operating leases primarily because of their limited access to debt and equity markets, the liquidity benefits of level fixed-rate payments, lower rents due to tax benefits transferred to the lessor and the "balloon effect" on pricing due to the lessor assuming a residual value as a cash flow. SME and NIG preparers are also higher bankruptcy risks and they are forced to agree to debt covenants that protect lenders in a bankruptcy scenario as noted in "Debt Covenants, Bankruptcy Risk, and Issuance Costs", by Sattar A. Mansi, Yaxuan Qi, and John K. Wald, May 4, 2011 (https://fisher.osu.edu/blogs/efa2011/files/CFE_6_3.pdf). The impact of the ED will be to be to require these entities to renegotiate debt covenants, as the ED does not label capitalized operating lease obligations as a non-debt liability. This will be a potentially costly and time consuming exercise for SMEs and NIG companies. If the lease model and classification tests are not aligned with the legal regime (i.e., the UCC in the U.S.), lenders and credit analysts will ask SMEs and NIGs to recast their lease assets and liabilities so that they may assess their position in a possible bankruptcy scenario. This is not to say we are suggesting accounting for leases assuming a bankruptcy but rather is a suggestion that the lease model should provide vital information to users just as they have under current GAAP.

Concluding Comments

The path to revising lease accounting has been long and difficult for the Boards. Leasing is a complex activity and the range of lease transactions, as noted in the corporate finance literature, is quite extensive. Leasing can range from transactions that are debt- like to transactions that are more equity-service oriented. Development of one model for all

lease transactions is not practical as any model that fits one end of the spectrum will not be faithful to transactions at the other end.

We are concerned with many of the elements of the proposed lessee and lessor accounting models, as they will unnecessarily increase the cost and complexity of lease accounting without significantly improving the quality and relevance of financial statements. In some cases, we believe the quality of the information presented will be impaired and the relevance of the financial statements reduced. A lessee model that considers all equipment leases to be the equivalent to the purchase of an asset and the separate incurrence of debt is not a valid accounting model and is not grounded in the economics of leasing. We therefore cannot support the lease accounting model presented in the ED.

The lease asset and lease liability related to operating leases exist together and they should not be subject to separate and distinct accounting after lease commencement, as if they were in fact separate transactions. The accelerated cost recognition that results from the separate accounting for the lease asset and lease liability under Type A accounting should not be accepted as a natural consequence of the right of use model. Leases are not simply the seller financing of an asset sale. Inherently, leases involve the separation of use and ownership. Accordingly, lessee accounting should allocate the total consideration based on usage while lessor accounting should faithfully portray the economics of the investment, including, when significant, the tax risks or rewards arising from the underlying.

The lease accounting model does not have to be as complex as it appears in the ED. The Boards could have met their primary objective, the capitalization of lease liabilities, using a simpler approach to lessee accounting. This would have entailed amending IAS 17, *Leases*, and ASC Topic 840 to capitalize leases with a lease term greater than one year by merely putting an accurate value on the balance sheet and by revising the approach to allocating lease costs. Alternatively, the Boards could adopt a display only model for lessees that is different from the recognition and measurement approach pursued to date. A display model would have lessees present value their lease obligations and record the resulting liability and asset at the end of each period, with rent expense reflected in the P&L. Either of these approaches would achieve the Boards objective of having lessees recognizing a lease asset and lease obligation without the aspects of the approach in the ED that will cause preparers and users the greatest difficulty.

As the Boards consider the leasing model during redeliberations, we think revisiting the American Accounting Association's ("AAA") comments on the G4+1 leasing paper [Exhibit A] is appropriate. In its paper, the AAA observed:

- The nature of the property under lease should not affect the accounting, nor should the length of the lease.
- The approach to leases should recognize that accounting for leases is a special case of accounting for contracts.
- The approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.
- The goal for lease accounting is to represent the value of the rights and obligations conveyed by the lease, not the value of the physical assets, unless there is no material difference between the value of the physical assets and the value of the rights and obligations.

These comments were valid when they were written more than 10 years ago, and they still resonate today.

In addition, there are a number of elements in Mr. Linsmeier's alternative view that merit further consideration. In particular he observes that:

- Users will not have the information they require regarding leasing activities or the information with which to derive the information they need,
- Leases that transfer ownership rights based on IAS 17 classification criteria should be scoped out of the proposed standard and they should be treated as a financed purchase,
- The ROU asset is a unique asset and subsequent accounting should not be defined by reference to other accounting literature,
- Type B accounting should be used as it supports the view that the contract as a whole is the unit of account that should be the basis for lease accounting, and
- There should not be symmetry between lessor and lessee accounting.

We respectfully suggest the Boards consider these thoughts as it re-deliberates the ED.

