# Tips for Submitting an Effective Comment Letter

Make Your Voice Heard on the Lease Accounting Exposure Draft

**The new Leases Project Exposure Draft was issued May 16, 2013. Lessees and their financing partners should submit a comment letter prior to the Sept. 13, 2013, deadline. Only then will the standards-setting bodies be aware of the real-life business impact if these rules changes are adopted. The following guidance is intended to assist readers in writing a formal comment letter.**

The process of setting accounting standards is an activity that is conducted in public, in an open and collaborative manner. The standards-setting bodies, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), welcome input from stakeholders who are impacted by proposed changes in accounting and financial reporting. Standards setting in the United States is conducted by the FASB with oversight by the U.S. Securities and Exchange Commission, which requires that accounting standards be developed in an open and transparent manner, in consultation with issuers and users affected by the rules.

Lessees and lessee groups should submit a comment letter prior to the Sept. 13, 2013, deadline. A link to the Exposure Draft and tips for submitting an effective comment letter are available on the Equipment Leasing and Finance Association's website at www.elfaonline.org/Issues/Accounting/.

It is not advisable to copy the following points verbatim or in a "form letter" response, as such communications are not viewed favorably by the standards-setters. Rather, the issues raised and the points made here are intended to serve as a guide to help the writer understand the proposed new rules and the application of these rules to their business. ELFA is planning to schedule a web seminar in late June/early July 2013 to further amplify the points made here and provide additional relevant information.

Emphasis should be placed on the user views, as accounting rules are designed to give users of financial statements adequate information upon which to make investment, lending and business decisions involving risk taking. Therefore, users of financial statements are considered the primary constituents of the FASB and IASB.

Comment letters may be filed via email. Visit the FASB or IASB websites for instructions. To view letters already on file, go to www.fasb.org/jsp/FASB/Page/SectionPage&cid=1218220137090 and look under "Leases." Reading others' comment letters may provide some ideas as to style and content.

You may consider including the following points in your comment letter:

1. A straight-line expense pattern for profit-and-loss reporting more truly reflects the economics of a true lease/operating lease.
2. Lease classification and balance sheet presentation based on the legal treatment in bankruptcy of leases is important for users of financial statements.
3. Leveraged lease accounting reflects the economic nature of the lease and reduces the cost to lessees.
4. An unnecessarily complex set of accounting rules is not in the best interest of businesses wishing to sustain themselves in a challenging economic environment.

# Suggested Issues That May Be Included in a Comment Letter

**Approach to Standard Setting**
The proposed rules:

- Focus too much on anti-abuse and are overly complex.
- Fail to test the market. Ninety-nine percent of equipment leases are small-ticket and short-term, so lots of work for no material consequences.
- Do not reflect the economic effects of leases for lessors and lessees.
- Are too theoretical and are not practical. Rent is an operating expense—why not just amend IAS 17/FAS 13 to capitalize operating leases and leave expense straight line?
- Do not consider cost/benefit, which will mean lessees have to keep records for tax and lenders for compliance purposes as the accounting will be out of sync with the legal and tax regimes, which are based on existing GAAP. This is burdensome—why not just amend IAS 17/FAS 13 to capitalize operating leases (separately reporting the liabilities and assets) and leave expense straight line?
- Do not provide information on the nature of owned (capital lease) vs. leased assets and debt (capital lease) versus executory contract obligations as well as the nature of lease costs and cash outflows.

**Rules Must Be Simple**

- We do not object to capitalizing operating leases, but leave expense straight line. This matches economic nature of right-of-use lease—rent is an operating expense.
- Legally, all operating leases are the same, yet equipment and real estate leases are treated differently.
- Leave current lessor rules in place. There are no complaints about lessor accounting.
- Most lessees of equipment leases are small- and medium-sized enterprises with limited accounting and systems resources to comply with complex rules for transactions that are not large.

**Specific User/Credit Analyst Issues**

| **Issue** | **Proposed Rule** | **Desired Outcome** | **Basis for Request** |
|---|---|---|---|
| Capital leases are legally different than operating leases in bankruptcy | Capitalized lease assets and liabilities will be combined on lessee balance sheets | Capital lease assets and debt should be reported separately from capitalized operating lease assets and liabilities which should be clearly labeled as **<u>not debt</u>** | - Separate reporting is core information need for credit analysts to understand lease asset and liability treatment in bankruptcy<br>- Need to differentiate operating lease liabilities from debt for debt limit covenants |
| Lessee lease expense | Equipment operating leases will have front ended costs (amortization + imputed interest) | Operating leases should have straight line rent expense | Operating leases are executory contracts where the rent payment is for the periodic use of the asset. There is n financing element when the rents are level. |

