

June 30, 2009

**VIA ELECTRONIC MAIL**

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Re: Leases: Preliminary Views

Dear Mr. Golden and Members of the International Accounting Standards Board:

The Office of Advocacy (Advocacy) offers the following comment to the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) regarding the Discussion Paper (DP) entitled "Leases: Preliminary Views." The DP provides a proposed accounting standard that would replace Statement of Financial Accounting Standards No. 13, Accounting for Leases (FAS 13), governing the accounting for commercial lease transactions in the United States. The DP invited comments on all matters discussed in the paper.

FASB and IASB intend that the proposed approach announced in the DP, if finalized, would mandate that leasing entities provide a more "complete and understandable picture" of their leasing activities in accounting statements.<sup>1</sup> Advocacy commends FASB and IASB for their efforts to create a common standard on lease accounting but recommends that the boards develop alternatives that would minimize the burden of the proposed standard on small businesses engaging in shorter-term, less-

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<sup>1</sup> Discussion Paper, available at [http://www.fasb.org/draft/DP\\_Leases.pdf](http://www.fasb.org/draft/DP_Leases.pdf); and <http://www.iasb.org/Current+Projects/IASB+Projects/Leases/Discussion+Paper+and+Comment+Letters/Discussion+Paper+and+Comment+Letters.htm>.

costly lease transactions. In particular, Advocacy recommends that FASB and IASB create a de minimis exception to the standard that would exempt lease transactions of less than \$250,000 from the proposed standard.

## **Office of Advocacy**

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration.

## **Background**

The current accounting standard for leasing distinguishes between two types of transactions: (1) “operating leases” and (2) “capital leases.” In an operating lease, the lessor transfers only the right to use the property to the lessee. At the end of the lease period, the lessee returns the property to the lessor. As the lessee does not assume the risk of ownership, the lessee treats the lease expense as an operating expense in the income statement and the lease does not affect the lessee’s balance sheet.

In a capital lease, the lessee assumes some of the risks of ownership and enjoys some of the benefits of the asset. Consequently, the lessee recognizes a capital lease as both an asset and a liability (for the lease payments) on the balance sheet. The lessee may claim depreciation each year on the asset and also deducts the interest expense component of the lease payment each year. In general, capital leases recognize expenses sooner than equivalent operating leases.

Since 2006, FASB and IASB have collectively been engaged in a project to create a common standard on lease accounting in an attempt to ensure that the assets and liabilities arising from lease contracts are recognized in entities’ statements of financial position.<sup>2</sup> On March 19, 2009, FASB and IASB issued the DP proposing a new approach to lease accounting.<sup>3</sup> The DP proposed changing how lessees account for leases, particularly changing the accounting for leases that are currently classified as operating leases.

Specifically, the DP proposed an overall approach that would apply the existing “finance lease” model to all leases, including operating leases. Under this approach, a lessee would recognize an asset on the balance sheet representing the lessee’s right to use the leased item and a liability for its obligation to make payments. Applying the existing finance capital lease model to all leases would require that all leases be accounted for as though the asset was purchased and financed with a loan. The DP would also require lessees with capital leases to make adjustments and rebook assets and liabilities currently on balance statements.

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<sup>2</sup> See <http://www.fasb.org/leases.shtml#objective>.

<sup>3</sup> Discussion Paper, available at [http://www.fasb.org/draft/DP\\_Leases.pdf](http://www.fasb.org/draft/DP_Leases.pdf); and <http://www.iasb.org/Current+Projects/IASB+Projects/Leases/Discussion+Paper+and+Comment+Letters/Discussion+Paper+and+Comment+Letters.htm>.

FASB and IASB stated that the purpose of the changed approach to lease accounting would be to provide a more "complete and understandable picture of an entity's leasing activities."<sup>4</sup> The DP would require lessees to provide more information on financial statements.

### **Small Business Concerns**

The proposed capitalization of all leases would impact all small businesses that lease equipment or real estate, regardless of the monetary value or duration of the lease. As an example of the wide-reaching scope of the proposed standard, even a small business that leased a \$1,000 photocopy machine for a fixed period of two years would be required to change its financial statement and report the photocopier on its asset sheet as if the small business owned the photocopier.

Small business stakeholders that have been in contact with Advocacy have expressed concern with the proposed lease accounting standard contained in the DP. As described in more detail below, small business stakeholders have identified two concerns associated with the proposed lease accounting standard regarding: (1) the capitalization of all leases, including operating leases; and (2) the increased bookkeeping and analytical costs that would result from compliance with the new standard.

#### *Capitalization of All Leases*

Under the current lease accounting standards, operating leases are accounted for as a rental expense and do not impact small business lessees' liability on financial statements. Because the DP would reclassify operating leases as capital leases, this would substantially increase the debt shown on small business lessees' financial statements. This would also cause these small companies to have financial statements that show reduced earnings and reduced capital. Further, with more assets on their balance sheets, certain small business lessees, like community banks, might be required to increase their capital reserves as risk mitigation to satisfy capital adequacy rules.

#### *Increased Bookkeeping and Analytical Costs*

The proposed changed standard would add complexity and result in small business lessees with financial statements that are less understandable and comparable than they are under the current standards. This increased complexity would also result in costs imposed on small businesses. Learning to comply with and actually implementing the proposed new lease accounting standards would require small business owners to incur training and attorney costs.

As an example, under the DP, all leases would have book/tax timing differences requiring complex deferred tax accounting; currently, most small business lessees do not contend with book/tax timing differences because the current lease accounting rules are consistent with the IRS lease rules. Additionally, the DP would also require small businesses that lease to be responsible for new, complicated calculations, including estimating contingent rents and renewal rents, revising estimates, and recording adjustments.

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<sup>4</sup> *Id.*

## Recommendations

Advocacy commends the efforts of FASB and IASB to create a common standard for lease accounting. However, because the costs and complexity of the proposed standard would likely result in small business lessees with financial statements that are less understandable and comparable than they currently are, Advocacy recommends that FASB and IASB develop alternatives that would minimize the burden of the proposed standard on small businesses engaging in shorter-term, less-costly lease transactions.

In particular, Advocacy recommends that FASB and IASB create a de minimis exception to the proposed standard that would exempt lease transactions of less than \$250,000 from the proposed standard. The Equipment Leasing and Finance Association (ELFA) recognizes that lease transactions of less than \$250,000 are considered “small ticket” leases relative to costlier and more significant lease transactions.<sup>5</sup> Exempting lease transactions of less than \$250,000 from the proposed standard would exclude small businesses with “small ticket” leases from administering the costly and complicated proposed standard but would still accomplish the boards’ objective by only requiring those significant, non-small ticket lease transactions of \$250,000 or more to comply with the new standard.

We appreciate this opportunity to voice the concerns of small businesses. Advocacy looks forward to working with FASB and IASB on this issue. If you have any questions or require additional information please contact Assistant Chief Counsel for Dillon Taylor at (202) 401-9787 or by email at [Dillon.Taylor@sba.gov](mailto:Dillon.Taylor@sba.gov).

Sincerely,

/s/

Shawne McGibbon  
Acting Chief Counsel for Advocacy

/s/

Dillon Taylor  
Assistant Chief Counsel

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<sup>5</sup> See, e.g., <https://www.elfaonline.org/pub/about/membership/MbrApp/>.