

Letter of Comment No: 12  
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September 12, 2005

Mr. Lawrence W. Smith  
Director—Technical Application and Implementation Issues  
Financial Accounting Standards Board  
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**Subject:** **Comment Letter on Proposed FASB Staff Position No. FAS 13-a,**  
*Accounting for a Change or Projected Change in the Timing of Cash Flows*  
*Relating to Income Taxes Generated by a Leveraged Lease Transaction*

Dear Mr. Smith:

Wachovia Corporation is pleased to have the opportunity to comment to the Financial Accounting Standards Board on the proposed FASB Staff Position No. FAS 13-a, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction* (the proposed FSP). Wachovia holds a significant investment in leveraged leases, and accordingly, this is a very important issue for us. Also, in June 2004, we entered into a settlement with the Internal Revenue Service (IRS) on our lease-in, lease-out leveraged leases (LILOs), and in connection therewith, made a payment to the IRS representing a portion of the deferred tax balances on these leases and related interest thereon. On a

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number of occasions before and during the negotiations with the IRS we confirmed our interpretation of Statement of Financial Accounting Standards (SFAS) No. 13 that timing-only changes in leveraged lease cash flows would not result in a recalculation of the related lease.

With all of the recent criticism of the current accounting model for leases under SFAS No. 13, as amended and interpreted a multitude of times over a span of many years, we are very disappointed that the FASB would single out these particular provisions relating to leveraged leases to amend and do so without giving appropriate consideration to “grand-fathering” existing transactions or previous changes in the timing of cash flows. In its recently issued and much-anticipated report on off-balance sheet arrangements, the SEC staff recommends that the FASB reconsider lease accounting with a view to removing “bright line” tests and increasing the transparency of leasing arrangements. It would seem prudent to us that the FASB postpone any reconsideration of leveraged lease accounting and address it in connection with its response to the SEC staff’s recommendation, especially in view of the fact that the SEC staff did not single out leveraged leases.

Notwithstanding the foregoing, the following are our comments on the specific issues in the proposed FSP on which the Board requested feedback:

*Issue 1: The scope of this proposed FSP would apply to all transactions classified as leveraged leases in accordance with Statement 13. Do you agree that the scope of this proposed FSP should be limited to only leveraged lease transactions or should the scope be expanded to include all leases under Statement 13? Why or why not?*

Response: It is our understanding that leveraged lease accounting is the only situation within lease accounting where income recognition is based on a level yield calculation (the MISF – Multiple Investment Sinking Fund – yield applied to the net investment in the lease in periods in which the net investment is positive), so it would appear that the

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issues addressed within the proposed FSP would not arise elsewhere in lease accounting. Accordingly, we agree with the scope of the proposed FSP subject to our introductory comments around the need to reevaluate lease accounting in its totality.

*Issue 2: The proposed FSP concludes that the timing of the cash flows relating to income taxes generated by a leveraged lease is an important assumption that should be accounted for within the guidance in paragraph 46 of Statement 13.*

*Additionally, this proposed FSP would require a leveraged lease to be reclassified if, at any time, a revision of an important assumption required a recalculation of a leveraged lease and changes the characteristics of the lease in a manner that would have resulted in the lease not qualifying as a leveraged lease had the revised assumption been included in the original or most recent leveraged lease computation. Do you agree? Why or why not?*

Response: We agree that the timing of cash flows relating to income taxes generated by a leveraged lease is an important assumption, but again, we do not believe that it is appropriate to make piecemeal changes to SFAS No. 13 without grand-fathering transactions done with a good-faith understanding of the applicable accounting model. Accordingly, leveraged leases which have been settled based on a reasonable interpretation of the applicable accounting model should be grand-fathered, especially in situations where the impact can be as dramatic as recalculating a leveraged lease.

We do not agree with the requirement in the proposed FSP to reevaluate lease classification of a leveraged lease whenever a revision to an important assumption triggers a recalculation. Paragraphs 7 and 8 of SFAS No. 13 are very clear that a lease is classified at inception. Further, paragraph 9 is very clear that changes in estimates or circumstances, "shall not give rise to a new classification." These provisions apply to all leases, and there is no theoretical reason or basis in the accounting literature to treat

leveraged leases differently. We strongly recommend that the FASB remove this provision.

