BRAD SHERMAN
UNITED STATES CONGRESS

PH: (202) 225-5911
FAX: (202) 225-5879

July 15, 2015

Via E-mail and Postal Mail

Mr. Russ Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Dear Chairman Golden:

The effort that you personally, and FASB as an organization, have made to keep me apprised of the progress of the Leases standard setting project is much appreciated. As you know, in prior written correspondence over the last two years, I and over 60 other Members of Congress have voiced our concerns over one issue in particular. We are concerned that implementation and compliance costs of the proposed standard on lease accounting will have negative impacts not only at the entity level, but cumulatively for our economy. To address these issues in a rigorous and substantive way, I have asked the Board to explain its plans for a formal and open cost-benefit analysis and field testing of the proposed standard.

While I appreciate the opportunity we have had to communicate with the Board, I have yet to receive any assurances that such empirical studies are being conducted or have even been planned.

Recently, the major global accounting firms have unveiled proprietary software packages to comply with the proposed new standard, priced in the six-figure range. This is just the latest evidence that implementation and compliance costs may be far higher than what the Board is assuming. Beyond the expensive software, implementing the new standard stands to be very complicated, subjective, and cumbersome, necessitating the collection and compilation of significant amounts of data for input into the software models. This data collection task will be required both upfront, and on a regular ongoing basis, in many cases for thousands of individual leases at a single company. So while a company pays six-figures for the software, the value of the staff and executives' time spent on the project would be much higher.

When last we spoke, you claimed that moving forward on the Leases standard was justified by the April 2015 report of Robert C. Lipe titled "Review of the Chang and Adams Leasing Study." For some reason, this Financial Accounting Foundation-funded review is not on your website,

RECYCLED PAPER

nor otherwise published, which may explain why it has not received the wide-spread excoriation it deserves.

Suffice it to say the July 1, 2015 letter of Andrew Chang and Co. (copy enclosed) clearly demonstrates that the FASB cannot rely on Professor Lipe's speculation and surmises.

As just one example of the unreliability of what the FAF has provided and the need for an actual study, the Lipe review asserts that the proposed standard will not trigger covenant breaches. The author bases his opinion on what has happened with past FASB standards, rather than examining the very standard the FASB is now proposing. Yet you have personally agreed with me that the covenant issue is substantial and indicated a five year phase-in might be called for. (I would think ten years would be necessary.)

The Lipe paper leaves unanswered the questions raised by the original private sector economic analysis predicting the new Leases standard will significantly increase costs to U.S. public companies, reduce U.S. employment, and lower U.S. household earnings and U.S. GDP. What is therefore still needed is field testing of compliance costs and behavioral effects from the standard. This will enable a cost-benefit analysis that actually quantifies predicted job losses and economic impact.

When over 60 members of Congress wrote to the Board, there was ample time in your published schedule to complete the necessary study and analysis. Now, we understand from your website that you plan to issue the new standard before the end of the year, apparently without even commencing this essential economic analysis, cost-benefit study, and field testing. Apparently the entire U.S. economy is to be the test bed, and only after the standard is imposed.

As you know, the Sarbanes-Oxley Act establishes criteria for any private sector standard setter appointed by the SEC. When it last determined that the Board could fulfill this role, the SEC stated that it "expects the FASB" to "weigh carefully...the expected benefits and perceived costs of each standard." This is consistent with the intent of Congress, and it is a requirement placed on any rulemaking by the SEC itself. Should the Board choose not to do what is necessary to fulfill this responsibility on such a consequential standard that will have such far-reaching consequences for the U.S. economy, I and the other members of Congress who have already written to you will seek a legislative remedy.

As you know well, I have personally done as much as any member of Congress to support the FASB, its funding, and independence. I would hope that your handling of this matter will prove my efforts warranted.

In Congress, even when we are making decisions of less importance to our economy than the issues you face, we gather information carefully. I believe your entire Board should meet with Mr. Chang soon.

And if you respect the tenets and purposes that persuaded Congress to pass the Administrative Procedures Act, such a meeting should be public and on the record.

