ACCOUNTING
BLOG

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Diversity among Analysts Makes Objective of FASB-IASB Lease Accounting Difficult to Achieve

NORWALK, Conn.-The diversity in how analysts and investors look at leases in practice appears to be making it much harder for the Financial Accounting Standards Board and the International Accounting Standards Board to achieve their objectives for the joint lease accounting project.

The boards have said that one of the key reasons for addressing lease accounting was that current lease accounting standards under both generally accepted accounting principles (GAAP) and international financial reporting standards (IFRSs) have been criticized as failing to meet the needs of financial statement users and presents structuring opportunities. The standards-setters have been redeliberating towards issuing an exposure draft in the fourth quarter this year-their second proposal.

In June the FASB and IASB decided upon an approach in which some lease contracts would be accounted for using an approach similar to that proposed in the 2010 leases Exposure Draft and some leases would be accounted for using an approach that results in a straight-line lease expense.

If financial statement users were unified in the manner in which they looked at leases it would be much easier for the boards to tailor the outcome to meet investors' needs. However, during a July 24 discussion with the FASB, members of its Investors Technical Advisory Committee made it clear that given the divergent views among analysts, the boards' solution is a compromise that misses the mark.

ITAC members held diverse views on how--in their analysis--it is most useful to present leases, said Gary Buesser, Director of Lazard Asset Management, LLC. ITAC's views fell among three categories:

- all leases should be off the balance sheet as rent expense
- all leases should be on the balance sheet with an amortization and interest approach

- it is a derivative, that is, a series of forwards on the entity's ability to extend its right to use the asset (minority view).

Form of Financing.

The crux of the whole issue may be stemming from the broad based belief among investors, financial statement users and analysts that leases are a form of financing. A significant number of analysts and investors who are using financial statements will make adjustments to put an item back on the balance sheet for leases, according to the ITAC discussion.

Some ITAC members said the boards may be in better position if they left the accounting guidance as it is currently with some minor improvements, including enhancements to disclosures that will further improve the ability of analysts and financial statement users and investors to make the adjustments they want to make to get to the numbers that they want to look at.

"Though current lease accounting rules are not ideal, the accounting today allows analysts to adjust in the way they want to adjust," said Mark LaMonte, Managing Director, Chief Credit Officer of Moody's Investors Service Financial Institutions Group.

"I think it's easier for me to adjust and get the lease number I want on the balance sheet from the current accounting, than it is to unwind a kind of half way there number and then have to adjust," said LaMonte.

"In our shop we believe leases belong on the balance sheet, so if they're already on as capital leases we accept it, if they're off balance sheet as operating leases, we're going to put them on," he said.

The Project.

Leasing is an important source of finance for many companies who lease assets. A FASB summary states that it is therefore important "that lease accounting provides users of financial statements with a complete and understandable picture of an entity's leasing activities."

FASB member Lawrence Smith told the ITAC that current GAAP has two different types of leases, but it is based upon the approach that an entity would follow a whole asset approach, that is, that it is either leasing an asset or effectively it is like it is buying the asset.

"[This is] why we get the difference between operating leases and capital leases," he explained. "In general does ITAC have a view that perhaps the way we're accounting for it now, following the whole asset is the appropriate way of doing it?" asked Smith.

With the level of diversity among analysts, even among ITAC, it would be difficult to come up with a one sized fixed all solution, the analysts said. "Maybe the best thing to do is to make sure that the information is there so that people can adjust to what they want," LaMonte said. "Keep it as simple as possible and give information so that people can make the adjustments they want to make," he said.

Dual Model Unanimously opposed.

One of the reasons the board decided to go down the route of having a dual model is because the board became convinced during outreach with constituents that there is more than one kind of lease economically, and to properly reflect that a dual model was needed.

But ITAC members, who unanimously opposed the dual model income statement approach, said they found it complex and confusing. "We thought that if I lease real estate, I continue with today's current accounting, if I moved toward leasing equipments, I go to a financing arrangement and I have amortization plus interest expense, this could require many adjustments in particular for companies that have both real estate leases and equipment leases," said Buesser. "So we felt that there was something about that--that supply," he said.

He stated ITAC's discussion was never one of 'do you think that it's financing and should have one type of accounting, or that the current accounting is appropriate', "but we didn't think that a dual income statement model was appropriate."

Other ITAC members felt that since there were such divergent views amongst users of financial statements, that the board ended up trying to "compromise to make everybody happy" but instead ended up with "a kind of jumbled mess".

Some users like the concept of rent expense, others like the idea of having--if its financing--it reflected in the income statement like a financing (having depreciation and interest expense, said LaMonte, explaining the level of diversity among analysts.

No one Solution would Satisfy.

Overall, ITAC members did not believe that the proposal-expected to be issued in the fourth quarter this year--is an improvement to current lease accounting guidance, said Buesser.

FASB and the IASB in general have felt that no one solution would satisfy everyone and therefore thought that they would do what was imperative in the project. [This was] to get these on the balance sheet and then we'll make different judgment calls about what was the right way to deal with the P&L issues at this point in time," said FASB Chairman Leslie Seidman. "I can hear that none of you think that we got it right," she said.

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