

**Accounting Changes:
What's Happening Now and Where are We Going**
by ELA's Accounting Committee, Feb. 27, 2002

We know that the SEC, FASB, and Big 5 accounting firms are all focused on issues resulting from Enron's bankruptcy. Off-balance sheet leasing has been swept into these discussions, and the implications for the leasing industry are still unclear. It may be helpful, however, to communicate what ELA does know about the thinking and actions to date of various involved entities.

Big 5 Current Practices:

At the ELA accounting Committee's winter meeting on February 5, the Big 5 representatives indicated that they were continuing to enforce the existing lease accounting rules and that, as a result of the sensitivity to off-balance sheet transactions, their people are showing the national offices more operating lease transactions. The firms are stressing the operating lease disclosure requirements for lessees and are reviewing client footnotes carefully. They are advising clients that FASB has announced its intention to change the SPE consolidation rules this year, and that the change is likely to be retroactive (see below).

ELA members report that their customers have been asking plenty of questions, especially about synthetic leases. They also confirm the higher level of scrutiny by the Big 5.

FASB Action on Consolidation Rules:

FASB has begun the process of changing the consolidation accounting rules for SPEs. While we won't know exactly what FASB will do until it issues a formal exposure draft, the new rules likely will cause lessees to consolidate synthetic lease SPEs. News reports say that FASB will raise the equity required for an SPE to be considered substantive from 3 percent to 10 percent. More important, it may make the criteria for determining who consolidates an SPE subjective. The following is an excerpt of the minutes from FASB's February 13 Board Meeting, one of several its held to focus on these issues. (Note that it contains some troubling discussion of guarantees of indebtedness which could impact all leveraged leases.)

“Consolidations: interpretive guidance for certain situations. The Board discussed a draft of an interpretation of FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, that would address issues related to identifying and accounting for special-purpose entities (SPEs). Also, the Board instructed the staff to develop an interpretation to address, as a new project, disclosure (and possibly accounting) issues for a guarantor that issues a guarantee of the indebtedness of others or other forms of guarantees to benefit another entity. Guarantees are commonly found in SPE situations but are also found in non-SPE situations. The guidance for guarantors will be discussed at the Board's February 20, 2002 meeting.”

SEC Statement on Disclosures:

Prompted by a request from the Big 5, the SEC issued a statement on disclosures in January. It does not appear to impact the operating lease business except for making disclosure requirements clearer and more complete. The following is an excerpt:

“Investors have become increasingly concerned about the sufficiency of disclosure regarding liquidity risk, market price risks, and effects of 'off-balance sheet' transaction structures. Also, many readers of financial statements have cited a lack of transparent disclosure about transactions with unconsolidated entities and other parties where that information appeared necessary to understand how significant aspects of the business were conducted.

Accordingly, the Commission is reminding companies of the requirements of MD&A as they relate to (1) liquidity and capital resources, including off-balance sheet arrangements; (2) certain trading activities involving non-exchange traded contracts accounted for at fair value; and (3) relationships and transactions on terms that would not be available from clearly independent third parties on an arm's-length basis. This statement suggests steps that companies should consider in meeting their disclosure obligations.

We also want to remind registrants that disclosure must be both useful and understandable. That is, management should provide the most relevant information and provide it using language and formats that investors can be expected to understand. Registrants should be aware also that investors will often find information relating to a particular matter more meaningful if it is disclosed in a single location, rather than presented in a fragmented manner throughout the filing."

Where Things are Going:

We know there will be changes to US GAAP regarding SPE consolidation accounting and increased clarity in disclosures. No other lease accounting rules changes are on the FASB agenda. The U.K. ASB is working on lease accounting under the watchful eye of the IASB. The project is moving slowly. We must understand that it could be the beginning of changes to US GAAP, as all the accounting standard setting bodies are trying to work towards global harmonization of rules. The IASB has been vocal in the news criticizing US GAAP as being form driven while IAS accounting has a simpler set of rules coupled with the understanding that the financials statements will be prepared considering the spirit of the rules.

ELA's Accounting and Federal Tax Committees will continue to closely monitor SEC/FASB developments. ELA is scheduled to meet with FASB in early May will address these issues.