Equipment Leasing & Finance Association
Statement to the Government Accounting Standards Board
April 8, 2015

Good morning. We are members of the Accounting Committee of the Equipment Leasing and Finance Association, also known as the ELFA, and we are here representing the ELFA. We would like to thank the GASB for allowing the ELFA to present its comments on the leasing topic. The statements delivered here represent the position of the ELFA and do not represent the position of either of the companies that we work for.

The ELFA is a trade association consisting of almost 600 financial services companies, including manufacturers' financing subsidiaries, involved in the $900 billion a year U.S. equipment financing sector. The equipment finance sector accounts for approximately 8 percent of the nation's Gross Domestic Product. ELFA members are a driving force behind the growth in the U.S. equipment finance market and contribute substantially to the providing of capital to finance the acquisition of both equipment and real estate assets in the United States used by commercial as well as governmental entities.

With respect to governmental entities, ELFA members provide leases and financing for assets as diverse as vehicles used by the road repair departments of state and local governments, computer technology used by towns and school systems, high-technology medical equipment such as MRIs and CAT scan machines used by state and local government-owned hospitals, solar energy installations and even real estate.

Leasing and financing is provided by ELFA members in a variety of forms, from tax-exempt municipal leases (that is, lease financings) to commercial equipment operating leases, to service contracts for the sale of energy. Incentives within the U.S. Tax Code and extensive U.S. capital markets provide a wide variety of alternative lease and financing products which enable ELFA members to provide these government entities with lease and financing products that allow them in turn, to acquire the use of these assets in the most financially-efficient manner possible. For instance, a special U.S. Tax Code provision enables ELFA members to lease certain qualified technology equipment, specifically high tech medical equipment, to tax-exempt state owned hospitals at rates lower than would be available through a loan. All in all, this market works.

As with the commercial equipment financing marketplace, many assets are acquired by governmental entities for their use only for a limited duration, often for periods substantially shorter than the economic useful life of the assets. In those cases a lessor assumes a substantial risk in the residual value of the asset and the lessee recognizes that they are simply paying for the temporary use of that asset. These are executory contracts under US commercial law whereby the use of the asset is provided in exchange for the payment of the lease. These are also often true tax leases under US tax law. In other cases an asset may be acquired and financed for substantially their entire economic useful life or may include nominal purchase options to buy the leased asset. These are leases in name only since their legal nature is as a financing. While we believe many equipment leases with government entities fall into the second category, we also believe there are a number of equipment leases and a larger number of real estate leases that fall into the first category.

As you are aware, the U.S. Financial Accounting Standards Board has proposed an approach to lease accounting reflecting both the legal and economic nature of leases. This approach separates leases that are the financing of the purchase of the asset, namely capital leases, from leases that are merely rental contracts, namely executory contracts or operating leases, which transfer only the right of use and not the ownership of the asset. For both sets of these contracts lease obligations are capitalized on the lessee's balance sheet. However the FASB has proposed to separate leases for income statement presentation purposes into what we will call capital leases and operating leases according to their nature. This is key information for lenders and credit rating agency analysts. That is, a capital lease is reflected as an asset which is owned by the lessee and is considered a debt obligation in bankruptcy liquidation. The asset and the obligation are accounted for as independent of one another, generally with the asset amortized following a straight-line approach and the obligation amortized reporting interest expense.

Conversely operating leases that are capitalized are presented as a right of use asset. The obligation is presented as a non-debt "other liability". As stated earlier this approach to leasing differs within the income statement of the lessees. For these leases, total costs are generally allocated based on the outflow of resources from the entity. This approach essentially recognizes that the distinction between leases and services is difficult to determine and that simply recognizing an asset and liability should not by itself change the way the cost of a contract is allocated.

The financed acquisition model creates larger expenses up front because interest costs typically are greatest at the beginning of a lease, consistent with actually acquiring the asset.

We have been supportive of the lease model proposed by the FASB, as we believe;

- That a lease model needs to be representationally faithful;
- That the model needs to provide information that is relevant to users of financial statements;
- That leases are a separate class of economic transactions that require their own model;
- That a lease model should not try and equate a lease to another type of transaction or produce the same result as another class of transaction, if as we believe, leases do differ; and
- That a lease model needs to be operational at the transaction level.

We do not believe the proposal in the Preliminary Views document achieves these goals. It appears to us that the desire to simplify lease accounting could have the effect of mischaracterizing a substantial number of transactions. We believe that the proposed treatment of operating lease obligations as debt, with the separate recognition of the leased asset and possible front-end loading of the total lease expense, may negatively impact credit rating agency's debt rating model for municipalities. As such we believe that this change, unless substantial modifications to those models are made and additional supplemental information is provided, may have the potential to increase the borrowing costs of municipalities.

