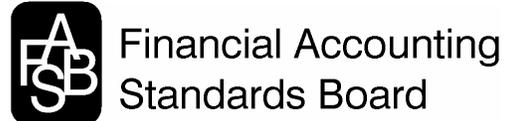


MINUTES



To: Board Members
From: Gagon (ext. 322)
Subject: Minutes of November 17, 2004 Board Meeting **Date:** November 22, 2004
cc: Smith, Bielstein, Petrone, Leisenring, Project Team, Golden, Swift, Polley, Gabriele, Vincent, Getz, Intranet (e-mail)

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Leveraged lease accounting

Basis for Discussion: Board Memorandums dated October 29, 2004 and November 16, 2004

Length of Discussion: 10:40 a.m. to 11:20 a.m.

Attendance:

Board members present: Herz, Trott (by phone), Schipper, Batavick, Seidman, and Schieneman

Board members absent: Crooch

Staff in charge of topic: Sogoloff

Other staff at Board table: Smith, Golden, Kispert, and Gagon

Outside participants: None

Summary of Decisions Reached:

The Board discussed two issues related to transactions that are classified as leveraged leases under the provisions of FASB Statement No. 13, *Accounting for Leases*. The Board considered whether to issue guidance to address these issues and, if so, in what form.

The Board decided that a change in the *timing* alone of the tax benefits that are realized by a lessor in a leveraged lease should result in a recalculation of the leveraged lease. The Board also discussed whether a threshold or scope limitation should be established such that a recalculation need not be performed in all instances when there is a change in timing. The Board directed the FASB staff to conduct additional research on what threshold or scope limitation, if any, should be incorporated into the guidance.

The Board tentatively decided that a lessor should reevaluate the classification of a leveraged lease when a recalculation for a change in the timing of the tax benefits is performed. However, this decision is subject to further staff research of EITF Issue No. 86-43, "Effect of a Change in Tax Law or Rates on Leveraged Leases."

The Board discussed whether guidance should be issued in the form of an FASB Staff Position or an Interpretation. The Board did not reach any decision and will discuss this at a future Board meeting.

Objective of Meeting:

The objectives of the Board meeting were for the Board to decide (1) whether a recalculation of a leveraged lease should be performed for a change in the timing of tax benefits and, if so, (2) whether a lessor should reevaluate the classification of a leveraged lease based on the recalculation.

Matters Discussed and Decisions Reached:

1. Mr. Sogoloff began the meeting by stating that recently, a number of issues have arisen regarding the accounting for potential income tax settlements in connection with transactions classified as leveraged leases under the provisions of Statement 13. He stated that these issues may apply to certain entities that are lessors or have made equity investments in entities formed to own the property being leased.

2. Mr. Sogoloff stated that while these issues are applicable for all leveraged lease transactions, the most significant impact will likely stem from transactions commonly referred to as “LILO” (lease-in/lease-out) transactions and “SILO” (sale-in/lease-out) transactions. LILO and SILO transactions are typically classified by lessors as leveraged leases in accordance with Statement 13. He stated that the Internal Revenue Service (IRS) issued Revenue Ruling 99-14 which states that the LILO transaction lacks the potential for significant economic consequences other than the creation of tax benefits and, therefore, lacks economic substance. Additionally, he stated that in October 2004, the American Jobs Creation Act of 2004 was enacted which restricts the tax benefits associated with SILO transactions.
3. Mr. Sogoloff stated that it is the FASB staff’s understanding that the IRS has settled or is in the process of settling with many U.S. companies that have entered into these types of transactions. As part of that settlement, a lessor may suffer a permanent loss of tax benefits or a temporary loss of tax benefits. He stated that a permanent loss of tax benefits would result in a change in *amount* of tax benefits to be realized over the lease term while a temporary loss of tax benefits would result in a change in *timing* of tax benefits to be realized over the lease term.
4. As a result of the income tax settlements or potential settlements, Mr. Sogoloff stated that questions have arisen regarding the impact on leveraged lease accounting when a change in timing of tax benefits occurs. He stated that the FASB staff is prepared to present three issues to the Board for the Board’s consideration at the meeting. He stated that depending on the Board’s decision on the first issue, the second issue may or may not need to be addressed. Furthermore, he stated that the staff will ask the Board whether guidance should be issued in the form of a FASB Staff Position or an Interpretation. The issues the staff presented to the Board are as follows:
 - a. Does the Board believe that a recalculation of a leveraged lease should be performed in situations in which the tax benefits are expected to be realized during the lease term but the tax benefits are not expected to be realized during the periods originally contemplated by the lessor at lease inception (that is, a change in timing of the tax benefits alone)?
 - b. If the Board does not believe a change in timing of tax benefits alone should result in a recalculation, when there is both a change in timing and amount of tax benefits, should the impact of a change in timing be included in the recalculation that is triggered by a change in amount?

c. Does the Board believe a lessor should reevaluate the classification of a leveraged lease when a recalculation of the lease is performed?

5. Each of these issues is discussed below.

Should a Recalculation be Required for a Change in the Timing of Tax Benefits Alone?

6. Mr. Trott stated that even when there is just a timing difference, there are very significant cash flow issues that arise such that the settlement in many cases will require the repayment of previously recognized (for both financial statement and tax return purposes) tax benefits.

7. Mr. Trott stated that with respect to the question, leveraged leases are a mechanism for passing tax benefits from the lessee to the lessor, and leveraged lease accounting was significantly influenced by the cash flows between the lessor and the government and the lender as the third party. He stated that the biggest determinant as to what transactions qualify for leveraged lease accounting was the impact of the transaction between the lessor and the government. He stated that if the relationship between the lessor and the government changes, the change should be reflected in the financial statements of the lessor. Therefore, he stated that there should be a recalculation performed when the timing of tax benefits has changed.