We certainly appreciate the opportunity to comment on the ED, and we also thank the Boards for their policy of open communications during the standards-setting process. We remain available to help in any way needed, and we are committed to assisting in the creation of a workable lease accounting standard that reflects the economic substance of transactions and improves the clarity in financial reporting.

Sincerely,

William G. Sutton, CAE
President and CEO

Attachment – Questions for Respondents
Exhibit A

Attachment

Questions for Respondents

ED Questions and Answers:

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. An entity would determine whether a contract contains a lease by assessing whether:

> *1. Fulfillment of the contract depends on the use of an identified asset.*
> *2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.*

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response

We generally agree with the definitions, but we also believe the Boards could simplify the proposals if they were to exclude transactions that are not leases that transfer a right of use. This would lead to leases that transfer ownership being accounted for under other areas of GAAP and would free the lease model from the perceived need to account for some lease transactions as if they were purchases with financing.

While we agree with the proposed basis for separating leases from service transactions, we believe the definitions require further field testing to determine if they work as intended and that there are no significant unintended consequences.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

We do believe there are differing lease transactions and that a general model for lessees and for lessors is not possible given the range of transactions. We provide further commentary on this point in our response to Question 4.

We do not agree with separating leases for purposes of determining how to allocate the cost of lease transactions based upon the nature of the underlying asset. We believe contracts should be separated based upon the nature of the contract. For example, leases that transfer the significant risks and rewards of ownership or control using an IAS 17 approach could be accounted for using the Type A model and all other leases could be accounted for using the Type B model. The proposed approach in the ED will not reflect the nature of equipment lease contracts and will add costs to the model by making it harder to determine the significance of equipment leases for purposes of materiality given the nature of the Type A model.

If the Boards do not accept a classification approach based upon the nature of the contracts, a display-oriented approach should be pursued. Under this model, lessees would record a lease liability for the present value of rents at the end of each period and an asset for an equal amount. Lease costs would be recognized on the basis of rent. Under this approach, the balance sheet and income statement would not be linked, but we believe linkage is not required in a display approach.

When it comes to allocating costs in lease transactions, we believe that rent expense is the appropriate governor for allocating costs. While some users of financial statements allocate the cost of some lease transactions into interest and amortization components, they do so by allocating rent and usually do not recast the transactions as is proposed in the Type A lessee model. Rent is an important measure of the outflow of resources and the artificial allocation of costs in the Type A model does not appropriately reflect this situation.

Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

As indicated in the prior comment, we do believe there are differing lease transactions and that a general model for lessees and for lessors is not possible given the range of transactions. We provide further commentary on this point in our response to Question 4.

Lessor income recognition should either be based upon the nature of the lease transaction or lessors should be allowed to determine the accounting for their investment in a lease

using the existing lessor models following a business model approach. Financial lessors like banks and finance companies should use a Type A or finance lease approach. These lessors should not use the operating lease method for their finance leases as it distorts the P&L and financial measures used by analysts. Analysts measure financial lenders/lessors by such measures as net finance revenue over interest cost (net spread/net revenue from invested funds) and operating efficiency (the ratio of net revenue to expenses). The operating lease rent and depreciation bears no relationship to the declining financial asset and its cost to carry. Mixing depreciation of leased assets with assets used in the business makes the bank/finance company appear less efficient. For the same reasons, the Boards must consider the accounting for tax credits and tax benefits for financial lessors. Reporting tax credits as tax expense rather than as a component of lease revenue and failing to recognize the reduction in cost to carry from tax shelter distorts the net revenue and operating efficiency ratios. Users want to see the results of investments considering all the elements of revenue in the appropriate line on the P&L based on the substance of the transaction.

Similarly, operating lessors should continue to use an operating lease model as that model most accurately reflects the nature of their business, which is the management of the asset. If the Boards believe users of financial statements require additional information about lessors' residual and credit risks, this information should be provided through additional disclosure and not through recognition and measurement.

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Response

We do believe that the nature of lease agreements varies, but we do not believe they vary based upon the nature of the underlying asset. A model that proposes to recast transactions into another category of transactions, which is the central element of the Type A model, should be based upon whether those transactions are substantively in the form of the transaction they are being recast into. A nine-year lease of an asset with a ten-year life is probably substantially similar to the separate acquisition and financing of an asset purchase. A two-year lease of the same asset is probably not and should not be forced into a different form through accounting.

We do agree that the relationship of lease term to the economic life of a leased asset is one of the factors used to determine if the rights and obligations in a lease are ownership rights or merely rights of use. The significance of the lease payments in relationship to the underlying asset is another factor. It should not matter what the leased asset is – real estate or equipment. The current GAAP risks and rewards tests accomplish the goal of classifying leases according to their economic and legal nature and those factors should

continue to be part of the new lease accounting model. If they are not, then users will have less information.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why

Response

We understand the Boards have attempted to replicate the existing GAAP requirements for determination of lease term. This has been done by using new terms, however, and we believe this will result in new interpretations. If the intent of the Boards is to continue the current requirements, then existing terms should be used as much as is possible to reduce the costs associated with transition and ongoing compliance.

