February 27, 2015

Mr. David A. Vaudt, Chairman
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Submitted via electronic mail to director@gasb.org

Re: Project No. 3-24P
Preliminary Views of the Governmental Accounting Standards Board on major issues related to Leases
Dated: November 11, 2014

Dear Chairman Vaudt:

The Equipment Leasing and Finance Association welcomes the opportunity to respond to the request for comments from the Governmental Accounting Standards Board (GASB) (the Board) on the proposal contained in the Preliminary Views of the Governmental Accounting Standards Board on major issues related to *Leases* (the PV).

The Equipment Leasing and Finance Association (ELFA) is the trade association representing over 580 financial services companies and manufacturers in the $903 billion U.S. equipment finance sector. ELFA members are the driving force behind the growth in the commercial equipment leasing and finance market and contribute to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the nation's GDP; the commercial equipment finance sector contributes about 4.5 percent to the GDP. ELFA members provide equipment leases in significant volumes to governmental agencies, both tax exempt municipal leases and operating leases. For more information, please visit http://www.elfaonline.org.

The Board's stated objective is to provide updated guidance on the accounting for leases so that financial statement users would receive enhanced decision-useful information about the effects of leases on a government's financial statements. The Board believes the proposed accounting

and financial reporting guidance on leases would be less complex for practitioners to apply and would provide a meaningful simplification compared to the existing accounting guidance. The Board also believes it would provide greater comparability as a single approach would be applied to accounting for all leases.

It is our view that the PV's single lease approach for lessee accounting, which is the same for both leases that are executory contract leases (operating leases) and leases that by their terms are financed purchases, will not provide enhanced decision useful information for financial statement users, specifically credit analysts, lenders and lessors. The proposed model would essentially account for all leases "as if" they were the same as or equivalent to the separate acquisition of an asset and the incurrence of debt. While some leases are equivalent to debt, not all leases are.

The proposal would ultimately require users of financial statements to recast the accounting for leases to match the substance of the transaction to properly assess an entity's credit risk. We also believe that if the accounting is not recast the bond ratings will erode, as 20% of the factors on Moody's' muni debt rating model will be negatively impacted by the changes in GAAP proposed by the PV. We recommend that the Board consider how users of financial statements, including lenders, lessors and credit analysts, define debt and how they use financial information in their decision making processes. We believe users of financial statements utilize UCC/legal definitions, which are dependent upon whether a liability has a claim in bankruptcy. The legal position of a lease is critical to their analysis, as they are concerned with which assets and liabilities survive to be a factor in a bankruptcy. Leases that are executory contracts disappear as assets and liabilities as the asset is returned to the lessor and the liability, being executory, is eliminated.

Our interest in commenting is to ensure that key decision useful financial information regarding lease contracts remains available for lessors, lenders and credit analysts. Under current GAAP leases that are capital leases are in the scope of GAAP for leases and are reported as physical assets and debt. This includes the "tax exempt" municipal leases that by law must contain a nominal purchase option – as a result they are financed purchases[1]. Under current GAAP, operating lease obligations are disclosed in the footnotes. This form of financial reporting has been effective in disclosing the nature of leases. That information is important to lenders, lessors and credit analysts, as they need to understand which lease obligations are debt that will compete with their claims and other debt claims in a bankruptcy liquidation and which lease assets are physical assets that are available as collateral in a liquidation to meet their debt claims. This need was pointed out to the FASB in their Leases project via comment letters from many independent sources. The FASB considered this feedback when developing their "two lease"

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[1] We note that the GASB PV excludes financed purchases from its scope and we trust that the GASB will include guidance as this is a change from current GAAP

model to continue to provide information identified as important to lenders, lessors and credit analysts.[2]

As the Board considers the leasing model, we suggest that consideration be given to the American Accounting Association's ("AAA") comments issued in 2001 in response to the FASB's *Commentary Evaluation of the Lease Accounting Proposed in the G4+1 Special Report* for the 1999 G4+1 leasing paper. In its paper, the AAA observed, among other comments, in its list of "Characteristics of a Conceptually Sound Leasing Standard", that:

- The approach to leases should recognize that accounting for leases is a special case of accounting for contracts; and
- The approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.

These comments were valid when they were written fourteen years ago, and they still resonate today.

