

December 1, 2010

**VIA ELECTRONIC MAIL**

Russell G. Golden  
Technical Director  
File Reference No. 1850-100  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116  
Electronic Address: [director@fasb.org](mailto:director@fasb.org)

Re: Proposed Accounting Standards Update, Leases (Topic 840)

Dear Mr. Golden:

The Office of Advocacy (Advocacy) offers the following comment to the Financial Accounting Standards Board (FASB) regarding the Exposure Draft (ED) of a proposed Accounting Standards Update of Leases (Topic 840). The ED 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 ED invited comments on all matters discussed in the paper.

FASB intends that the proposed approach announced in the ED, if finalized, would mandate that leasing entities provide a more consistent picture of their leasing activities in accounting statements.<sup>1</sup> Advocacy commends FASB for its efforts to create a common standard on lease accounting but recommends that the board 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 create a de minimis exception to the standard that would exempt lease transactions of less than \$250,000 from the proposed standard.

---

<sup>1</sup> Exposure Draft, *available at* <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175821125393&blobheader=application%2Fpdf>.

## Office of Advocacy

Advocacy was established pursuant to P.L. 94-305 to represent the views of small business before Federal agencies and Congress.<sup>2</sup> 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 has 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>3</sup> On March 19, 2009, FASB issued a Discussion Paper (DP) proposing a new approach to lease accounting.<sup>4</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 were 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.

FASB 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>5</sup> The DP would require lessees to provide more information on financial statements.

On June 30, 2009, Advocacy filed a comment letter with FASB in response to the DP.<sup>6</sup> In the comment letter, Advocacy conveyed the concerns of small businesses regarding the DP and

---

<sup>2</sup> 5 U.S.C. § 634a (1976). [http://www.sba.gov/advo/laws/law\\_sta.html#634a](http://www.sba.gov/advo/laws/law_sta.html#634a).

<sup>3</sup> See <http://www.fasb.org/leases.shtml#objective>.

<sup>4</sup> Discussion Paper, available at [http://www.fasb.org/draft/DP\\_Leases.pdf](http://www.fasb.org/draft/DP_Leases.pdf).

<sup>5</sup> *Id.*

<sup>6</sup> Comment letter, available at [http://www.sba.gov/advo/laws/comments/fasb\\_iasb09\\_0630.html](http://www.sba.gov/advo/laws/comments/fasb_iasb09_0630.html).

recommended that FASB develop alternatives that would minimize the burden of the proposed standard on small businesses engaging in shorter-term, less-costly lease transactions. Specifically, Advocacy recommended that FASB create a de minimis exception to the standard that would exempt lease transactions of less than \$250,000 from the proposed standard.

Advocacy recommended exempting this lease transaction amount because 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>7</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 FASB’s objective by requiring significant lease transactions of \$250,000 or more to comply with the new standard.

In its ED, issued on August 17, 2010, FASB continued to propose an overall approach that would apply the existing “finance lease” model to all leases, including operating leases. The ED did not adopt or otherwise address Advocacy’s recommendation to create a \$250,000 exception to the standard from the proposed standard.

### **Small Business Concerns**

As described in Advocacy’s June 30, 2009, letter, 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 photocopier 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 ED. 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 ED 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.

---

<sup>7</sup> See, e.g., <https://www.elfaonline.org/pub/about/membership/MbrApp/>.

### *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 less comparable than they are under the current standards. This increased complexity would also result in costs imposed on small businesses. In addition, 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 ED, 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 ED 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.

### **Recommendations**

Advocacy commends the efforts of FASB 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 again recommends that FASB develop alternatives that would minimize the burden of the proposed standard on small businesses engaging in shorter-term, less-costly lease transactions. Specifically, Advocacy continues to recommend that FASB create a de minimis exception to the proposed standard that would exempt lease transactions of less than \$250,000 from the proposed standard. 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 FASB’s objective by requiring significant 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 you 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,

Winslow Sargeant, Ph.D.  
Chief Counsel for Advocacy