AVIATION WORKING GROUP

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Re: **Leasing Accounting Project – Lessee Accounting Approaches and Lessor Accounting Models**

Dear Mr. Hoogervost and Ms. Seidman,

The Aviation Working Group (***AWG***) is an industry group whose members consist of the leading manufacturers, lessors, and financiers of aircraft and aircraft engines. AWG has been closely following the leasing accounting project and provided several comment letters on it. At this stage, we would like to express views on the lessee accounting approaches being considered by the Boards (the International Accounting Standards Board and the Financial Accounting Standards Board), as well on lessor accounting models.

Lessee accounting approaches

As a threshold matter, AWG supports recognizing the right-of-use asset and lease liability on a lessee's balance sheet. It is a practical solution to resolving concerns about off-balance sheet transactions. That support is expressed, given such practicalities, despite our view that executory lease contracts have a limited set of obligations. A lessee's right to use the underlying leased asset is conditioned on its contractual performance, including payment of amounts due thereunder.

The Boards are considering four accounting approaches for lessees. We recommend the use of Approach D for operating leases, while retaining a capital lease model for leases that are in substances purchases and financing of leased assets. AWG supports removing the bright line tests in favor of a transfer of substantial risks and rewards. Guidance similar to that in IAS 17 would be appropriate.

Below are summary comments on each of the proposed lessee accounting approaches. The order reflects a descending order of support.

Approach D – whole contract approach

AWG supports Approach D since (1) it recognizes the lease contract as one unit of account, and (2) the right-of-use asset and lease liability are inextricably linked at lease commencement and throughout the lease term. This approach does not view a lease as a financing transaction since, economically, it is not one. AWG supports recognizing the lease payments as lease expense evenly throughout the lease term, as that represents the economics of a lease contract. We believe that Approach D represents the approach that will allow the Boards to successfully advance the new lease accounting standard.

Approach B – interest-based amortization

With reservations, AWG would find Approach B acceptable. While this approach does not maintain the "inextricably linked" characteristic of the right-of-use asset and lease liability, it reflects the economics of operating lease transactions (in effect, the consumption of the future benefits of a right-of-use asset) to a reasonable degree.

Our reservations are as follows: First, although users may view the amounts and timing of lease payments as a practical means to measure the future benefits of a right-of-use asset, such terms set out the result of negotiations between lessee and lessor. They do not necessarily indicate future usage of the underlying leased asset by the lessee. Secondly, in contrast with Approach D, the cost allocation of the interest and amortization expense in Approach B does not represent the *true* economics of an operating lease contract. Thirdly, Approach B introduces a new method for amortizing a right-of-use asset which has no accounting practice precedent in the context of owned assets.

<u>Approach C – underlying asset approach</u>

AWG does not support this approach. Approach C does not reflect the true economics of an operating lease contract. Nor are the economics reasonably reflected. It assumes that the lessee is borrowing the residual asset and financing this borrowing over the lease term. That is not the case. If the lessee were borrowing the residual asset, the lessee would recognize a liability to return the underlying asset. That is not proposed in this approach. From a practical perspective, implementing the "borrowing" accounting for the residual asset will not be feasible without significant cost related to information systems and processes. Approach C would be operationally complex to implement due to the right-of-use asset amortization, and, similar to Approach B, introduces a new amortization method without accounting precedent in this context.

<u>Approach A – current tentative decision</u>

AWG does not support this approach since an operating lease contract is not a financing transaction. This approach is cenetred on that incorrect assumption, and, thus, is conceptually flawed. It also does not retain the "inextricably linked" characteristic of the right-of-use asset and lease liability. The cost allocation resulting from the interest and amortization expense does not reflect the economics of a lease contract.

<u>Lessor accounting models</u>

The Boards have not addressed the topic of lessor accounting models for several months. The Boards should re-focuse on this topic.

As a starting point, the receivable and residual model proposed by the Boards does not reflect the economics of operating lease contracts.

AWG supports retaining current accounting guidance for lessors. AWG would support removal of the current U.S. GAAP bright line tests in favor of the guidance along the lines of IAS 17. In this context, the Boards should also make use of the relevant transfer of control concepts in the revenue recognition proposed standard. Lessors should be permitted to use different accounting models (operating v. finance models) depending on the commercial intent of the subject lease contract. Specifically, if a lessor expects the asset to be returned at the end of the lease, an operating lease accounting model should be used. If not, a finance lease accounting model should be used. AWG recommends that the Boards (1) include clear guidance for differentiating between leasing and service activities, and (2) ensure consistency with the proposed revenue recognition standard.

We would be pleased to discuss these matters in more detail.

Sincerely yours,

Jeffrey Wool
Secretary General
Aviation Working Group

CC: Claude Brandes (Airbus) and Scott Scherer (Boeing), AWG Co-Chairman