September 13, 2013

Mr. Russell Golden
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Mr. Hans Hoogervorst
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Submitted via electronic mail to director@fasb.org

Dear Chairman Goldman and Chairman Hoogervorst,

Thank you for providing me the opportunity to share my comments with respect to the latest Exposure Draft (ED) issued May 16, 2013. I am the Chief Financial Officer of Pacific Rim Capital, Inc. (PRC) and have held senior financial positions in the lease and finance industry for close to thirty years. PRC has been in business for twenty-three years and leases primarily material handling equipment.

I can see the Boards took comments from the first exposure draft seriously as evidenced by the time between ED’s and the content in the second ED. With that said, I believe the current draft could still benefit from comments from the leasing industry and, as a seasoned member of that industry, I hope you find my comments worth considering. I would begin by stating that the leasing industry agrees with the Boards’ contention that lease obligations should be included on the balance sheet for both lessors and lessees. My comments focus on the areas of:

1) The Dual Model Approach
2) Lease Term
3) Unbundling of Services
4) Lease Commencement Date
5) Lease Measurement at Transition
6) Symmetry in Reporting between Lessor and Lessee
7) Financial Statement Reporting Requirements

Dual-Model Approach
I disagree with the dual-model classification of leases. The current ED uses the terms “insignificant”, “major part” and “substantially all” without formally defining these terms. Given they are the driving factors in determining whether a lease is Type A or Type B in this ED, I believe defining these terms is a necessity.
The ED differentiates leases by whether the lease term represents an “insignificant” portion of the economic benefits embedded in the underlying lease. If the lease term is deemed to represent a significant portion of the economic benefits we go down the path of a Type A lease and if a lease consumes an insignificant portion of the economic life we go down the path of a Type B lease. What may be insignificant to one person may be deemed significant to another individual. An asset with a lease term of three to five years may have a useful life of ten to fifteen years. Without definition, the average person could conclude that the term “insignificant” means less than 50%. In this case one could conclude that either lease term would be insignificant in relation to the estimated useful life.

In classifying Type B leases the ED seems focused on property. Rather than use the term “insignificant” as it did with “assets other than property”, to describe amount of asset consumption by the lease in relation to an asset’s life, the Boards used the term “major part” when evaluating whether property is Type A or Type B. The difference in terminology is concerning because the Boards are differentiating between property and other assets despite the fact that both the lessor and lessee have the same contractual rights and obligations.

The ED takes the definition of classification of Type A and Type B leases a step further by focusing on the PV of lease payments in comparison to the relative fair value of the assets. In doing so, it uses separate terms “insignificant” and “substantially all” for other assets and property, respectively. Again, we don’t understand why there is a difference in terminology.

The Boards use different terms to differentiate between property and other assets. In doing so one class gets penalized by having to recognize expense on an accelerated basis while the other class recognizes expense based on their consumption of the asset equally over time. Tying the terms “insignificant” and “major part” to the dual model seems unbalanced as both assets have the same contractual obligation to make fixed periodic payments for fixed use of the assets over a specified period of time.

I encourage the Boards to revise the ED to reflect one lease model with attributes similar to the Type B model.
Lease Term
I agree that the cost of accounting and reporting for short term leases outweighs the benefit of bringing such assets on balance sheet. As for lease term, I would ask the Boards to consider extending such term from 12 months to 24 months to ensure that both lessor and lessee have adequate time to recover their costs. I agree with the Boards that optional extension periods documented in each contract should be included when evaluating whether a contract meets the 24 month threshold. I agree it makes sense to account for these leases straight-line as we currently do with operating leases.

Unbundling of Services from Leases
I disagree with the Boards’ position on the unbundling of services from leases. If a company goes out and purchases a piece of equipment they know that, as owners of that equipment, they are responsible for the upkeep of the equipment. It is their decision when and how much maintenance should be performed. Companies that lease equipment know they must return equipment at end of lease in a condition specified by the terms of their lease. Many like the simplicity of leasing equipment inclusive of maintenance as they know their equipment will work when they need it, they don’t have to staff for such activities (think “Affordable Care Act”), and the equipment will be in a condition at end of lease that is in compliance with their contract. In these instances, maintenance is an integral part of the contractual terms and, as such, should not be bifurcated from the lease as the ED proposes.

Lease Commencement Date
The ED defines commencement date as “The date which a lessor makes an underlying asset available for use by a lessee.” This runs contrary to the terms of our contracts with our lessees. We often provide lease-lines to our lessees whereby over a period of time (e.g. quarterly), equipment that delivers during this period is included in one lease schedule with the first rental due the first of the period following close of a particular lease-line. The equipment on order often comes from multiple vendors and is delivered to multiple locations over a period of time. We offer lease-lines to specific lessees as it makes it simpler for them to order and manage their equipment fleets.

If I understand the ED correctly, the lease term starts when each asset becomes available for use by the lessee. This would be an absolute nightmare to account for as there could be many conceivable sub-lease start dates for a given lease as equipment delivers over a given period of time, according to each vendor’s manufacturing schedule. This would be costly to account for by both lessor and lessee and, given it varies from the contractual start date, has lessors reporting economics of a transaction that does not reflect the underlying legal documents. Please consider changing this definition to reflect the start date as when all equipment under a given schedule has delivered (or however the lease start date is reflected contractually). It is more cost effective to manage and reflects the economic and legal realities of the transaction.

