

OPINION

LETTERS TO THE EDITOR

Accounting Change Isn't Evil Plot. It Recognizes Reality

Reps. Peter King and Brad Sherman ("A Sure-Fire Way to Harm the Economy," op-ed, Nov. 10) considerably overstate the impact of the proposed accounting-rule change that operating leases be capitalized.

They say that this rule change "could cost millions of jobs and billions in lost economic growth" because treating operating leases as debt on corporate balance sheets will prompt lenders to consider the borrower to be more leveraged, and then either reduce future access to debt capital or increase rates to compensate for the increased risk.

However, the capital markets are ahead of the Financial Accounting Services Board and the two representatives, as it is already common practice for operating leases to be treated as debt in loan agreements. While current generally accepted accounting principles (GAAP) treat operating leases as "off-balance sheet" liabilities, banks commonly treat these leases as debt when calculating leverage ratios and covenants. In most cases this change in GAAP would have no effect on leverage tests or covenants.

It's unlikely that a change in the rules would affect corporate values. The change would have no impact on cash earnings or cash return on cash invested, which is what investors use to estimate values. It's analogous to baseball—whether the scorekeeper rules it a hit or an error, the runner

is still on first base.

GAAP is catching up with the capital markets, not leading us all off a cliff.

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How quickly we forget. Despite many knowledgeable voices urging FASB to change policy, its stubborn insistence on imposing mark-to-market accounting in 2008 helped to heighten fears and deepen our economic contraction. When it finally relented in early 2009, the market responded with the start of a bull run we are still enjoying today. Now FASB appears to be taking us "back to the future" pursuing another damaging and capricious change in the name of providing a "complete and understandable picture."

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To think that the capital markets don't consider operating leases when pricing a firm's debt and equity is simply absurd. FASB's new accounting standard recognizes that capital and operating leases are contracts that require the lessee to make periodic payments to the lessor. These obligations are no different than traditional debt where borrowers make periodic payments of interest and principal to the lender. This

change in accounting for leases is directly related to FASB's objective of creating more transparent financial statements. Generally speaking, the chief benefit of more transparency in financial reporting is reduced capital costs since suppliers of capital are more likely to believe that more transparent financial statements are more accurate indicators of a firm's financial condition. Hence, in a more transparent reporting environment, investors have to spend far less time and money monitoring a firm's performance. The result is a lower, not a higher, cost of capital.

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Lease accounting is a perfect example of the failure to report economic reality. Most leases (apart from short-term rentals) are acquisitions of "rights to use" property, often for the property's entire useful economic life. The lessee obtains rights to use and incurs long-term financial obligations, just as when it borrows from a bank to purchase the asset outright. Everyone knows this, but accounting has permitted many leases to remain "off the books," confusing some users and forcing analysts to make adjustments so that actual leverage and financial commitments can be properly understood.

The proposals would take a giant step toward reporting economic reality. The costs projected haven't been demonstrated, but it would be no different from the costs of complying with SEC rules, other government-imposed mandates and GAAP. There is a price to be paid for decision-relevant information to protect investors.

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