2013-270
Comment Letter No. 126

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Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116
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In re: Proposed Accounting Standards Update, Leases (Topic 842) of May 16, 2013 (the "Proposal"); File Reference No. 2013-270

Ladies and Gentlemen,

AeroCentury Corp ("ACY") is a publicly traded company that purchases aircraft for long-term investment to be placed on short-term operating leases to aircraft operators around the world. As such, the comments provided in this letter primarily address the impact of the adoption of the Proposal on a lessor of shorter-term (three to five year) leases of long-lived (twenty-five or more year) assets with a substantial "residual" value at lease end and significant lessor exposure to risks and benefits associated with the asset, both during the expected term of the lease and thereafter.

Specifically, we address the points raised in the Proposal's Question 3 regarding lessor accounting, and whether and how accounting for leases should be bifurcated. We believe the Proposal's approach would be unduly complicated for operating lessors to execute. More importantly, the Proposal, if adopted in its current form, would not make the information provided to financial statement users regarding a lessor's financial condition more meaningful than information currently provided. On the contrary, the Proposal contains complexities and assumptions that obscure a lessor's economics and could result in confusion to users of a lessor's financial statements.

Current operating lease accounting requires that the rent revenue arising from minimum lease payments be recognized on a level basis; contingent or variable payments are recognized as income when the right to receipt of such payments occurs. Leased equipment is subject to the lessor's ordinary depreciation polices, and the net book value is reported as an asset and evaluated periodically for impairment based on estimates of future cash flows (e.g. from rent and residual/sale proceeds).

The Proposal would require ACY to account for each asset it leases by "bifurcating" the asset into a lease receivable and a residual asset. For the reasons set forth below, we believe that the Proposal does not serve to improve the dissemination of useful information to financial statement users, which should be the goal of any revision to accounting standards. We believe there are better alternatives, for example, expanded disclosures as to timing and amount of future rental amounts receivable, that could serve the same purpose that motivates the Proposal, but in a way that is more meaningful and less confusing to financial statement users.

We note four areas of concern with the Proposal:

First, the terminology used in the Proposal is unusual and can be confusing. A lessor is required to determine whether the lease being analyzed is a lease of "property" or "not-property." Under this Proposal, ACY's aircraft, each with a life of twenty-five or more years, would be referred to as "not-property." This nomenclature is clearly inconsistent with how the business and investment communities view these "hard assets." Leases would need to be classified as "Type A" or "Type B." This non-descriptive and even counter-intuitive terminology is indicative of the potential confusion that could result from adoption of Proposal.

Second, the Proposal would make it impossible for users of ACY's financial statements to determine the relationship between ACY's outstanding debt payable and the value of the leased aircraft assets that secure the assets' debt financing. This is a key metric that stakeholders in leasing companies universally track. As an operating lessor that holds assets for long-term investment, ACY leases each of its assets under short-term leases with one or multiple lessees throughout the asset's useful life. Under the Proposal, when an asset is placed on lease, its net book value would be "derecognized" from the balance sheet, and "phantom" receivables and residuals would be entered on the balance sheet. Those entries would in turn disappear at lease end, and the asset book value would then reappear on the balance sheet.

Because ACY's asset portfolio serves as the primary collateral for ACY's debt financing, this de-recognition and re-recognition process would result in confusion to those attempting to track and compare the status of the value of Company's leased assets relative to the company's overall debt load over time. While under the Proposal, a lease receivable and residual would replace the asset's book value on the balance sheet on lease commencement, the lease receivable would not be an entry that users would readily understand as a hard asset securing the lessor's debt or be transparent as part of the collateral securing a lessor's debt financing.

Third, bifurcating operating leases through the use of multiple estimates is a misguided effort to "get the balance sheet right" at the expense of obscuring the lease rental revenue recognized by a lessor over a certain period, which is the index that most users analyzing lessor financial statements want to track. The bifurcation process requires use of varying estimates to determine asset carrying values and recognize income. The introduction of these multiple estimates into the presentation of the balance sheet (current value, residual value, the lessor's rate charged to the lessee) would not provide meaningful information to the users of a business' financial statements. Most users are more interested in the earnings process of the business, rather than the "snap shot" of assets and liabilities afforded by the balance sheet. And for a leasing company, most users analyze the rental revenue recognized on leased assets to determine the company's earnings process. If the Proposal is adopted, users would have difficulty relating the "interest" income entries that arise when an aircraft is put on lease required by the Proposal to lease rental revenue.

Fourth, the Proposal would alter the current scheme of recognizing impairment and thereby add to volatility of an operating lessor's income statements. Although the Proposal is mostly silent on the idea of loss recognition, it is implicit in the Proposal that a new *de facto* form of impairment testing would be performed at lease commencement. Because the underlying asset would be derecognized and replaced with *present values* of lease receivables and residuals, new leases of assets with a lower current value than carrying value would almost certainly result in loss recognition and lower asset values on the balance sheet, despite the fact that the asset's carrying value can and would be realized under traditional impairment analysis. Thus, the Proposal would add to income statement volatility by requiring a lessor to recognize losses at lease commencement.

Furthermore, this resulting loss reporting is at odds with another aspect of the Proposal, which requires that a lessor only recognize a portion of gain on a new lease (only that part associated with the lease receivable and not that portion attributable to the residual would be recognized). The overall impact of the Proposal would be to require some sort of pseudo-fair-value balance sheet to be calculated on a seemingly random basis as new lease commencements occur. This is a radical departure from the recurring examination of recovery of carrying cost as required under existing impairment literature.

In summary, we believe the Proposal would add confusion and clutter to the financial statements and would actually make lessors' financial statements less meaningful to their users. Requiring expanded disclosure by lessors of future cash flows from leases could serve as a simpler and more useful means to provide transparency regarding leased assets to financial statement users than the Proposal's requirements. We do believe that an accounting approach that differentiates and treats various types of leases is appropriate, but we believe that the approach should be similar to existing accounting pronouncements, where leases that effectively transfer ownership of an asset to a lessee are accounted for as a financing, but that short term leases of long lived assets should be accounted for in a manner consistent with current operating lease treatment.

Respectfully,

AeroCentury Corp.