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Technical Director
Financial Accounting Standards Board

File Reference #2013-270
Proposed Accounting Standards Update (Revised) – Leases (Topic 842)

Thank you for the opportunity to comment on the recently released Lease Accounting Exposure Draft.

Cover & Rossiter is a regional accounting firm with offices in Wilmington and Middletown Delaware. We provide audit, tax and other services to nonprofits of all sizes, small- to medium-sized businesses and individuals primarily in the Delaware Valley region. The comments below will look at the changes proposed in the exposure draft from the perspective of those clients.

We registered our objections to the original 2010 exposure draft shortly following its issuance. While minor changes have been made as accommodations to those concerns, our position that the exposure draft will cause confusion, does not take into account the full costs of implementation and ongoing compliance and will be thwarted in achieving its desired objectives remains unchanged.

While I respectfully disagree with the Board's conclusions in the exposure draft, I would like to commend the Board for its extensive outreach efforts around this proposed change.

The revised exposure draft appears to treat the fundamental change in lease accounting as a settled issue since there are no specific questions addressing its overall efficacy. Our concerns with the new lease accounting approach are discussed below:

Accounting For Leases Under the New Standard Will Lead to Confusion:

Nearly all financial statement users – including non-accountants - understand what the substance of a lease is. As operating leases are currently accounted for, users understand that the cost of the lease is recognized ratably over the lease term and that the benefits of the lease will be similarly realized. The proposed treatment will require financial statement users to assimilate "right of use assets" and "future lease payment liabilities" with discounting and interest components. From a purely theoretical standpoint, this treatment may make sense to academically-oriented CPAs but it will need a lengthy translation to most others. For most users that I am familiar with (my clients and their boards) this change will represent another brick in the growing wall between GAAP and useable and understandable financial information.

The Cost of Implementation and Compliance Will Outweigh the Benefit:

In discussing this potential change with my clients, their responses were nearly universal. There will be no effort to comply with this on an ongoing basis for internal reporting since the information will not make sense to their financial statement users and will not be relevant to their daily operations. As they relate to my client base, the benefits of the accounting change represented by the exposure draft are close to zero. There are however, very real direct and indirect costs that will appear on the opposite side of the ledger. Nearly all of my clients are required to have audits performed and qualified opinions with GAAP departures are unacceptable. In some cases, spreadsheet calculations will be performed. In others entities will pay a software provider for programs to perform the calculations. In all cases additional time and effort will be required of accounting staffs to comply (and for auditors to audit). Book vs. tax differences, deferred taxes, consideration of impairment of right of use assets, etc. are all ancillary to the objective of the change but will nevertheless require substantial resources to be properly accounted for under the proposed standard.

The Ultimate Objective is Likely to Remain Elusive:

It is absolutely true that there are leasing transactions specifically structured to be treated as operating leases for accounting purposes whose substance is a capital transaction. The Board is undoubtedly cognizant of the cottage industry of accountants and attorneys that focus on the FAS-13 capital vs. operating lease decision point and how to structure transactions that will meet the definition of an operating lease under FAS-13, regardless of the transaction's true nature. It goes without saying that these people will not simply accept the premise that all leases are capital transactions. In the 2 ½ years since the issuance of the 2010 exposure draft, they have had ample time to develop strategies and leasing structures to continue to circumvent treatment as a capital transaction. It would be naïve not to expect a proliferation of leases with variable rate terms, as an example.

In my opinion, the problems with lease accounting exist not so much due to flaws in the existing standard as to entities desiring to achieve a specific outcome without regard to the substance of the transaction. I certainly sympathize with the Board and understand its efforts to root out this practice, but those motivations will remain after the changes become effective and I believe they will continue to dog efforts to bring consistency and accounting clarity to this subject.

Users of Financial Statements:

When substantive and critical financial decisions are being made, GAAP financial statements can serve as a guide but certain aspects of the statements will always warrant deeper examination. When purchasing a business, the prudent buyer will never rely on the GAAP value of a building which is reflected at historic cost less depreciation. The buyer will instead commission an appraisal of the building. They will similarly hire an expert to comb through the financial data to find related party arrangements, inventory valuation issues, owner's perks and other items including leasing arrangements.

Paragraph BC322 of the exposure draft contains the following statement:

“The FASB concluded that because users of nonpublic financial statements generally have greater ability to directly access management and to obtain additional information beyond what is included in the financial statements, the incremental benefits of the information provided by the reconciliations often would not justify the added costs to provide and audit that information.”

I wholeheartedly agree with this logic but I think the Board should consider the implications of that statement and its logic beyond the limited context of the required disclosure to reconcile the lease payment liabilities. Why does this same logic not apply to the entirety of the proposed changes?

From another perspective, while users of public financial statements may lack the direct access of nonpublic users, generally they possess the wherewithal to commission detailed studies by experts when making significant financial decisions. I can substitute “public” for “nonpublic” and “resources” for “ability to directly access management” in the statement above to reach the same conclusion with similar logic.

In the cases of users of both public and nonpublic financial statements, I would surmise that they will continue to use their access and resources to obtain additional information – whether the changes are adopted or not. Where substantive financial decisions are being made, users will seek additional information to look past the accounting treatment into the substance of leasing transactions anyway.

Conclusion:

It is generally understood by all financial statement users that GAAP financial statements, as a practical matter, will never be a pure depiction of the true financial condition of an entity. There will always be a trade-off between accounting purity and the practical cost of gathering the required information. I believe that with the changes proposed in the exposure draft we are reaching for a level of theoretical accounting purity that is not practically achievable and that the significant costs of compliance will not prove to be worthwhile. Thank you for your consideration of these comments.

Very respectfully,

A handwritten signature in black ink, appearing to read 'Peter S. Kennedy', written in a cursive style.

Peter S. Kennedy, CPA
Audit Director