

September 28, 2012

Ms. Leslie Seidman, Chairman  
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**Delivered Electronically**

**SUBJECT: COMMENTS RE: Final Tentative Decisions in the Lease Project**

Dear Chairman Seidman and Chairman Hoogervorst:

We, the undersigned, represent a coalition of railcar lessors doing business in North America, with some companies operating globally as well. Our companies represent 13 of the largest railcar lessors in the US. According to the Association of American Railroads (AAR), more than fifty-five percent of the 1.5 million railcars utilized in the US are leased. The vast majority of our lessee-customers enter into these railcar leases for the purpose of gaining the right to temporarily use the cars in their respective businesses, which cover a broad range of industries. We have closely followed the progress of the Lease Project and wish to comment on the tentative decisions which we understand will be included in the forthcoming Exposure Draft. We have significant concerns regarding the proposed lease classification approach as well as the proposed lessor accounting model. We also question whether the Board's recent decisions will provide improved information for users of lessee and lessor financial statements over today's GAAP and share the concerns expressed by the Financial Accounting Standards Board's (FASB) Investors Technical Advisory Committee (ITAC).

By way of background, railcar lessors typically lease and manage extensive fleets of railcars over the assets' useful lives and retain risks of equipment ownership including maintenance and obsolescence. These railcar assets represent our "stock in trade" assets rather than financial investments. In addition to leasing railcars and locomotives, we often provide maintenance, repair, and administrative (e. g., regulatory and property tax compliance) services. While our customers may choose among any of the product offerings individually or combined as a full service lease, our leases are typically full service leases with lease terms ranging from three to

seven years. We may also transact short term per diem leases and net leases. Railcars may have a useful life of up to fifty (50) years or longer, so we may lease one railcar as many as fifteen times to one or more lessees. We generally depreciate all of our railcars on a straight line basis to an estimated salvage value. Thus the depreciation policy is not impacted by whether the railcar is on-lease. Rental rates are primarily based on supply and demand and the prevailing economic climate rather than an interest-based rate derived from a discounted cash flow analysis. For the reasons stated above, we believe our business represents an “operating” lease model. Furthermore, we believe railcars share the characteristics of “investment property”, such as land and buildings, which are high value assets typically leased multiple times over long useful lives.

Our customers often view their leases as service arrangements where they acquire the temporary right to use the railcars and treat the rent paid as an operating expense. Most often, the prime reasons for leasing are to obtain the use of railcars for a relatively short term and to outsource the servicing and maintenance responsibilities. Our customers generally view their leases neither as financings of the railcars nor as financings of the right of use of the railcars; in other words, our customers generally are not interested in owning railcars, but rather they require access to functioning railcars to support their primary business operations.

### **Lease Classification Tests**

We agree with the Boards’ conclusion that there are two types of leases. However, we have concerns with the Boards’ decision to create different classification models based primarily on whether the leased asset is real estate or equipment. We believe the current approach lacks a conceptual basis and appears to be an arbitrary rule that will generally result in front-ended expenses for equipment lessees and straight-line expenses for real estate lessees. We are not clear why the Boards believe straight-line expense is generally appropriate for real estate leases but not for equipment leases or how this approach results in relevant information for users of financial statements. Further, we note that the objective of the joint project is to develop a new approach to lease accounting that will provide appropriate recognition of the assets and liabilities representing rights and obligations arising under lease contract. We do not understand how a rule focusing on the nature of the leased asset, rather than the rights and obligations arising under the lease contract, is consistent with this objective. Failure to develop a consistent principles-based classification approach for both equipment and real estate leases will result in different accounting for economically similar transactions.

In our view, there are two types of leases for lessees, regardless of the type of asset leased: those that transfer substantial ownership risks and those that merely transfer a temporary right of use of an asset. This is consistent with the conceptual basis of FAS 13 and IAS 17, which have been in effect since 1977 and 1984, respectively. The classification and resulting financial information are well understood by users and generally provides for the same accounting for real estate and equipment leases. The classification tests are consistent with the legal and tax systems in the US so the accounting records and financial reports provide relevant information for tax compliance and bankruptcy analysis of assets and liabilities. For these reasons, we believe classification based on the criteria currently existing in GAAP, excluding the quantitative thresholds of ASC Topic 840, would be preferable to the Boards’ tentative conclusions.

We also have concerns about the application of proposed lease classification criteria and the meaning of the term “insignificant” as it relates to the portion of the economic life of the leased asset “consumed” during the lease term. We understand that the FASB Staff believes the lease term should be compared to the asset’s remaining useful life for purposes of determining which lease accounting model to apply (the “interest and amortization” (I&A) model or the “single lease expense” (SLE) model). We believe this approach will produce illogical results in practice. With respect to our specific asset types, the utility value (that is, the value to the lessee) of a properly maintained railcar could be the same for a new railcar with a fifty year useful life as for a forty year old railcar. If the lease term is five years, then the percentage of the lease term relative to the remaining useful life of a new railcar is ten percent (possibly insignificant). However, if the railcar is forty years old, the lease term is fifty percent of the remaining useful life (most likely significant). This classification approach would mean that both lessees and lessors could have significantly different accounting for transactions with the same economic effects depending solely on the age of the leased railcar. We note that currently, US GAAP addresses this situation by providing that the lease term (75%) and minimum lease payment (90%) tests should not be used in determining lease classification if the beginning of the lease term falls within the last 25% of the total estimated economic life of the leased property. We recommend that the Boards provide similar guidance in the revised exposure draft.