Sincerely,

Brad Sherman
Member of Congress

cc: Mary Jo White, SEC Chair

All SEC Commissioners

All members of Financial Accounting Standards Board

All members of International Accounting Standards Board

Enclosure: July 1, 2015 Letter of Andrew Chang

July 1, 2015

Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

International Accounting Standards Board
First Floor
30 Cannon St.
London EC4M 6XH
United Kingdom

Re: Economic Impact of Proposed Accounting Standard Revision (Leases, Topic 842)

Dear Board Members and Staff:

Dr. Justin Adams and I undertook a study of the then-pending Exposure Draft on Leases in 2012 entitled, "The Economic Impact of the Current IASB and FASB Exposure Draft on Leases." It has come to my attention that the Financial Accounting Foundation (FAF) has funded a paper by Prof. Robert Lipe at the University of South Carolina reviewing the study. Apparently this paper has not been published on the FASB or IASB websites or otherwise. As the paper contains several material errors, I request that this correspondence, which includes the paper as an Exhibit, be included in the comment file for the pending standard revision.

Since our study was published in February 2012, several publications appear to have validated our position that the proposed Leases standard, which as amended since 2012 still retains the most troubling provisions from an economic impact standpoint, will have negative consequences on an indeterminate number of U.S. companies, leading to an erosion of jobs and output throughout the U.S. economy. The Lipe paper does not address these publications. Instead, it is focused on four areas in which the author offers his opinions without resort to empirical data. I address each of the four points in what follows.

1. The paper asserts that currently off-balance sheet operating leases are already treated by many analysts as on-balance sheet liabilities, and infers from this that our analysis wrongly predicted that the proposed standard will induce changes in both borrowing costs and spending behavior. Prof. Lipe states that his inference is based on insights he has derived from his teaching, practice and secondary research of intermediate accounting textbooks and credit rating documents.

Despite Lipe's speculations, industry is becoming more vocal about the negative impact that the proposed standard will have on business operations. *See, e.g.,* "Lease Accounting Changes Jar Bank Covenants," CFO.com, February 2014 ("Changes to financial statements of banks and their borrower customers would be vast", quoting Dennis E. Dixon, President, International Bancshares Corp.). Dixon predicts the proposed Leases standard will "result in a de facto

increase in the regulatory capital requirements of financial institutions. This is especially troublesome because financial institutions are already subject to increased capital levels due to Dodd-Frank and the Basel III capital requirements."

Dixon echoes the testimony of Francoise Flores, Chairman of the European Financial Reporting Advisory Group. "The proposals are also likely to impact financial ratios and debt covenants of entities," according to Chairman Flores. "This may affect capital requirements based on local regulation and possibly increase the cost of capital for entities."

Moreover, two recent studies further support our study's prediction that the pending Leases standard may impact companies' loans. As reported in the *Wall Street Journal* on September 2, 2014, Grant Thornton International surveyed more than 2,000 directors and C-level executives concerning the proposed changes. Fully *75 percent* of the executives polled reported that their loans could be recalled if covenant violations are triggered by the standard, such as a specific debt-to-equity ratio, fixed-asset ratio or various earnings metrics. While approximately five percent thought that proposed changes would in fact negatively impact them, the CEO of Grant Thornton, Ed Nussbaum, believes the figure will be higher. "Many companies are in for a big surprise when this comes out and they have to go to the bank," he said. "They need to start talking to their bankers."

Morgan Stanley recently reported that retailers would be hit hard by the accounting change as well. Though the study focused on the Australian retail market, the points are telling for the US and other markets as well. "The impact on retailers will be 'considerable,' blowing out gearing levels and reducing return on capital employed," they predict. Similarly, KPMG audit partner Patricia Stebbens expects that the proposed changes will boost leverage ratios, forcing some companies to renegotiate debt covenants with bankers. "They should be having that conversation earlier," Ms. Stebbens said. (See "Retailers Face Multibillion-Dollar Hit from Proposed Lease Accounting Changes," Sydney Morning Herald, April 22, 2015.)

Both the Grant Thornton and Morgan Stanley analyses suggest that the Leases standard will have not merely a theoretical effect but a real-world negative impact. It takes nothing away from this concern that it is difficult to precisely quantify these effects in advance. Our study establishes a range of outcomes to account for uncertainty.