Further support for our recommendation can be found in business combination accounting. A lease is not subject to reclassification as a result of a business combination as articulated in paragraph 15 of FASB Interpretation (FIN) No. 21, *Accounting for Leases in a Business Combination*, which states in part, “. . . the acquiring enterprise shall retain the previous classification in accordance with *FASB Statement No. 13* for the leases of an acquired enterprise unless the provisions of the lease as modified.” FIN 21 prescribes a method of recording leveraged leases acquired in a business combination that is very similar to a recalculation and yet does not require, or even permit, a reassessment of the lease classification.

*Issue 3: This proposed FSP would require that the recalculation be based on actual cash flows that occurred up to and including the point of the actual settlement or expected settlement and the estimated cash flows thereafter. Additionally, this proposed FSP would require that the recalculation include any interest and penalties assessed or expected to be assessed by the taxing authority. Do you agree? Why or why not?*

Response: Negotiations and settlements with the IRS generally involve a revision to the originally reported taxable income/loss for prior periods and an agreement as to what amounts will be deductible in future years. To the extent that certain previous deductions are disallowed, the IRS assesses interest and in some cases penalties.

Conceptually there are two ways to recalculate a leveraged lease with respect to the timing of income tax cash flows. The first is the approach in the proposed FSP, which is to include taxes in the cash flow analysis and the calculation of the MISF yield on an actual basis (actual to date and projected in future years) (“actual cash flows”). The other is to include taxes resulting from an actual or expected settlement in the cash

flow analysis and the calculation of the MISF yield as if the settlement had occurred at the inception of the lease (“implied cash flows”). We agree that a recalculation should be based on actual cash flows because leveraged lease accounting as promulgated in paragraphs 43 through 46 of SFAS No. 13 is based on projected cash flows, and accordingly, the method in the proposed FSP is more consistent with the rest of the inputs into the leveraged lease accounting model. We also agree that interest should be included in the recalculation because interest is an integral component of a settlement with the IRS and is inextricably linked to the change in the timing of the cash flows under a leveraged lease.

With that said, however, it is important to consider the potential double counting of interest that will occur at the adoption date of the final FSP. As a matter of policy, many companies, including Wachovia, have been accruing interest in accordance with SFAS No. 5 outside of the leverage lease accounting model. As indicated in the preceding paragraph, we believe that interest related to a settlement with the IRS should most appropriately be reflected in the leveraged lease recalculation. Doing so would result in recording the previously accrued interest twice: once in the SFAS No. 5 reserve and again in the leveraged lease recalculation. To bring clarity to this matter and to avoid the almost-certain controversy that will surround this issue, we recommend that the FASB specifically address in the final FSP the accounting for amounts that were previously accrued for interest related to a tax settlement, whether or not a settlement has actually occurred and the interest paid. We strongly believe that existing SFAS No. 5 liabilities for settlement interest should be reversed as part of the cumulative effect adjustment, because doing so is the only reasonable alternative if such interest is to be included in a leveraged lease recalculation.

We would like to bring another issue related to the proposed FSP to the FASB’s attention. References are made throughout the proposed FSP to “income taxes.” The

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specific reference in paragraph 4 to the IRS creates an inference that the term "income taxes" generally relates to federal income taxes. We recommend that the FASB clarify whether adjustments to the timing of only federal income taxes are to be included in a recalculation determination, or whether changes in timing of state income taxes are also to be included.

Additionally, we recommend that a change in state apportionment factors be expressly excluded as a change in important assumptions. As long as the amount of state pre-apportionment taxable income related to a leveraged lease (which is generally federal taxable income from the lease) has not changed, then changes in apportionment factors should be excluded as a trigger for recalculating a leveraged lease because such changes do not have a direct relationship to taxable income from the lease. Apportionment factors change on a frequent and routine basis for many reasons, which typically have no relationship to leveraged leases.

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We would be pleased to address any questions you may have regarding the comments in this letter or to discuss our position in more detail, at your convenience. I can be reached at 704-383-6101 or by email at [david.julian@wachovia.com](mailto:david.julian@wachovia.com).

Sincerely,  
David M. Julian  
Executive Vice President and Controller

cc: Robert P. Kelly, Senior Executive Vice President and Chief Financial Officer