The American Accounting Association comment letter (no. 396) to the FASB dated September 13, 2013 provides the following insight regarding lease differentiation and balance sheet presentation:

> *B. How Lenders and Rating Agencies Treat Lease-Related Assets and Liabilities –*
>
> *Empirical evidence suggests that banks and credit rating agencies adjust for off balance-sheet lease obligations in their credit assessments. For example, Altamuro et al.(2012) report that lease-adjusted financial ratios are more closely associated with loan spread than unadjusted ratios, especially for larger lenders. In fact, lenders appear to be skilled at assessing which lease contracts are more like rental agreements than financed purchases. Similarly, credit rating agencies appear to capitalize operating leases; however, credit rating agencies seem not to distinguish between leases that are more similar to rental agreements than financed purchases. These results suggest that lenders and credit rating agencies already appear to capitalize operating leases in their calculations and models, with lenders even distinguishing between finance-type and rental-type leases. The fact that lenders can distinguish between finance-type and rental-type leases using the current standards leads Altamuro et al. (2012) to question whether the proposed new standard is warranted. In fact, if all lease obligations were reported together on the balance sheet without a clear distinction between Type A (equipment/vehicle) and Type B (real estate) leases, the results in Altamuro et al. (2012) might imply that the standard is moving in the wrong direction for lenders and rating*

[2] Attached to this letter are the ELFA's comment letters written in response to the two exposure drafts on lease accounting issued by the FASB and the International Accounting Standards Board. These letters contain further information regarding our position on lessee and lessor accounting.

> *agencies. Said more forcefully, this study seems to suggest that lenders and credit rating agencies (obviously both sophisticated users of financial statements) already distinguish between finance- and rental-type leases using the lease guidance that exists today.* ***If future standards make it more difficult to distinguish between these two types of leases because both are capitalized, lenders may consider themselves ill served****. (emphasis added)*

Further to this point, the AICPA Private Companies Practice Section comment letter (no. 614) to the FASB dated October 10, 2013 states that its Technical Issues Committee (TIC):

> *. . . recommends that private entities be allowed an exemption from adopting the new model and be permitted to retain the guidance in extant standards. Some of the TIC members discussed the proposal with lenders in their communities and did not find support for putting operating leases on the balance sheet. These lenders would ignore a right-to-use asset because such assets cannot serve as collateral on loans.* ***They have their own lending models, which allow them to derive information about the lease obligation from the commitments note in the financial statements and from direct interaction with management, and analyze cash flow sensitivity without considering the lease commitment a liability.****(emphasis added)*

Operating leases by their nature are executory contracts under US commercial law. Delivery is not the only lessor performance obligation in an operating/executory lease. It may be the most significant performance obligation but US commercial law provides that the other lessor performance obligations are significant enough not to change the legal nature. The decision that delivery ends performance is an accounting decision but does not change the legal conclusion. The legal nature of a lease should matter in the balance sheet and profit and loss statement presentations of the contracts.

With regards to the issue of complexity, it is a question that depends on the definition of complexity and what the amount of work effort and cost is related to the benefits that are achieved from additional effort. We believe the issue arising from the added effort that is required to appropriately categorize lease transactions needs to be weighed against the benefits that arise from a financial statement presentation that more appropriately considers the nature of the contract. The lease classification criteria in existing GAAP may be considered complex (until one understands the tests), but it is well understood and has been in effect and working well since 1976. It is a risks and rewards analysis and it generally matches the methods used in the UCC, income tax, property tax and bank regulatory capital rules used to differentiate between financed purchases/capital leases and executory contracts/operating leases. We do not view that as being complex; rather, we view the approaches in the PV as adding complexity for users through ongoing adjustments to financial information and as diminishing the usefulness of financial statements. All things considered, in our opinion, using current leases GAAP as a

framework, as the FASB has done, would reduce complexity for preparers and users compared to the method proposed in the PV.

We believe the FASB has proposed a model that reasonably presents leasing in a lessee's financial statements and that the model is one that is cost effective to apply. Preparers only need to put the present valued capitalized operating lease asset and liability (the FASB specifically labels the liability as a non-debt "other" liability) on balance sheet each reporting period. The P&L cost accounting remains unchanged from current GAAP, reflecting the observation that the line between leases and other executory services is hard to determine. The FASB view is that operating leases are contracts that are by their executory nature arrangements that result in a level cost for the periodic use of the leased asset. This view closely matches the income tax treatment of an operating lease.

Preparers should be able to readily apply this model. The present value calculation can be easily derived by using the preparer's spread sheet of future operating lease payments (usually kept on an excel type spread sheet) and adding a present values calculation to each column. The sum of the present values of all leases is the basis for the periodic balance sheet entry.

With regard to lessor accounting, although we do not view it as important of an issue as lessee accounting, it is our opinion that the proposed lessor accounting method will overstate lease assets as the leased asset will not be derecognized when the asset representing the present value rent is added to the balance sheet. Also, the addition of the accounting for the imputed interest revenue and the reduction in the rent receivable as rents are received adds a level of complexity that we do not think is necessary. It may actually be confusing to readers of the financial statements. We do not see sub leasing as a significant activity of governmental entities. Retaining existing GAAP for lessors is less complex and more representative of the actual lease assets.

In summary we believe the lessee model needs to be reconsidered, as we do not believe it will produce a representationally faithful depiction of lease transaction and it has the potential to have an inadvertent impact on credit analysis.

We appreciate your open process and the opportunity to comment. We offer to meet as a group or individually to discuss the issues in detail. Thank you for your consideration.

Respectfully yours,

William G. Sutton, CAE
President and CEO

Attachments

CC: FASB, SEC