July 27, 2000

Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Lucas:

This letter and attachment are sent in response to the FASB's invitation for comments on the Discussion Paper, *Leases: Implementation Of A New Approach*. The Equipment Leasing Association of America appreciates the invitation and opportunity to comment on this Discussion Paper. The ELA is the Trade Association of the Equipment Leasing and Finance Industry in the United States. In addition, approximately fifty (50) of our eight hundred and sixty (860) members operate in the international arena. Our members provide leases of all categories of equipment for all types of industries through a wide variety of lease programs and structures. In 1999, U.S. companies originated leasing transactions involving $210 Billion worth of equipment.

Because of the huge size of the leasing market and the sophistication and differentiation of lease products, the accounting treatment for leases is critical. We agree with FASB and the other G4+1 members that lease accounting should be reviewed to ensure that the standards and practice capture the economic realities of transactions. This Discussion Paper is useful in reviewing current lease accounting standards and practice and its authors should be commended for their efforts and contribution.

ELA and its colleagues in other National Leasing Associations have been studying the so called *New Approach* outlined in the Discussion Papers since 1997. Our study and these comments are a work in progress. These comments reflect where ELA is now in its analysis. As we continue to further develop our views, we will forward additional comments to FASB and other accounting standards bodies. Most of our specific comments are in the form of answers to the nineteen (19) questions raised in the paper. In answering each question, we include the disclaimer that these questions are all within the narrow framework of the asset / liability framework promoted in the paper. ELA understands that the Discussion Paper has not been developed and positioned as a scholarly work. Neither is it a study in that it does not look at the topic of lease accounting and alternative approaches broadly. The proposals suggested in the paper are quite minimalist out of necessity. The simplicity and consistency sought by the proponents of *The New Approach* would break down under the detail of the standards and subsequent application that must necessarily come from the paper. A 30,000 foot view can ignore many realities that an up close view must deal with. Hence, the nineteen (19) questions reflect the need to avoid measuring or quantifying provisions of leases.

In this Discussion Paper and a prior G4+1 Discussion Paper prepared in 1996, the authors argue the need for improved lease accounting standards that meet the criteria of transparency, comparability and consistency and assert that a new approach is required to achieve that objective. These are important criteria. In 1998, ELA commissioned a study by the Barents Group, a subsidiary of KPMG. The paper documents the desire by standards setters (i.e., the FASB), users of financial statements (i.e., the analysts) and regulators (i.e., the SEC) for lease accounting standards that satisfy these criteria. However, a theme runs through the comments of all parties interviewed. They want *simplicity*. This desire for simplicity is in direct conflict with the complex nature of leasing. We do not believe the simplicity of *The New Approach* will satisfy the desire for transparency and comparability. In addition, the need for subjective judgement in valuation of options and contingent rents will not result in consistency.

This desire for simplicity has led to a proposed lease accounting standards framework that attempts to adapt the financial components model, currently applied to transfers of financial assets, to leasing transactions. Although some may view this approach as being theoretically consistent with the existing conceptual frameworks of the G4+1 standard setters, the ELA is concerned that the proposed new approach, if implemented would not achieve the stated objectives of transparency, comparability or consistency.

However, we are confident that it most assuredly would increase the level of complexity of accounting for all lessees and lessors. Current lease accounting standards are relatively simple and straightforward for the vast majority of lease transactions. As transactions become more complex structurally, accounting becomes more complex. Regardless of the complexity of a transaction, the accounting under the current risk / rewards framework captures the economic realities of the transaction. The terms of lease contracts are varied and complex reflecting the specific needs of the lessees and lessors as well as the unique attributes of the leased assets. The value of equipment at inception, during the term and at lease expiry is a complicating factor.

The current accounting rules are complex to deal with but reflect market realities. These complexities will have to be built into any new standard because the economic realities are still present.

Users of financial statements who want a simple financial report that tells them everything they need to know about a company's obligations and rights are dissatisfied with current lease accounting and reporting. They will be just as disappointed with the financials under *The New Approach*. Users have to look beyond the basic financial statements for full understanding. The Barents Study describes how serious users of financial statements such as rating agencies do actually dig into disclosures and footnotes and use analytic modeling to reach the level of understanding they need. This is the reality of a complex financial world, there are no simple approaches that result in an optimal final representation. If the authors of the Discussion Paper believe that *The New Approach* will eliminate the need for such analysis in the future it is because they do not recognize the complexity and flexibility of this industry and its products and services. The analyses will be different under this approach but further analysis will continue to be necessary if users are to draw meaningful conclusions about the reported figures. Such complexities are unavoidable.

