

*Ms Leslie F. Seidman, Acting Chairman
Financial Accounting Standards Board*

*Sir David Tweedie, Chairman
International Accounting Standards Board*

12 May 2011

Global Leasing Industry Views on Accounting for Lessors

Dear Ms Seidman, dear Sir David,

The global leasing industry, as represented by the US Equipment Leasing and Finance Association (ELFA), Leaseurope (the European leasing and automotive rental federation)¹, the Japanese Leasing Association (JLA), the China Leasing Business Association (CLBA), the Canadian Finance and Leasing Association (CFLA), the Australian Equipment Lessors Association (AELA), the Australian Fleet Lessors Association (AFLA) and the Truck Renting and Leasing Association (TRALA), has followed the Boards' recent re-deliberations on the Leases project with great interest. In light of recent Board discussions, we wish to reiterate our common views on lessor accounting before the Boards progress further in their re-deliberations on this topic.

Our position on accounting for lessors can be summarised as follows:

1. The de-recognition model, with accretion of residual assets, must be the general approach for lessor accounting. This will allow for manufacturing/sales profit recognition for manufacturer/dealer lessors, which we believe to be an entirely appropriate outcome.
2. The performance obligation model lacks conceptual grounding and fails to depict the economics of leases. It must be abandoned.
3. New guidance for lessors must be issued simultaneously with new guidance for lessees and be given full and proper consideration in order to achieve a high quality final standard.

We briefly develop these issues below and invite you to consult the various submissions of the individual leasing associations for more detailed information on these matters.

Yours sincerely,
The global leasing industry associations



¹ Leaseurope represents 45 leasing and automotive rental associations in 32 European countries

1. The de-recognition model, with accretion of residual assets, must be the general approach for lessor accounting. This will allow for manufacturing/sales profit recognition for manufacturer/dealer lessors, which we believe to be an entirely appropriate outcome.

The right of use model that has been developed for lessees is built on the premise that the lessee has acquired a valuable asset by virtue of a lease. The de-recognition model for lessors is the only approach that is conceptually consistent with this right of use model because it reflects the fact that the lessor has transferred the right to use the leased asset to the lessee for the duration of the lease². Additionally, the de-recognition model provides users of accounts with the most useful information as it reflects levels of both credit and asset risks that are involved in a lease transaction. The de-recognition model must therefore apply as the general model to those contracts defined as leases³.

The de-recognition approach presented in the ED proposed to freeze the subsequent measurement of a lessor's residual asset. Freezing residuals does not faithfully reflect the contractual yield of a lease, hampers comparability between lessor financial statements and fails to provide users of accounts with the most meaningful information. In order to appropriately reflect the economics of a lease transaction, the discount on a lessor's residual must be unwound over the lease term to reach the expected future value of the asset at the end of the lease (absent impairment).

We also wish to recall that, in our view, concerns surrounding up-front revenue recognition for lessors under the de-recognition model are unfounded and do not represent grounds to justify the use of another model for lessors. For instance, only manufacturer/dealer lessors are potentially in a position to recognise manufacturing/sales profit, whereas third party lessors are not (they are not in the business of selling assets). We consider that it is appropriate that manufacturer/dealer lessors are able to recognise their manufacturing/sales profit. Moreover, lessors are always able to separate service and lease components. By doing so, they will never recognise up-front revenue on service components under the de-recognition approach.

2. The performance obligation model lacks conceptual grounding and fails to depict the economics of leases. It must be abandoned.

The undersigned leasing associations have, collectively⁴ and through individual submissions, presented their views on the performance obligation model to the Boards on numerous occasions. The model does not reflect the economic reality of leases because the cash flows of a lease contract cannot simultaneously support both a lessor's receivable as well as the physical asset it is required to hold at the same carrying value as if there were no lease.

² This remains true regardless of whether the Boards ultimately decide to retain different P&L treatments for lessees or not.

³ We recognise that there may be a need to introduce practical expedients to this model for certain types of leases.

⁴ [Joint views of the global leasing associations on the Leases Exposure Draft](#)

The model is also fundamentally inconsistent with the underlying concept of the Leases project that an asset is a bundle of rights and that a lessor has performed upon delivery of the asset to the lessee. If the Boards were to decide that a lessor does have a performance obligation to make the underlying asset available throughout the lease, they cannot simultaneously come to the conclusion that a lessee has a liability for its obligation to make payments over the lease term.

We therefore urge the Boards to drop the performance obligation model and all its derivatives, including the various forms of “net presentation” of the model that have been envisaged.

3. New guidance for lessors must be issued simultaneously with new guidance for lessees and be given full and proper consideration in order to achieve a high quality final standard.

The objections of the global leasing industry to the ED proposals for lessor accounting were not motivated by the desire to retain the existing approach for lessors whilst a new conceptual approach was being developed for lessees. Instead, the objections related to the conceptual shortcomings of the lessor proposals, which were inconsistent with proposals for lessees.

While it is true that many do not consider current lessor accounting to be significantly broken, if the Boards adopt a right of use approach to accounting for lessees, it does become necessary to simultaneously change the accounting approach for lessors too. A lessor accounting “status quo”, although preferable to the performance obligation approach, would result in conceptually irreconcilable accounting approaches being maintained for an indefinite period of time⁵. A wholly consistent approach for lessees and lessors is superior as it addresses the issues that would otherwise arise for the many firms are either both lessees and lessors or enter into sub-lease arrangements. Moreover, if lessor accounting is not dealt together with lessee accounting, the Boards run a significant risk of having to make further revisions to lease accounting in the short term.

⁵ Further details on why it is necessary to change both lessee and lessor accounting simultaneously see for instance the [global leasing associations letter to the IFRS Trustees](#) dated 30 March 2011.