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| Lessee cash paid for rent | Cash paid for rent will not be reported as an operating cash outflow | Report cash paid under operating leases as an operating cash outflow | Best reflects the economics of an executory contract where the payment is for the periodic use, not a loan payment. |
| Lessor accounting | Lessor and lessee lease classification test are the same | Lessor classification should be based on business model where operating leasers use the operating method and financial lessors use the Receivable and Residual (R&R) method | -Financial lessors should have finance earnings (leases are discrete financial investments where the leased asset is sold at lease expiry) and no depreciation of the leased asset (analysts include depreciation of assets used in the financial lessors business in operating efficiency measures).<br>-Operating lessors should depreciate assets (they intend to lease the asset multiple times) and report rent income (matches their operating and maintenance costs). |

**Specific Lessor Issues**

| Issue | Proposed Rule | Desired Outcome | Basis for Request |
|---|---|---|---|
| Required symmetry in lease classification with the lessee tests means lessor accounting may not match its business model | Lease classification criteria for lessor will be same as for lessees | Lessor business model should be the basis for lease classification | - For financial lessors, the R&R method best reflects the economics for their business<br>- For operating lessors, operating lease accounting reflects the economics of their business |
| Leveraged leases survival | Eliminate completely with no grandfathering | - Grandfather existing deals<br>- Retain some form of leveraged lease accounting | -Reflects economics of the transaction as grossed up rent and non-recourse debt are not assets and liabilities of the lessor<br>-Avoids capital adequacy issues<br>-Existing deals done in good faith that accounting treatment |

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| | | | would remain intact through the transaction life<br>-Reduces lease rates charged to lessees |
| Tax benefits not factored into the revenue recognition of leases | ITC will be a credit to tax expense, not a part of lease revenue, and the yield on the lease will be the pretax yield | -ITC should be a lease revenue item amortized at a constant rate vs. the net cash investment<br>-After tax yield on net cash invested should be used for R&R leases | -Tax benefits (cash flows) are revenue just like rents and residual<br>-Some transactions have significant tax benefits and ignoring them distorts revenue recognition |
| Gross profits deferred in proportion to residual risk | Limit up front profit to a ratio of PV of rents/FV of leased asset while ignoring residual guarantees | Residual insurance and guarantees should to be considered in the profit calculation | A residual guarantee or insurance changes the residual's nature to a financial asset |

**Specific Lessee Issues**

| **Issue** | **Proposed Rule** | **Desired Outcome** | **Basis for Request** |
|---|---|---|---|
| Capital leases are legally different than operating leases in bankruptcy | Capitalized lease assets and liabilities will be combined | Capital lease assets and debt reported separately from capitalized operating lease assets and liabilities (clearly labeled as not debt) | -Separate reporting of operating lease assets and liabilities is core information need for credit analysts to understand asset and liability treatment in bankruptcy<br>-Need to differentiate liabilities from debt for debt limit covenants |
| Equipment and real estate leases are legally and in substance the same | Equipment leases will be treated differently than real estate leases. Most equipment leases will be Interest and Amortization (I&A) leases with front ended costs. Most real estate leases will be Single Lease Expense Leases (SLE) with level costs. | -All leases should be treated using the same principles regardless of the underlying asset.<br>-There are 2 types of leases – capital and operating leases (executory contracts) | -The basic principles should be applied to all leased assets.<br>-The nature of a capital lease vs. an executory contract is significantly different from a bankruptcy and tax perspective. |
| Lease expense | Equipment operating leases will have front ended costs (amortization + imputed interest) | Operating leases should have straight line rent expense | -Operating leases are executory contracts where the rent payment is for the periodic use of the asset<br>-The unit of account is the contract. The value |

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| | | | of the asset and liability created by the contract should be equal over time, absent impairment; otherwise the balance sheet values are misrepresented. |
| Cash paid for rent | Cash paid for rent will not be reported as an operating cash outflow | Cash paid for rent in an operating lease should be reported as an operating cash outflow | Operating leases are executory contracts where the payment does not have a principal and interest component. |

It is very important that the Boards receive well-reasoned and thoughtful comment letters from business practitioners who will be impacted by the changed rules. The Boards and staff take the view that hastily crafted and few comment letters indicate that there is general agreement with their proposed approach.

The tentative decisions reached in the Leases Project thus far will not meet the objectives of sound and meaningful financial reporting as core information on the economic impacts of a lease to both the lessee and lessor will be obscured. The Investors Technical Advisory Committee to the FASB advised the Board of this unfortunate fact, yet the Boards continue their efforts to replace the current lease accounting rules with an approach that will mask the true economics of a lease transaction and be unnecessarily costly to implement. Do not count on others to write letters.

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