8. Mr. Schieneman stated that he agrees with Mr. Trott's analysis of the cash flow changes. He stated that the effect of the change in cash flow is to dramatically reduce the rate of return. He stated that the problem he has with accounting for transactions that are going to be winding down is that the income has already been reflected in prior years. If a recalculation was performed, an entity would recognize a loss for the income that was previously recognized, only to rerecognize that income over the remaining life of the lease. He stated that from his perspective, entities would be essentially recognizing income twice on these types of transactions. Therefore, he doesn't believe a recalculation should be required because he does not want the income to be recognized twice.

9. Mr. Golden clarified that the staff is not bringing this question to the Board solely for LILLO and SILO transactions—the guidance would apply broadly to all leveraged lease transactions. Therefore, the Board's decision would apply for future transactions that are accounted for as leveraged leases.

10. Mr. Schieneman stated that he did not realize the staff was talking about leveraged leases in general—he thought the issues to be addressed by the Board applied only to LILO and SILO transactions.
11. Ms. Seidman stated that keeping in mind that this issue is being addressed in a broader circumstance for all leveraged leases, it seems to her that if a minor change in timing occurs she may agree that a recalculation may not be required. However, she stated that she believes that at some point in time, the change in timing of tax benefits would be so significant that a recalculation should be required. Therefore, she stated that depending on the facts and circumstances, a recalculation may or may not be required. She questioned whether an appropriate approach for this issue would be to state that if the change in timing is so significant that it calls into question whether the requirements in paragraph 42(d) of Statement 13 have been met, then a recalculation should be performed. However, if the change in timing is “minor” and, therefore, does not have a significant impact, she is not sure that she would require a recalculation in those cases.
12. Ms. Schipper stated that she agrees with Mr. Trott’s conclusions but followed a different path of reasoning to get to the same conclusions. She stated that she understands Ms. Seidman’s concerns about minor changes in timing that occur that have no impact on the economic return, but she stated that she does not know how she would describe the notion of “minor.” She stated that if the timing changes alter the economic return of the leveraged lease, then she would require a recalculation. Messrs. Batavick and Herz agreed with Ms. Schipper’s comments and conclusions.
13. Mr. Smith stated that the staff can bring a recommendation back to the Board at a future meeting on how to describe the notion of “minor” when determining if a recalculation of the leveraged lease is required. This may also be done through limiting the scope of the project.
14. The Board decided that when a significant change in the timing of tax benefits occurs, a recalculation should be required. The Board will discuss the threshold and scope issues at a future meeting after the staff has conducted additional research. The Board’s decision obviated the need to address the second issue that the staff was prepared to discuss, which was outlined in paragraph 4(b) of these minutes.

Should a Lessor Reevaluate the Classification of a Leveraged Lease when a Recalculation of the Lease is Performed?

15. Ms. Schipper stated that she believes the answer to this question is “yes,” and that the dissent in Statement 13 makes it clear that the prior Board that addressed Statement 13 believed that leveraged leases are special and should have special accounting. She stated that she would not apply paragraph 9 of Statement 13, which applies to all types of leases other than leveraged leases, and she would, therefore, reevaluate the classification of the leveraged lease.
16. Mr. Golden stated that he agrees with Ms. Schipper that leveraged leases were designed to have special accounting. He stated that paragraph 9 of Statement 13 talks about negotiations between a lessor and lessee, but makes no mention of a third party creditor. He stated that practice has taken the view that leveraged leases involve three parties, the lessor, the lessee, and a third party unsecured creditor. However, there is arguably a fourth party that should be considered, the government, when determining whether the four criteria of a leveraged lease have been met.
17. Mr. Herz agreed with Ms. Schipper and Mr. Golden’s comments that leveraged leases have special accounting. He clarified that to his knowledge there are no other instances or types of leases where lessors are permitted to keep unsecured debt off of the balance sheet. He pointed out that being able to keep unsecured debt off the balance sheet is unique to leveraged leases and helps reinforce that leveraged leases have special accounting as Ms. Schipper and Mr. Golden had implied.
18. Ms. Seidman mentioned Issue 86-43 and asked the staff if it had any insight into why Issue 86-43 required a recalculation but did not require a reclassification. She asked if there was something different from the situation in Issue 86-43 than in the current situation that the Board was discussing. The staff stated that they would research that question further and bring it back to the Board at a future meeting.
19. Mr. Batavick clarified that the staff is asking whether there should be a reevaluation, not necessarily a reclassification. If upon reevaluation the lease still meets the criteria of a leveraged lease, it would continue to be accounted for as a leveraged lease.

20. The Board decided that pending the staff's research of Issue 86-43, a lessor should be required to reevaluate the classification of a leveraged lease when a recalculation of the lease is performed.
21. Additionally, the Board did not make any decisions on the form of this guidance. The Board asked the staff to bring a scope question back to the Board before it makes any final decisions on the appropriate form of the guidance.

Follow-up Items:

The Board asked the staff to conduct additional research and make recommendations at a future Board meeting on the following issues:

- a. Whether a threshold or scope limitation should be established such that a recalculation need not be performed in all instances when there is a change in timing.
- b. Provide insight as to why Issue 86-43 requires a recalculation but not a reclassification of a leveraged lease.
- c. Whether the guidance should be issued in the form of a FASB Staff Position or an Interpretation.

General Announcements:

None