### **Lessor Models**

In previous meetings, the Boards tentatively decided to allow lessors of “investment properties” to use the operating lease method which best suits their business model, with the rebuttable presumption that “investment property” is real estate. We anticipated that the Boards would debate aspects of lessor accounting in their subsequent meetings, including possibly expanding the definition of investment properties to include equipment leased under the business model that we employ. This new tentative decision to mandate lessor symmetry to lessee accounting using the new lessee classification test appears to have been adopted with virtually no additional debate or consideration of lessor specific issues.

We believe that lessor accounting should be based on the business model of the lessor. Similar to real estate lessors, the economics of our business model include revenues when our assets are on lease and significant costs over the asset’s life, including depreciation, maintenance, repairs, insurance and taxes. We generally retain significant asset residual risk and often provide full-service leases to ensure that our assets are well-maintained while on lease. We sometimes buy cars on a speculative basis with no committed lessee in order to secure “inventory” that can be leased to new or existing customers. Our cars can be idle between leases and when they are being repaired. The interest cost to carry our fleet of leased cars is only one of the primary expenses of our business - other primary expenses include railcar maintenance expenses and property taxes. Consequently, rent revenue earned from the lease more closely matches the nature of the key costs. As a result, we believe operating lease accounting best reflects the economics of our business as lessors and provides the most useful information to readers of our financial statements.

In contrast, many “financial” lessors buy assets only when they have a lessee committed to a lease for a significant portion of the asset’s life. Each lease is priced as a discrete financial

transaction including the assumption that the lessor will sell the asset at lease expiry rather than continue to lease it. Financial lessors' leases are usually "triple net" leases, meaning the lessee is responsible for the operating costs of the leased asset. The primary risk for most financial lessors is often the credit risk related to a lessee default. For certain of these financial lessors, the receivable and residual method may be reasonable as it would present finance revenue alongside the interest expense, which is often the primary cost on a financial lessor's statement of comprehensive income.

We note that if the current proposal is implemented, railcar lessors may have both receivable and residual leases as well as operating leases in their portfolio, creating an unintelligible mix of finance revenue and rent revenue. As a result, rent revenue per railcar, a key performance measure that reflects the relative efficiency of our leasing business, will be lost. Another detrimental consequence is that depreciation expense will be presented for only a portion of the rental fleet on operating leases and, potentially, for railcars that are idled between assignments on receivable and residual leases. We do not believe these results faithfully represent the economics of our business.

### **Cost Benefit Analysis**

We believe that the proposed changes for lessors will require significant costs to implement and maintain with no tangible benefit (possibly some negative effects) in improved financial information for users. Lessors will be required to evaluate each lease for appropriate classification, and will also need to regularly determine new estimates for the associated receivable and residual amounts along with, potentially, any profit to be recognized at lease commencement. In addition, significant systems changes will be required to provide the ability to "turn off" book depreciation for leased assets pursuant to the receivable and residual approach. Further, we may be required to evaluate the lease classification at the individual leased asset (railcar) level depending on the age of the underlying railcar (early in life vs. late in life). For example, it is possible that in a given lease contract of one hundred otherwise similar railcars, fifty could be reported on an operating lease method and the other fifty could be reported on a receivable and residual method.

The benefits of the proposed approach for users are doubtful at best. The feedback from ITAC suggests that the proposed lessee model will not provide users with better information than they receive under current guidance. We also believe that users of lessor statements will find the proposed changes even less useful than the lessee changes. Lessors with a mix of operating and receivable and residual leases (which may be common due to various interpretations of the term "insignificant") will be required to present an income statement that will bear no resemblance to how those businesses typically manage operations and will fail to provide a coherent picture of financial performance for users. Under the proposed approach, it is conceivable that a railcar lessor could present a balance sheet without any railcar assets. Rather than providing benefits, we believe these changes will impose substantial costs on users as they attempt to analyze and adjust the financial statements to compare multiple companies or the same company over several periods.

## Conclusion

We respectfully request the Boards to re-open deliberations, particularly with respect to lessor accounting. In our opinion, current GAAP for lessor accounting is operating effectively and appropriately reflects the underlying substance of the typical operating lease transaction. We share the concerns noted by ITAC, and believe many of those concerns could be addressed by retaining the concepts of existing GAAP for purposes of lease classification.

We are available to assist the Boards and staff and provide any additional information as may be necessary to further support our stated positions.

Sincerely,

American Railcar Industries, Inc.  
American Railcar Leasing, LLC  
Chicago Freight Car Leasing Co.  
CIT Rail  
Equipment Leasing and Finance Association (ELFA)  
First Union Rail Corporation, A Wells Fargo Company  
Flagship Rail Services, LLC  
GATX Corporation  
Helm Financial Corporation  
Midwest Railcar Corporation  
The Andersons, Inc.  
The Greenbrier Companies, Inc.  
Trinity Industries, Inc.  
VTG Rail, Inc.