The New Approach would replace a quantitative approach with a qualitative approach to achieve comparability. Following in the footsteps of the financial components model as applied to financial instruments, the *New Approach* relies heavily on lessee and lessor estimates of fair value. From its study of the proposal, ELA believes the problems of valuing would be difficult for lessees and lessors alike. There would be a need for comparables to be used in valuing certain options, contingencies and conditions. The good comparables will not exist in most cases and will not be publicly available. This will increase the problem of comparability and consistency. In addition, determining *probability* or degrees of *economic compulsion* is subjective and will lead to a wide range of arbitrary results. Finally, the need to break transactions into component parts which must be measured and tracked individually at fair value will add so much complexity as to render consistency and comparability nearly impossible.

The simplistic approach to capitalize all material leases creates tremendous implementation burdens for lessees. In master leases of equipment like PC's, cars and trucks, and certain industrial equipment, each piece of equipment is a separate lease schedule with its unique lease rate. A lessee will have to record and depreciate each asset separately. A unique imputed liability will have to be established for each leased asset. As rent is paid it will have to be separated into its liability and interest components.

If the accounting rules are clear, specific and enforced and are based on economic reality, a quantified "bright" line, even if somewhat arbitrary, serves a purpose. The line is the guide and all users understand the rule and can have confidence in what they see. *The New Approach* will not give that certainty or confidence and certainly will not promote comparability.

Transparency is not improved under *The New Approach*. *The New Approach* results in a "different number" on the financial reports than the current lease accounting standards, but it tells the user no more than current financial reports. ELA has just received a study regarding the financial statement impact of changes in lease accounting standards prepared by PriceWaterhouseCoopers. The study compares current financial statements of four major public companies under the current lease accounting method and under *The New Approach*. Not only did ELA want to know if *The New Approach* provided a different result, it wanted to see if the result was better in terms of transparency, comparability or any other measure (a copy of the study is attached).

In each case, the assets and liabilities of the companies on the balance sheet increased. However, the results provide no better insight or understanding of the rights and obligations of the companies with regard to their plant and equipment than under the current lease accounting framework. Is the picture presented in the new financials better than in the financials using current lease accounting standards? It is not evident. There is no simple way to capture this information in balance sheets and income statements that will enable users to use the reported information correctly without significant additional analysis. ELA believes that users already know what additional analyses are required to understand information reported under the existing model and we believe their analysis models are essentially correct. All *The New Approach* serves to accomplish is to create an exercise that saves analysts a PV calculation. *The New Approach* makes no progress in understanding the underlying risks and rewards related to leased assets.

ELA does not believe that consistency will be achieved under *The New Approach*. The subjectivity in measurement alone will cause inconsistency. The use of "bright line" tests in current lease accounting standards is criticized as being arbitrary. A standard known and used by all is not arbitrary. When FASB established the current bright line twenty five years ago it did so after extensive deliberation and reference to experience. FASB did not make an "arbitrary" decision. The tests that are used were the result of careful consideration by standards setters looking at actual lease transactions. Also, "bright lines" can be trusted to give guidance and consistency in application and comparability.

In the United States, both the U.S. Tax Code and the Uniform Commercial Code employ bright line tests relative to judgements about lease transactions. *The New Approach* introduces genuine arbitrariness. The fundamental decision to treat all leases the same is arbitrary. They are clearly not the same. The decision to not treat leases as executory contracts is arbitrary. The basis for the decision that the delivery of the asset by the lessor to the lessee completes the execution of the transaction is false. Both parties must continue to perform and if the lease payments are not made the lessor takes back the equipment. The proponents of *The New Approach* are inviting lessees, and to a less extent, lessors to be arbitrary in the complex valuations and separations they must make. However, the biggest source of inconsistency, and therefore arbitrary action, will come from the issue of materiality. The compliance burdens imposed on companies by *The New Approach* will invite a wide variety of practice under any interpretation of materiality. In addition, the SEC's recent guidance concerning what is material for U.S. companies will only exacerbate problems for applying this approach in the United States. Materiality problems would be reduced or eliminated by "bright line" tests.

There will be an enormous cost to implement *The New Approach* as each leased asset will have unique value and have an offsetting imputed liability. Because *The New Approach* is liability driven, the rent must be split between interest and principal components. Whether a company has hundreds of separate small lease schedules to account or has a small number of lease schedules or is a very small company with one or two leases, practice under *The New Approach* will have wide discrepancy because it is so complicated to administer. Companies and their accountants will opt for solutions that are simple and reasonable just as they do now. Capitalizing all leases also would create complexities in deferred tax accounting for U.S. companies as most operating leases are true leases for tax purposes in the United States.

ELA thanks the FASB for its attention to the comments in this letter and to our answers to the attached questions. ELA has gone on record as far back as three years ago stating its belief that review and revision of lease accounting standards would be healthy. However, while The Discussion Paper raises valuable questions for such a review and ultimate revision, a revision should be considered within the risk / rewards framework which more accurately reflects the economic substance of lease transactions and their economic impact on the companies that engage in them.

Sincerely,

Michael Fleming, CAE
President