EQUIPMENT LEASING AND FINANCING ASSOCIATION: NEWS

INDUSTRY NEWS: AROUND THE INDUSTRY

FEEDBACK ON LEASE ACCOUNTING PROJECT REVEALS SIGNIFICANT OPPOSITION

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The comment period for the second lease accounting Exposure Draft (ED) ended in mid-September with 625 letters received. An analysis of the comment letters reveals substantial opposition to the proposal. Some 80% of the letters were negative, 10-15% were partly positive but pointed out serious concerns, and the remaining 5% were fully positive.

Following release of the second Exposure Draft in May 2013, the Boards held individual meetings with interested groups, including the ELFA. In addition, they scheduled a series of roundtable outreach meetings in Brazil (Sept. 10), London (Sept. 16), Norwalk (Sept. 23), Los Angeles (Oct. 3) and Singapore (Oct. 4) with selected organizations who submitted comment letters to solicit additional feedback. I observed the meetings in London and Norwalk and represented ELFA in one of the Norwalk sessions. At the meetings, Board members and staff asked if attendees agreed that leases create assets and liabilities, and then discussed lessee and lessor accounting models, measurement (including the definition of the lease term and lease payments) and scope. They also provided an opportunity for open-ended comments by participants.

Each of the outreach roundtable meetings had its own character and level of technical focus based, in large part, on the mix of roundtable participants.. In addition to organizations like ELFA, the attendees included the audit firms (the “Big Four,” Grant Thornton and BDO), users of financial statements, and lessees and lessors of both equipment and real estate.

The following is a summary of topics raised by those who commented and participated in the outreach sessions:

Should operating leases be moved to the balance sheet? Some participants said that some leases do not belong on the balance sheet, with small-ticket, “non-core” and real estate leases most often cited. Generally, most agreed that there is an enforceable obligation and the gaining of rights by the lessee in an operating lease, but also that the Boards need to work on conceptual grounding for decisions as to which leases get capitalized and how they get accounted for.

Lessee Models: Most participants, including the audit firms, did not agree with the decision to classify leases based on the type of asset leased and how much of the value of the asset is “consumed” during the lease term. The favored approach is to use IAS 17 classification criteria, which better reflect the substance and legal nature of leases. Since the U.S. legal and tax frameworks are based on risk-and-reward classification tests, a decision to use IAS 17 would be a great improvement over the ED. Many felt that lessee balance sheet presentation should follow the substance of the leases, with capital leases presented as tangible assets and “true” debt; and executory contracts/operating leases presented as intangible assets and non-debt liabilities. The question of P&L cost is split among users, with some believing that there is an interest and amortization component to lease cost (creating the front loaded cost pattern), while others, including the “Big Four” representatives, indicate that current P&L GAAP for leases should be retained.

Lessor Models: At the meetings where lessors were present, the general consensus was that current lessor GAAP works well, although many favor a switch to a business model approach where financial lessors (like banks and captives) would use a finance lease model while operating lessors (like commercial real estate and full service/operating equipment lessors) would use an operating lease model.

Measurement: Most agreed with the ED’s definitions of the lease term and lease payments. Many said that the new concept of determining if options are lease payments using the “significant economic incentive” criteria is virtually the same as current GAAP. They recommended using current definitions and terminology including “bargain” and “economic penalty for failure to renew or exercise” options as they are well understood and are operating effectively today.

Scope: This is the determining factor for on- or off-balance-sheet accounting. Most agreed with the scope but said some of the examples as to what is a lease versus a service contract needed more clarification as they did not necessarily agree with the ED’s conclusions regarding the examples.

Complexity: Virtually all agreed that lessee accounting under the ED, including reassessment, is too complex. The transition rules for reviewing every sale/leaseback for both lessors and lessees were cited as onerous. The need to use the current fair value for each piece of equipment in the transition of equipment operating leases to the new "Type A" accounting and re-booking leveraged leases was also cited as being too complex and costly and, in all likelihood, not feasible.

New Timeline

The staff planned to collect and review all the issues identified in the comment letters, outreach sessions and roundtables by sometime in November. They will present the results with recommendations for the Boards to begin new re-deliberation meetings beginning in December. Re-deliberations will continue into 2014. Given the high volume of negative comments, many of which deal with basic principles and concepts that are the foundation of the basic ROU (right of use) approach, it appears there will be subsequent meetings to address the concerns raised. As a result, it is likely that the project may be delayed again, with 2018 the new transition date.

Bosco's Predictions

There is a good chance that many of ELFA's key advocacy issues, including the straight line lessee P&L, preserving current GAAP as the foundation of the new standard, and reducing complexity and onerous lessee compliance costs will be addressed in the Boards' meetings in 2014. Hopefully, these issues will be addressed and the ED revised to the benefit of our industry, and most important, our customers.

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