Lease Measurement at Transition
Allowing lessees to utilize the Modified Retrospective Approach is a vast improvement over the Retrospective Approach, given it allows lessees to use information either at date of transition or to apply hindsight in transition. Allowing lessees to use composite discount rates for leases with similar characteristics is a marked improvement over requiring that a separate discount rate be used for each individual lease.
I do have concerns about the impact to lessees' financial statements from Type A leases. Lessees with unseasoned lease commitments will be penalized as substantial expense could flow to the equity statement. This would be a moot point if the Boards would accept the industry's suggestion to eliminate Type A leases and focus on one lease model based on the definition of Type B leases.

**Symmetry in Reporting between Lessor and Lessee**

This project began as an attempt by the Boards to address the fact that lessees' balance sheets did not fully convey their contractual obligations and the solution, in whatever form, involved placing their lease obligations on the balance sheet. As the project evolved it became apparent to the Boards that they needed to address lessor accounting as well, so as to reflect symmetry between lessor and lessee financial reporting.

I agree that such symmetry exists in the ED's explanation of Type B leases. A lessor will recognize rental income on a straight-line basis and a lessee will recognize rental expense on a straight-line basis. Assuming the underlying discount rates by lessor and lessee are relatively close, we have symmetry. With Type A leases the ED throws the notion of symmetry out the door. The ED generously allows the lessor to accelerate revenue over the contractual term (as compared with an operating lease) while a lessee is punished by accelerating lease expense (as compared with straight-line payments). The lessor benefits at the lessee's expense. This is not symmetry.

Another thing to consider is lessees who have leased for a number of years and continue to lease. Given their mature portfolios, and assuming their lease volume is relatively constant from year-to-year, they will reach a point of equilibrium whereby the financial results will be no different than from current operating lease treatment. Given this, the Boards should not introduce an extra level of complexity in accounting and reporting for Type A leases. This is not an improvement over current lease accounting and it unfairly punishes customers new to leasing.

One lease model similar to the Type B lease model would resolve this issue.

**Financial Statement Reporting Requirements**

I note the Boards are proposing substantially more disclosure than is currently reported. Of particular concern is the requirement (paragraphs 842-30-50-7 and 842-20-50-4) that lessors and lessees provide a reconciliation of opening and closing lease receivables and liabilities. This seems to be overkill and I question the value to the user of the financial statements. If an end user of the financial statements could not determine a lessee's liability from existing footnotes they will not understand the proposed complex reporting requirements going forward.

From the lessor's standpoint disclosure is even worse. The ED requires lessors to disclose many factors with emphasis on how it sets and monitors residual values. Given the competitiveness in the industry and that fact that residual setting is a key component of a lessor's pricing strategy, this is a significant disclosure problem. Disclosing any variable that impacts a lessor's ability to price a lease transaction should be removed from disclosure reporting requirements.
I encourage the Boards to reconsider the proposed disclosure requirements by eliminating reconciliation of lease receivables and liabilities as well as eliminate any disclosure requirement that could impact a lessor’s ability to price a transaction.

In Summary

In summary, I appreciate the efforts of both Boards in producing this revised exposure draft. While a substantial improvement over the first exposure draft, I feel the Boards can still benefit from the experience of the leasing industry to further improve upon this second exposure draft.

I don’t see the connection between the terms “insignificant”, “major part” and “substantially” in creating two lease models. Given a lessee can have identical contractual obligations under either lease of property or other assets, the relation between a lease’s contractual term and the life of the underlying assets does not have any bearing on a lessee’s contractual obligation to perform under a given lease contract. The definition of a Type A lease with requirement that expense be front-loaded by a lessee seems punitive and does not reflect the economic reality that a lessee is given use of a specified asset, for a specified period of time, at a fixed rate. I believe the Boards generally got the treatment of leases correct in their definition of Type B leases although I believe this definition should be extended to all leases, exclusive of short-term leases, rather than solely applied to property or other assets meeting the undefined term of insignificant. Why property received this preferential treatment in this ED escapes me as whether a lease term is significant or insignificant in relation to an asset’s expected life is not a reflection of the economic reality of a lease, nor the rights and obligations of a lessor or lessee, respectively.

PRC is a privately-held organization and issues financials subject to U.S. GAAP. As such, I have not followed differences in FAS 13 and IAS 17. Given lease consumption in the United States versus the rest of the world, I would caution against convergence of lease accounting for the sake of convergence if it adversely impacts leasing in the United States.

Please consider simplifying the disclosure requirements for both lessor and lessee. My understanding is this project began because users of financial statements could not add back future lease obligations, as disclosed in existing financials, to determine a lessee’s lease obligations. With this added layer of complexity, I expect there will be a lot of glassy eyes trying to make sense of the voluminous data required by this ED. This is an excellent place to adopt the axiom “less is more”.

Finally, I ask that you allow us substantial time for implementation of the final Standard. It will be a significant cultural change for our lessees requiring a period of education, systems evaluation and modification, with significant work in lease measurement at time of transition. Given it is already September 2013, I ask that implementation be effective no earlier than January 1, 2018 as that puts us only two years out to start accumulating data for companies with three year’s comparative data.

Respectfully submitted,

Eric L. Eckes
Chief Financial Officer