ACEC

AMERICAN COUNCIL OF ENGINEERING COMPANIES

100 Years of Excellence

September 4, 2013

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

Re: File No. 2013-270

On behalf of the American Council of Engineering Companies (ACEC) – the national voice of America's engineering industry – I am writing to provide our comments on the Financial Accounting Standards Board (FASB) revised exposure draft entitled *Leases*. We appreciate the opportunity to highlight our concerns about how the proposal would impact the engineering industry.

ACEC members – numbering more than 5,000 firms representing hundreds of thousands of engineers and other specialists throughout the country – are engaged in a wide range of engineering works that propel the nation's economy, and enhance and safeguard America's quality of life. The Council represents engineering businesses of all sizes, from the single professional engineer to firms that employ tens of thousands of professionals working in the United States and throughout the world. Changes to accounting standards for leases would have a particular impact on engineering firms that receive government contracts subject to the provisions of the Federal Acquisition Regulation (FAR).

As you know, under current accounting standards, leases can be structured as operating leases or capital leases. We continue to be very concerned that the exposure draft would treat all leases with terms longer than 12 months as capital leases because of the financial implications for firms that are subject to the FAR.

Under the FAR, the costs associated with operating leases are generally allowable. However, the costs of a capital lease must be divided between amortization expense and interest. Interest expense is expressly unallowable under the FAR and, therefore, cannot be reimbursed.

We recognize that approximately 60 percent of the incremental interest expense associated with the adoption of the exposure draft would be recoverable via the Facilities Capital Cost of Money (FCCM) if established in accordance with Cost Accounting Standard (CAS) 414. However, if adopted the new rules would create a situation where

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approximately 40 percent of the interest expense from affected leases would be unrecoverable, imposing a significant financial burden on engineering firms.

Our analysis is predicated on the assumption that the "right-of-use" assets discussed in the exposure draft would appropriately be classified as "tangible" assets and included in the computation of the FCCM factors. The FCCM factors are developed based on the published Secretary of the Treasury's interest rate. The true interest cost to the contractor, however, is the commercial borrowing rate. Therefore, the 40 percent non-recoverable interest amount represents the difference between the FAR-acceptable Treasury interest rate and the commercial borrowing rate.

In light of the apparent conflict with the FAR and the resulting impact this change would have on many engineering firms, we respectfully urge FASB to reconsider this change or consider further modifications that would reduce the financial consequences for affected firms.

An additional issue that would arise from the change from operating to capital leases is the impact on net worth as a result of the assets and liabilities that would have to be recorded. This could affect bank covenants for many ACEC member firms, jeopardizing their ability to secure a line of credit, or increasing their borrowing costs because the lending institution may consider the client to be a higher credit risk. Financing has been particularly difficult for small and mid-sized engineering firms to obtain since the banking crisis, and we are concerned about accounting changes that would exacerbate this problem.

We also have questions about the issue of personal property taxes. It is unclear whether capitalizing an operating lease would cause these capitalized leases to be considered personal property of the lessor and subsequently give rise to a personal property tax obligation. ACEC requests that FASB clarify this point.

The exposure draft also proposes a number of significant disclosure requirements. Financial statements would have to detail the nature of lease contracts, information about variable lease payments and options, maturity analyses, and significant assumptions and judgments, among other information. While these details may be useful to the users of financial statement, we should not lose sight of the fact that these requirements would add substantially to the administrative burden associated with implementation of the new standards. These administrative costs will be particularly challenging for small and mid-sized firms to absorb.

Further, if these changes are adopted, ACEC strongly recommends a lengthy implementation period in order to allow engineering firms sufficient time to comply. Implementing the kind of changes FASB has envisioned would require modifications to IT and accounting systems, as well as additional staff training. It would be challenging to allocate scarce resources to this accounting change without significant lead time.

ACEC respectfully requests that FASB consider not only the significant administrative burden associated with these proposed accounting changes, but also the substantial financial consequences to those firms that are parties to government FAR-based contracts if all leases with terms longer than 12 months are treated as capital leases.

Sincerely,

Katharine Mottley

Katharine Mottley
Director of Tax & Regulatory Affairs