
**Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
National Credit Union Administration
Office of the Comptroller of the Currency
Office of Thrift Supervision**

December 16, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
Norwalk, Connecticut 06856-5116

RE: *File Reference No. 1850-100 – Proposed Accounting Standards Update, Leases (Topic 840)*

Dear Sir or Madam:

The five federal regulatory agencies responsible for supervising the safety and soundness of U.S. financial institutions (the Agencies) appreciate the opportunity to comment on the *Proposed Accounting Standards Update, Leases (Topic 840)* (the Exposure Draft). The Exposure Draft would improve the transparency of leasing activities and address concerns that existing accounting standards for leases permit some entities to achieve a particular accounting outcome by the careful structuring of lease transactions. Under existing rules, the bright-line distinction between operating leases and capital leases can result in leases that have similar economics receiving different accounting treatment while leases having dissimilar economics can receive the same accounting treatment. Moreover, the existing lease accounting standards permit lessees to accumulate substantial amounts of off-balance-sheet leverage. The Exposure Draft would enhance the comparability of companies that own and finance property to companies that obtain rights to use similar property and incur payment obligations through leasing.

We support the FASB's objective of providing financial statement users with more transparency into companies' leasing transactions and reducing structuring opportunities available under U.S. generally accepted accounting principles (GAAP). However, we have several specific concerns with the Exposure Draft, the most significant of which is the complexity of measurement, which we expand upon in the following comments and observations.

Recognition

We support the accounting recognition of a right-of-use asset and an associated liability for future lease payments by lessees. We concur with the Board's determination that a lessee's right to use leased property represents an asset of the lessee and a performance obligation (or a derecognition event) of the lessor. Similarly, future lease payments are

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an obligation that should be recognized as a liability of the lessee (and as an asset of the lessor).

We also support the two proposed accounting approaches for lessors: derecognition and performance obligation. We believe these two approaches would appropriately represent the different business strategies that exist among lessors. For example, financial institutions, as financiers, typically offer leases and loans as different financing options to commercial customers to fund the acquisition of assets to be used in their businesses. When the financing option is in the form of a lease, the leasing activity would typically align with the derecognition model.

We concur with the comments in the Basis for Conclusions regarding lessee presentation that a right-of-use asset has traits in common with tangible assets such as property, plant, and equipment, more so than intangible assets. We request the FASB clarify in its final standard that a right-of-use asset is not an intangible asset.

Measurement

In developing the Exposure Draft, the FASB considered a number of measurement approaches; we support its decision to use amortized cost for initial measurement based on present value, with estimated cash flows discounted using either the lessee's incremental borrowing rate or the lessor's implicit lease rate. However, we believe the proposed measurement method is overly complex for many leases and a simpler approach could be allowed with minimal sacrifice to the relevance of information provided financial statement users.

In our view, the Exposure Draft's probability-weighted present value technique to measure contractual conditional elements¹ is unduly complex for many leases and would provide little if any net benefit over a simpler, more straightforward approach to measurement. We see significant merit to the position the FASB took during an earlier stage of the project to base the measurement on management's best estimate of conditional elements for purposes of estimating future cash flows. We are skeptical that probability-weighted present values will provide information that is materially more decision-useful to financial statement users than present values of best-estimate cash flows. Any difference between the estimates from the two approaches should be reduced by the Exposure Draft's requirement for subsequent reassessment when facts and circumstances indicate a significant change in a lease's estimated cash flows.

¹ Conditional elements to a lease include (1) options for term extensions and termination and (2) variable lease payments that reference indices, such as a consumer price index; external non-index events, such as performance by tenants other than the lessee in a multi-tenant retail center; events within the lessee's control or influence, such as the lessee's sales in leased retail premises; or equipment usage, such as hours or distance. In many leases, conditional elements can span many years with consequential effects on estimated cash flows.

With regard to the comparative cost of the two measurement techniques, best-estimate present value is less costly and more straightforward to apply than probability-weighted present value. Cost considerations that favor best-estimate present value include its wide use as an analytical technique in business and finance and its flexibility to be adapted to different approaches among companies when analyzing buy-or-lease situations. It is also less quantitative and can be applied more readily where data are not available or objectively determinable or the use of probability-based present value analysis would not materially alter a buy-or-lease decision.

