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LEASE ACCOUNTING PROPOSAL THREATENS WIDESPREAD NEGATIVE IMPACT ON U.S. ECONOMY, FOUNDATION STUDY FINDS

Complex proposal presents more hurdles for U.S. businesses already hard hit by a weakened economy

WASHINGTON, D.C., December 7, 2011 - A proposal to change how leases are accounted for on corporate balance sheets could have a widespread, detrimental impact on the U.S. economy, triggering a $10 billion reduction in gross domestic product (GDP) and 60,000 fewer jobs by 2016, the Equipment Leasing and Finance Association (ELFA) announced today. ELFA cited a new study, "Economic Impacts of the Proposed Changes to Lease Accounting Standards," conducted by information and analysis provider IHS for the Equipment Leasing & Finance Foundation, as the first independent study to substantiate how the complex proposal might affect an already fragile U.S. economy.

Most U.S. companies across a wide spectrum of industries lease equipment or real estate as part of their day-to-day operations. Currently, operating leases are not reported on companies' balance sheets; they are reported in the footnotes to companies' financial statements. The proposed lease accounting changes, from the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), would require companies to record virtually all leases on their balance sheets. The study's analysis of financial data reveals that the proposal would depress company profits, economic growth and financial stability.

According to the study, many businesses do not object to having to record leases on their books. Rather, they object to *how* the proposal would require them to account for and report lease transactions, contending that aspects of the proposal are too complex, impose burdensome regulation on businesses and do not accurately reflect the economics of the lease transaction.

Key Findings

The new study finds that under the lease accounting proposals being considered by the IASB and FASB:

- U.S. companies would add an estimated $2 trillion to their balance sheets—an 11% increase in total debt. Higher debt-to-equity ratios can increase volatility in corporate earnings and companies' ability to secure financing, among other consequences.
- U.S. companies could experience a 2.4% reduction in pre-tax net income in the first year of the new accounting rule.
- The cost of debt could rise through higher interest rates—every 50 basis point increase would trigger a $10 billion reduction in GDP and 60,000 fewer jobs by 2016.
- The proposal would cause a permanent reduction of $96 billion in the equity—net worth—of U.S. companies, a sizable erosion of shareholder ownership value.

Stumbling Blocks Facing Businesses

Several components of the proposal could act as stumbling blocks for U.S. businesses. The potential negative fallout from changing lease accounting rules includes:

1. **Lower earnings, reduced capital and deferred tax assets for companies that lease.** These circumstances would result from the proposal's front-ended cost pattern, in which companies would be required to front-load the cost of a lease in its early years rather than spread the average cost of the lease over its lifetime. The study's analysis of comment letters submitted to the FASB and IASB revealed that many companies and accounting professionals feel this does not reflect theeconomic reality of a lease transaction, which is a monthly lease payment.
2. **Costly implementation.** The complexity of developing the new processes and implementing the new information technology infrastructure needed to ensure compliance with the new standards will

represent a significant financial burden for many businesses. The companies most affected will try to offset the negative financial impacts by cutting costs, reducing capital expenditures and inventories, and passing on increased lease costs to customers. They will also look to restructure future leases to lessen the impact of the new accounting regime.
3. **Elimination of vital financing options.** Leveraged leases, which would disappear under the new rules, are a vital means for obtaining assets at a lower cost, particularly in the airline and railroad industries. Heavy users of these leases may need to significantly alter their business models to successfully adapt. Sales-type leases offered by small and medium sized equipment ranging from PCs to medical equipment would be less attractive to manufacturers, leading to less availability and higher prices for lessees.
4. **Adjustment to key financial metrics that investors use to determine company valuations and credit agencies use to determine credit worthiness.** Industries that make extensive use of operating leases, such as retail, transportation, banking and telecommunications, would be the most affected as investors and credit agencies seek to re-calibrate the metrics they use to determine valuations, including peer-to-peer performance comparisons, credit worthiness and capital requirements.
5. **Unintended consequences** such as:

- The triggering of existing debt and lease covenants due to changes in lessee debt levels and the front ending of reported lease costs.
- An increase in lease costs. Although the benefits of leasing will remain, U.S. companies could incur greater costs due to changes in lessor accounting that would impact lease pricing.

Call to Action for Businesses
ELFA, in advocating to protect economic and financial interests of U.S. businesses, proposes that FASB and IASB include four key considerations in their revised lease accounting rules. In a call for businesses to act, the association recommends they submit a comment to the Boards in support of these considerations.

1. Recognize that there are at least two types of leases. Retain the time tested distinction between capital leases and operating leases and retain straight-line expense recognition for the leases that are now considered operating leases.
2. Offer relief from the complexity and compliance burden of the proposal in areas such as transition, adjustment of estimates in the lease term, accounting for variable rents and disclosures.
3. Preserve the netting in leveraged lease accounting that allows lease providers to reduce the cost to lease users by hundreds of basis points.
4. Preserve sales-type lease gross profit recognition that allows captive companies to charge lower rates (as much as 100 basis points).

Looking Ahead
The FASB and IASB have announced plans to issue a new draft of their proposal by early April 2012, with a 120-day comment period. ELFA is urging the Boards to listen carefully to the feedback they receive on their proposal.

“Leases account for hundreds of billions of dollars in transactions annually, contributing not only to businesses’ success, but also to U.S. economic growth, manufacturing and jobs,” said William G. Sutton, CAE, President and CEO of ELFA. “It is essential that the Boards carefully consider comprehensive public input and comment before finalizing their proposal to ensure a workable lease accounting standard. The Foundation study is the first comprehensive and objective analysis of the macroeconomic impacts of the lease accounting proposals under consideration by the Boards. It is our hope that the Boards will seriously consider the negative consequences of some of these proposals and ultimately arrive at alternative approaches that do not harm American businesses and the U.S. economy.”

“There are many benefits to leasing, and the primary reasons to lease equipment will remain intact under the lease accounting proposals, from maintaining cash flow, to preserving capital, to obtaining flexible financial solutions, to avoiding obsolescence,” said ELFA Chairman Crit DeMent, Chairman and CEO of LEAF Commercial Capital, Inc. “However, the financial burdens imposed by the standards under consideration are the last thing American businesses already struggling to regain their footing in a challenging economic landscape need. We urge the Boards to reconsider some of the more onerous and burdensome proposals under consideration to minimize the negative financial impact on businesses.”

About the Study

"Economic Impacts of Proposed Changes to Lease Accounting Standards," was conducted by IHS for the Equipment Leasing & Finance Foundation, an independent organization that publishes research for the equipment leasing and finance industry. IHS combined financial data for more than 1,800 US companies from Standard & Poor's CompuStat database with its own proprietary data to develop pro forma financial statements to model the magnitude of the impact of the new accounting standards on specific companies as well as major sectors of the US economy. The modeling effort was augmented and enhanced by a qualitative review of 105 representative comment letters submitted to FASB (in response to an Exposure Draft of the proposed rules) as well as a general literature meta-study. The study is available for free download at www.LeaseFoundation.org .

About ELFA
The Equipment Leasing and Finance Association (ELFA) is the trade association that represents companies in the $628 billion equipment finance sector, which includes financial services companies and manufacturers engaged in financing capital goods. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. Its over 550 members include independent and captive leasing and finance companies, banks, financial services corporations, broker/packagers and investment banks, as well as manufacturers and service providers. In 2011, ELFA is celebrating 50 years of equipping business for success. For more information, please visit www.elfaonline.org .

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