



The Financial Analysts Federation

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October 8, 1971

TO: Committee on Accounting for Leases by Lessees
and
Committee on Accounting for Leases by Lessors
of the
Accounting Principles Board

SUBJECT: Proposed Changes in Accounting of Lessees and Lessors

PURPOSE: Position of the Financial Analysts Federation

1. Scope of the FAF Position

The Federation position pertains specifically to the Draft Opinion on Accounting for Leases by Lessees sections 4c, 8a, 8b, 8c, and 9f. Additionally, it makes general recommendations applicable throughout its text to interpretation of the opinion.

2. Accounting Principles

2.1. General

The Federation believes that proper accounting for leases under generally accepted principles should be reflected in the financial statements as follows:

- Balance sheets of lessees and lessors should include the substantive arrangements between parties rather than the legal form (particularly on third party leases).
- Future obligations arising from leases and capitalized should be stated on equivalent terms to other types of capital.
- The appropriate capitalization rate used to value lease obligations at the time of capitalization should reflect total company credit circumstance and differences between leasing and other types of obligations.
- Consistent and comparable application of these principles should apply equally to lessees and lessors.

2.2. Comparability

To the extent that lease obligations constitute an alternative form of capital, comparability and consistency require published financial statements disclosing economic ownership and obligations rather than legal forms. The same principles that govern reporting of equivalent alternative forms of capital should govern reporting of lease obligations.

2.3. Form of Presentation

2.31 Financial Statement

The application of the principles must be made to lessors as well as leasees. Consistently applying the general principles recommended would avoid ambiguity arising from such situations as paragraphs 8a or 8b of the draft opinion where disclosure requirements for leases are less stringent than those of direct debt obligations.

Capitalization rates used to define stated lease values should be disclosed in the balance sheet. Contingent payments and/or contract provisions should be noted. Estimated future obligations when reported should note the method used for estimation.

2.32 Income Statement

The same comparability cited above should apply to the accounting for gains and losses in leasing transactions as well as for annual charges to income.

3. Disclosure

We believe the financial statements should disclose all material information regarding lease obligations including rates used for capitalization and salvage value. Segregation of direct and indirect obligations in the balance sheet and income statement with supporting notation for contingencies and estimation procedures is appropriate. While management determines the foregoing, procedures should be reviewed by independent auditors for consistency and suitability.

4. Conclusion

The draft opinion is considerably more suited to the requirements of financial analysts than APB Opinion 5 and the sections of APB Opinion 7 and APB Statement No. 4 which it amends. However, it is not sufficiently definitive in the respects cited to eliminate significant inconsistencies between companies and industries. We would like to emphasize our interest in the treatment of third-party leases. These have the greatest potential for abuse. The standards of risk-reward responsibility should be liberally interpreted so that new loopholes are not created. Since such inconsistencies can lead to inappropriate value judgments regarding company securities and therefore to inefficient allocation of resources in the economy, we believe there is sufficient reason to make lease reporting requirements more stringent and comparable than called for under present provisions of the draft opinion.

Financial Accounting Policy Committee
Sub-Committee on Accounting for Leases
David A. Baker, C.F.A., Chairman
For the full Committee:
Frances Stone, C.F.A. Chairman