We consider a standard that factors conditional elements into the measurement of leases to be an improvement over existing accounting rules, which are focused on contractual minimums. This aspect alone should inhibit structuring opportunities and increase the transparency of leasing in financial statements. Although it may be attractive from a theoretical perspective, we do not believe the incremental benefit to financial statement users of requiring probability-weighted cash-flow analysis exceeds its additional costs to preparers. Therefore, we encourage the FASB to allow both the probability-weighted present value and the best-estimate present value in its final standard. A final standard that permits both present value techniques could be seen as a practical expedient that reduces burden and complexity, in particular for small public and privately held companies that have more limited resources for accounting compliance. We also believe that permitting both techniques would be consistent with FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, as amended,² and also would be consistent with the FASB's goal to issue principles-based accounting standards.

Lessor's Impairment Recognition Under the Performance Obligation Approach

In the discussion of financial statement presentation in the Basis for Conclusions, the FASB noted that the leased asset, the lease receivable, and the performance obligation are interdependent. We agree with this observation; however, we believe the existing standards on asset impairment and measurement of liabilities like the performance obligation do not reflect this relationship. In many leases, the risk of impairment (due to such factors as functional obsolescence) is shared in varying degrees between the lessor and the lessee. However, the Exposure Draft does not address the accounting from the lessor's perspective for the portion of risk that has been transferred to the lessee.

Given the acknowledged interdependency between the assets (both the leased property and the lease receivable) and the performance obligation, it seems reasonable that the risk transference should reduce the amount of any impairment loss measurement to be recognized by the lessor or reduce the performance obligation. We encourage the FASB to consider addressing the accounting for such risk transference in the final standard.

² For example, see paragraph 51 of Concepts Statement No. 7 regarding cost-benefit considerations.

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Transition and Effective Date

We encourage the FASB to take into consideration the following issues when it evaluates the timeframe under which companies will adopt a final standard. First, leasing is widespread and, in some industries, is extensive. Among financial institutions supervised by the Agencies, an institution can be both a lessor and lessee and may also lend to companies that have extensive lease arrangements with third parties. We are concerned that the application of the new standard could lead to technical defaults on debt covenants or similar contractual requirements. Since leasing is a common means of financing, the FASB should consider this potential consequence, in addition to the typical record-keeping and systems issues, when deciding how soon to require the adoption of a final standard.

We also note that the FASB has numerous projects on its agenda. Some, such as a final standard on financial instrument accounting, may result in substantial differences from current practice that would require extensive changes to accounting systems. Resources available to preparers are not unlimited. The effective date of a leasing standard should take into account other changes to accounting standards that the FASB plans to issue. The FASB should weigh carefully comments from both users and preparers when assessing the needs of the former versus the capacity of the latter to accommodate extensive change. These comments should help inform the FASB about how to coordinate the effective dates of its new standards so as to balance the benefits gained with the disruption caused by changes.

The FASB also should consider the tradeoffs between the longer lead time necessary for companies to implement the simplified retrospective treatment required in the Exposure Draft, in some cases for leases that will have expired or will have been terminated before the standard's effective date, and an earlier application of a final standard under which outstanding leases would be recognized in accordance with the new accounting requirements, but need not be recast for prior comparative periods.

Lastly, we encourage the FASB to reflect on the information needs of financial statement users with respect to organizations that are not investor owned or are privately held. Financial institutions of this type are generally small companies for which the costs of applying new accounting standards can be disproportionately high. We encourage the FASB to consider whether a delayed effective date is warranted for these kinds of organizations.

Convergence

The efforts of the FASB and the International Accounting Standards Board (IASB) to issue closely aligned leasing proposals for review and comment by a worldwide audience should help to improve the quality of financial reporting, which bodes well for eventual harmonization. We believe that when the two standard-setting bodies issue similar proposals, as in this instance, it reduces uncertainty among preparers and allows them to better focus resources to comment on the proposals and plan for their efficient

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implementation. The FASB and the IASB should strive to achieve such close collaboration when formulating all accounting standards on their convergence agenda.

Although the FASB and the IASB are closely aligned on this project, we acknowledge their different approaches to revaluation of the right-of-use asset. We encourage the FASB and the IASB to address the difference. We support the current treatment of property, plant, and equipment under U.S. GAAP that would not permit a company to revalue a right-of-use asset other than to recognize an impairment loss.

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The Agencies appreciate your consideration of our comments. We would be pleased to discuss in more detail our views on the Exposure Draft.

Sincerely,

Robert F. Storch
Chief Accountant
Federal Deposit Insurance Corporation

Arthur W. Lindo
Senior Associate Director and Chief
Accountant
Board of Governors of
the Federal Reserve System

Melinda Love
Director, Office of Examination and
Insurance
National Credit Union Administration

Randall J. Black
Acting Chief Accountant
Office of the Comptroller of the Currency

Jeffrey J. Geer
Chief Accountant
Office of Thrift Supervision