

## **Bad News/Good News From the FASB Leases Project**

*Two decisions will harm the industry; one will help*

By Bill Bosco, Leasing 101

The FASB discussed 2 major FASB-only issues at their meeting on August 27. They dealt with Leveraged Lease (LL) and sale leaseback (SLB) accounting (where the leaseback has a purchase option). The leveraged lease issue is a major issue for most large ticket lessors and the sale leaseback issue is a major issue for most all lessors. The ELFA has been commenting on these issues throughout the project in comment letters and in meetings. Sadly the FASB received only one comment letter on the LL issue and only two comment letters on the SLB issue despite these issues being very important to industry members and our customers. I cannot understand the reluctance of lessors to comment to the FASB. There are no repercussions possible (it is not like you are commenting to the IRS or SEC) and most importantly – they do listen to and value feedback to help them make the right decisions. If they get no comment letters they naturally take that as meaning that they have made the right decisions.

### **The Key Decisions:**

**Leveraged leases** - The FASB reaffirmed its decision to eliminate leveraged-lease accounting for all new arrangements closed after the transition date in a close 4 to 3 vote. A little piece of me died when I saw only three hands go up in support of maintaining leveraged lease accounting. However, in a pleasantly surprising vote, the Board tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to leveraged-lease arrangements that exist as of the final standard's effective date.

**Commentary** – The decision to grandfather leveraged leases in existence at the transition date is good news on two fronts. First the cost, complexity and misleading financial reporting that would have resulted from unwinding existing leveraged leases is avoided. Secondly it allows time to execute new leveraged leases up until the transition date, which, although undecided, is likely to be no earlier than 2018.

The decision to eliminate leveraged lease accounting was expected but it was not expected to be as close as it was. It is an unfortunate decision as the cost effective benefits of leveraged leases executed beyond the transition date will be lost to lessees. It disturbs me that many of the largest lessors do not comment to the FASB. Had we had more comment letters they may have voted differently.

**The accounting for sale-leaseback transactions that involve repurchase options** - The Board decided to follow the recently issued revenue recognition guidance and clarify that a repurchase option exercisable only at the then-prevailing fair market value would not preclude sale treatment, provided that the underlying asset is non-specialized and readily available in the

marketplace. The repurchase option must be substantive (the FMV option, with caveats, as they voted is not considered substantive) in order to affect the accounting for the SLB transaction. In reaching this decision, some Board members said that this application was consistent with language provided in the basis for conclusions of the recently issued Revenue Recognition Standard. I strongly believe that had the Board not gotten the two comment letters that explained the issues in SLBs with purchase options, they would not even have allowed even FMV purchase options. For those keeping track of the project you know that they had tentatively decided that ANY purchase option allowed the lessee to “control” the asset and would negate sale treatment.

In other words, they decided that a seller-lessee’s option to repurchase an asset would *not* prevent the seller-lessee from concluding that the underlying asset was sold *if the asset is a non-specialized asset and the exercise price is at fair value*. The Board also tentatively decided that the final standard would include application guidance on how repurchase options should be evaluated.

They did not specifically discuss non-bargain fixed price purchase options but that means that their presence in the leaseback terms would preclude sale treatment in a sale leaseback. Leasebacks with fixed purchase options would be “failed” sale-leasebacks.

The Board tentatively reaffirmed the guidance that the seller-lessee and buyer-lessor should account for a “failed” sale leaseback transaction as a financing arrangement, but asked the staff to come back at a future meeting to present detailed “failed” SLB accounting.

**Commentary** – This decision is a serious setback as a “failed” sale leaseback where the leaseback is a “Type B”/operating lease but has a non-bargain fixed price purchase option means that it counteracts the “good” decision that the Board made regarding the financial statement presentation of a Type B/operating lease. That decision was that the lessee’s asset and liability in a Type B/operating lease are unique in that the asset is not a physical asset and the liability is not debt. To record a “failed” sale leaseback where the leaseback is a Type B/operating lease means that the whole asset stays on the lessee’s books and the proceeds received are accounted for as a loan (debt). From a legal perspective that presentation is not representative of the substance of the SLB transaction. It will mislead lenders and credit analysts and other key users of financial statements who need to know the “real/true” owned physical assets and the true debt of a preparer. Hopefully when the Board examines the results of a “failed” sale leaseback accounting example they will revisit this decision.

The decision to allow FMV purchase option in non-specialized assts sale leasebacks is a “good” decision as it reflects the substance of that type of transaction.

It will be interesting to see how they handle transition as sale leasebacks are very common in all types of equipment leases and a fixed price non-bargain purchase option is a common term. If, in transition, they force lessees and lessors to re evaluate every sale leaseback that is present in their lease portfolio it will be a costly exercise and would have significant financial reporting implications if all those lease are to be re-booked and accounted for as financings. Think about the fact that lessors sell their interest in leases on the secondary market – the second lessor really never cares if the original transaction was an SLB. If SLBs are not grandfathered they would have to retrieve and read the documents on every lease.

There is still hope as at the ELFA's recent accounting conference Tom Linsmeier, the FASB Board member invited to speak, was asked a few questions from the audience that he asked to be put into a comment letter to the FASB board. One question asked when a lessee is considered an owner of an asset in a SLB (many assets involve the lessee committing to purchase, paying deposits, progress payments and down payments). The board needs to clarify or we need to understand the new concept of transfer of "control" defining when a sale takes place under the newly issued Revenue Recognition Standard. It may be that since the lessee has not fully performed its obligation, a sale has not taken place. Another question centered on those SLBs that occur as a convenience in a master lease (where the lessee funds individual assets and the lessor does a once-a-month mass SLB). In this case the lessee may be acting as an agent and not a principal to the transaction. Whether one is an agent or a principal is a consideration under the Revenue Recognition Standard regarding sale treatment and we need to understand how to structure new SLBs to qualify as sales. The last comment from the audience stressed the complexity in transition of requiring lessees and lessors to examine every lease with a purchase option to see if they would be "failed" SLBs, suggesting that grandfathering be considered. Tom Linsmeier suggested that the Board would consider these issues if presented in a comment letter. Gary Kabureck, an IASB Board member, was also on the panel with Tom. Both Tom and Gary said the FASB and IASB Boards appreciated the comments from the ELFA throughout the Leases Project as they provided needed details and positive suggestions to help the Boards with the complex issues in lease transactions. I appeal to you readers to get your organization to comment on these important issues. If you don't vote don't complain.

### **Next steps in the project:**

While the boards have redeliberated many aspects of the proposed leases model, they still need to discuss a number of issues, including the following:

- Lessee disclosures.
- Transition.
- Effective date.

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