Investor Panel Pans Lease Project Progress
by Nicola White - July 26, 2012
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The FASB and IASB have justified controversial decisions on their lease accounting project by saying investors and analysts deserve more insight into a company's financial obligations.

But some investors are criticizing the project's latest developments, and saying the proposed standard won't give them better information.

At a July 24, 2012, meeting at the FASB's offices in Norwalk, CT, the board's Investors Technical Advisory Committee said attempts to dampen criticism from businesses has watered down the original proposal and still keeps investors in the dark. As a result, investors and analysts will have to continue doing what they've been doing for years—adjusting financial statements for the effects of a company's lease commitments.

"The problem is you have such divergent views and approaches out there for users of financial statements, and where you've kind of ended up in all this is this massive compromise to make everybody happy," Moody's managing director Mark LaMonte said. "You just end up with this jumbled mess in financial statements that people are going to still have to adjust. And I'm not sure what's been improved."

The ITAC members rejected a June decision that varies the treatment on the income statement depending on the type of lease. Some leases will be accounted for as financing arrangements and others like rentals. The distinction will depend on how much of the leased item is used up during the contract. Leases of buildings and property—usually a company's biggest expense—will be treated like rentals, while equipment and vehicle rentals will be considered financing contracts.

The boards endorsed the different approaches because of criticism they received from businesses that if all leases were treated like financing arrangements, a company's income statement would look "front loaded." Companies would appear to have disproportionately large expenses at the beginning of a lease.

The front-loading effect was the result of the FASB and IASB wanting all leases to be recorded as both the value of the leased asset amortized over the contract's life and the remaining payments accumulating interest. Instead, the boards agreed that some leases should be recorded simply as rental expenses, with straight-line, or even, payments over the contract term.

This distinction is "complex and confusing," said ITAC member Gary Buesser, a director at Lazard Asset Management LLC.

Dane Mott, a senior equity analyst at J.P. Morgan Securities Inc., said the resulting number would be arbitrary.

The number “doesn't seem to be based in any sort of conceptual framework,” Mott said.

Morgan Stanley director Gregory Jonas warned that the boards “don’t want to be in a space of having a high-cost model that doesn’t meet anybody’s needs.”

The harsh words came from a group that FASB expected to support the effort to put lease contract liabilities on company balance sheets. The current practice means that investors and credit rating agencies have to estimate how much a company pays to lease its factory equipment, photocopiers, or retail space.

But the complexity of the project and the resistance from industry has been a persistent problem for the FASB and IASB.

FASB Chairman Leslie Seidman seemed deflated when she summed up the boards' decisions.

“I can hear that none of you think that we got it right,” Seidman said.

After the meeting, Seidman toldAccounting & Compliance Alert that the boards would take the comments into consideration when deliberating the second formal proposal that is expected to be released by late November.

This has been a tough summer for the FASB and IASB. During a joint videoconference meeting on July 18, the FASB said U.S. banks had raised too many questions about the mechanics of the impairment phase of the financial instruments project, and the board needed to do more research before agreeing to release a joint proposal with its international counterpart. IASB Chairman Hans Hoogervorst criticized the potential delay, saying it could unravel years of work and be “deeply embarrassing” to the standard-setters. (SeeProgress on Converged Impairment Model Hits Stumbling Block in the July 19, 2012, edition of Accounting & Compliance Alert.)

The joint insurance project also has had problems. In June, Seidman said the FASB and IASB were disagreeing too much on core elements of the project and a converged solution did not seem likely.

The leases project originally was one that found both boards in agreement. It also had the support of the investor community because it would eliminate guesswork, said Georgia Tech accounting professor Charles Mulford.

But the twists in the project have left all parties with little satisfaction, he said.

“If we go through this process, it would be unfortunate if we come out the other end with analysts still having to make adjustments for leases because they disagree with the accounting,” Mulford said.