2. The second part of Lipe's review of our study presumes that the adoption of the Leases standard will be similar in effect to the adoption of SFAS 106 in the early 1990s. This is a classic example of begging the question. Based entirely on this unfounded assumption, Lipe purports to predict the impact of the proposed Leases standard by examining the borrowing cost and expenditures of AT&T and Chrysler after SFAS 106. Since neither AT&T nor Chrysler behaved in the manner our study predicts many corporations will respond to the Leases standard, he claims the study's prediction must be wrong.

Lipe's method, inasmuch as it is based entirely on fallacious logic, is to say the least unconventional. It necessarily produced a flawed generalization.

His assumption fails to account for other compounding factors which could either increase or decrease the companies' cost of capital during the study time period. For example, factors such as increases and decreases in the overall borrowing rate are not included. For this reason, his approach does not sufficiently isolate the impact of SFAS 106.

This methodology of cherry-picking two companies and relying entirely on their experience during this period cannot be generalizable. Indeed, were we to generalize solely from the experiences of AT&T and Chrysler during this period, we would also conclude that increased balance sheet liabilities recognition leads to the reduction of interest rates and an increase of expenditures. This plainly illustrates why Lipe's conclusions are an overreach based on a simplistic approach.

3. Lipe's contention that our study should have discounted cash flows is simply in error. Please note that our study is a standard policy analysis and uses standard acceptable conventions of policy analysis. Organizations including the Congressional Budget Office regularly use constant dollar figures to report results of policy analyses. Also the analytical tool used for this purpose, the RIMS II jobs multipliers produced by the US Bureau of Economic Analysis, mandates the use of constant dollars in order to correctly apply the jobs multipliers. Discounting the dollars as described by Lipe to estimate jobs impacts would be a significant technical error leading to incorrect results.

4. Lipe does seem to understand that the Leases standard as proposed would result in at least some harm to the economy. He notes that "adoption of the new leasing guidance will undoubtedly affect some companies." Unfortunately he makes no attempt to quantify the effect on jobs and GDP. Instead, he simply opines that it will "likely" be a "blip." Such surmise does not provide policy makers reliable, evidence-based information they need to make decisions.

The Boards' goal of improving the accounting presentation of leases is laudable. However, there is tremendous uncertainty and risk associated with imposing this particularly sweeping new accounting standard that will reclassify literally trillions of dollars on financial statements. Entering into this *terra nova* without any data on actual implementation costs and behavioral change is exceedingly risky business.

Because of the lack of empirical data, our study was forced to report on a very large range of potential outcomes. These ranged from a loss of 190,000 jobs (roughly equivalent to the amount of jobs that the US has gained every 20 days during the last year) to a loss of approximately 3.3 million jobs. We are concerned that the FASB and IASB have not used your considerable resources over the past three years since the release of our study to provide more clarity in the form of empirical data. Such data could be used to better evaluate the potential economic impact of the proposed changes, and to isolate those portions of the proposal that carry the greatest risk of negative economic impact and distortive behavioral change.

We would welcome, as I am certain the financial and business community generally would welcome, the development of such data for more sound analysis of the costs and benefits of the pending proposal. Instead, the paper by Prof. Lipe appears to represent an effort to trivialize the

real-world concerns that have been raised and to obscure rather than illuminate the issues. It is our hope that FASB and IASB choose to use the time remaining before promulgation of a Leases standard in final form to develop useable empirical data to inform the ultimate choices you will have to make in the standard.

In the meantime, it would be extremely dangerous for the FASB and IASB to rely on Prof. Lipe's surmise as to economic impact (or more particularly, his surmise that economic impacts can be safely ignored). If the Boards wish to resolve the question of whether his opinions are correct, then clearly the production of actual empirical data concerning cost of implementation and impacts on behavior is the answer. To my knowledge, that has yet to be done. I believe the FASB and IASB process would be strengthened by doing this.

Thank you for providing me this opportunity to comment on the Lipe paper. If you have any additional questions or comments, please feel free to contact me at andrew.chang@AChangLLC.com or 916-538-6091.

Sincerely,

Andrew Chang