The requirement to reassess leases will add to the costs of the proposals, and we believe that lease term extensions should only be accounted for when they occur. Basing accounting recognition on anticipated outcomes is not consistent with other acquisition or service accounting models.

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Response

We agree with the treatment of variable lease payments if the payments are indexed, but we also believe if the impact of changes in variable rate lease payments will not result in any significant change in the lease asset and lease liability, they should be excluded from the model on a cost versus benefit basis. Changes in interest rates will not, however, have a significant impact on the measurement of the lease asset and obligation and should be excluded from reassessments.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Response

Lessee transition for Type A leases is far too complex because the method front loads costs and the transition method attempts to lessen the current period P&L impact. It should also be noted the entry in the 842-10-55-77 example of a Type A lease transition lacks a charge to deferred tax assets.

In 842-10-55-89 the fair value of an asset may not be readily available for many asset types. In 842-10-55-90 it seems to allow the residual to be "written up" if it is higher than the residual value at inception. To simplify things and to conform to the principle that residuals cannot be written up, we would use "at inception/commencement" data for cost/fair value, residual and implicit rate. As a result, the value of the lease at transition will be the PV of the rents and original residual using the original implicit rate as the discount rate to PV the amounts that are recorded at the transition date.

In 842-10-65-1, we would suggest the following language: "For leases that were classified as direct finance or sales-type leases in accordance with Topic 840, the carrying amount of the lease receivable and residual asset at the beginning of the earliest comparative period presented shall be the bifurcated carrying amount of the net investment in the lease immediately before that date (using the implicit rate in the lease to calculate the amounts) in accordance with Topic 840."

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response

We do not agree that a lessee in a lease with services needs to disclose future non lease components/service contract payments as the same disclosure is not required for a service contract with the exact same terms that is contracted separate from the lease. Also, if an asset is owned and a preparer enters into a service contract on the asset that has the exact same terms as the service contract connected to a lease, it would not need to be disclosed. In all the cases cited, the service contract is legally the same – it is an executory contract.

The requirements in 42-20-50-4 to disclose reconciliations for the assets and liabilities for both Type A and Type B leases present a great deal of information that we question whether users really need. This is a question that should be posed in targeted outreach with lenders, investors and analysts.

The fact that most companies lease many types of assets and have numerous leases means that the requirements in 842-20-50-3 to describe lease terms will result in very general descriptions**.**

Questions 9, 10, 11, 12

Responses

None

Exhibit A

Excerpts from:

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COMMENTARY

Evaluation of the Lease Accounting Proposed in G4+1 Special Report

AAA Financial Accounting Standards Committee
Stephen G. Ryan (Chair); Robert H. Herz; Teresa E. Iannaconi; Laureen A. Maines; Krishna G. Palepu; Katherine Schipper; Catherine

M. Schrand; Douglas J. Skinner; Linda Vincent

CHARACTERISTICS OF A CONCEPTUALLY SOUND LEASING STANDARD

The Committee supports development of a single, conceptually sound approach to accounting for all types of leases and believes that such an approach should have the following characteristics:

1. The approach should recognize that *all* leases, regardless of their specific terms and conditions, convey rights and obligations, and so create assets and liabilities. The nature of the property under lease should not affect the accounting, nor should the length of the lease.
2. The approach should recognize that accounting for leases is a special case of accounting for contracts. Accounting for *all* contracts should be placed on a sound conceptual footing, and the principles developed for leases should be both internally consistent and generalizable, in the sense that the principles governing accounting for leases should be suitable for application to accounting for contracts generally.
3. The approach should be robust to shifts in the contractual details of lease contracts when such shifts do not materially alter the economic substance of the arrangements. In particular, the approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.

4. The approach should take account of practiced realities of the leasing market that make measuring lease assets and liabilities difficult. Because lease contracts are frequently tailored to the desires of the parties to the lease, it can be difficult or even infeasible to identify similar lease contracts. Moreover, public information about the specifics of lease contracts is often unavailable. For these reasons, the markets for trading lease assets and liabilities are relatively undeveloped. In addition, the existence of transaction costs associated with relocating and releasing assets under lease may yield incentives that affect the contractual lease provisions.

While the measurement difficulties discussed in point 4 above must be considered carefully, the Committee believes that the principles governing accounting for lease receivables and liabilities should conform to the accounting for other financial instruments. In this regard, we note that in previous comment letters to the FASB (most recently, to its December 1999 Preliminary Views "Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value"), the Committee stated its support for fair value accounting for financial instruments once the conceptual and measurement issues are resolved.