We agree with the GASB's approach to consider the deliberations of both the FASB and the IASB when determining how the current GASB leasing standard should be revised. Historically the GASB has adopted the FASB pronouncements regarding lease accounting, adjusting only where differences exist specifically related to unique government issues that are not also issues for commercial entities. We do not see a difference between government and commercial entity financial reporting needs regarding leases, nor do we believe there are substantial differences between the leases both groups enter into. The ELFA has been deeply involved with the FASB and the IASB since the initial analyses regarding revising the lease accounting standard commenced and we support the FASB view because it reflects the legal reality of lease contracts under commercial law within the U.S., which both government and commercial entities operate under.

A principal objective of the new lease accounting standard sought by both the FASB and IASB was to reflect operating lease obligations of lessees on their balance sheets since users typically estimate the debt equivalent of operating leases to adjust their ratios and measurements. Numerous objections had previously been raised regarding the lack of these obligations being on lessees' balance sheets. However these users also do not consider those operating lease obligations as debt – again, they use the term "debt-like" to describe such operating lease obligations. Of equal

importance to the balance sheet presentation objective is the objective of reflecting the economic substance of all aspects of the transaction. At the end of the day we all agree that a financial statement presentation should present the economic nature of the transactions it is reporting on. We believe that for this reason the FASB has crafted their approach.

We believe that government entities and commercial entities all compete for the same limited available equipment financing capital. Similarly we believe that the decision-making processes followed by these government entities used to select assets and determine how they will be financed are often very similar to those followed by commercial entities. Government entities first determine what assets they need, whether the cost to acquire the use of those assets fits into their capital budget or operating budget and lastly how the costs of that usage will be presented in their annual financial reports.

As you know, such government entities provide financial reports to credit rating agencies, credit analysts in lending institutions, other government agencies and even to their own constituents. Decisions concerning the providing of capital or credit to government entities go through very similar processes as that for commercial institutions. Lenders and credit analysts are concerned with bankruptcy and analyze which assets are truly collateral that may satisfy their claims and which liabilities are truly obligations that would compete for that collateral in a bankruptcy-liquidation. That information is available only under the two lease model. Credit analysts also determine whether these institutions will have adequate liquid resources to fund the government entity's annual operating budget as well as have sufficient resources to pay their lease obligations. Additionally, many budgetary proposals are also often put forward by the governmental entity to a vote for their constituents for approval. For instance, educational budgets are often voted for or against by constituents based on how the costs are presented in the financial reports. The point here is that annual financial statement presentations of government entities are equally relevant to many parties and we believe the accounting for some leases "as if" they were the separate acquisition of an asset and the incurrence of debt will not present an accurate enough picture.

As such, the ELFA believes that the approach to lease accounting that should be used by such government entities should be consistent with the approaches used by commercial entities to the extent that such leasing transactions are similar. We believe that the fundamental accounting conclusions arrived at to date by the FASB regarding the Type A lease, basically a capital lease, and the Type B lease, basically an operating lease, provide the correct presentation of the variety of

lease and financing transactions in the United States marketplace whether found in a commercial environment or a governmental environment. The FASB's current approach, which we believe will ultimately be issued as a final lease accounting standard shortly, accomplishes the goals desired by all parties; namely to properly reflect the economic nature of these arrangements by recording the assets and the obligations on the balance sheets of the lessees while reporting the expenses associated with them consistent with their underlying economic nature. We believe that only an approach to lease accounting that separates leases from financings will provide the most decision-useful information for users while accomplishing the goal of capitalizing all leases.

In summary, the ELFA believes the GASB should consider the following tenets in establishing a new leasing standard;

- First, we believe the GASB should provide a standard that reflects the economics of the transactions and we believe that the current FASB proposals accomplish this objective.
- Second, we believe that any approach should be consistent with that followed by commercial entities to the extent the transaction is consistent with a commercial transaction, because the transactions operate in similar environments.
- Third, we believe that the FASB two-model approach serves the needs of all users, from credit analysts to constituents.
- And lastly, we believe that the GASB accounting change, if passed as suggested, may necessitate additional information for users to enable them to adjust their analyses to be consistent with those followed in commercial settings or it may have the potential to impact the cost of borrowing and add complexity to a municipality's borrowing process.

We thank you again for this opportunity to address the Committee and are available to respond to follow up inquires as needed.