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Leasing

FASB Issues Lease Rules; Will Have Big Balance Sheet Impacts

By Steve Burkholder

Feb. 25 — The balance sheets of airlines, retailers, many banks, hotel and restaurant chains, telecoms and other companies are expected to balloon under new lease accounting rules issued by the Financial Accounting Standards Board.

About 85 percent of leases aren't currently reported on balance sheets globally, making investors' analysis of companies' leasing activities and of lessee liabilities more difficult, accounting rulemakers say.

BNA Snapshot

Major Development: Financial Accounting Standards Board issues final rules that will require booking on balance sheets of all leases for the first time, starting in 2019, plus enhanced disclosures.

Impact: Some companies to see balance sheets balloon by billions of dollars.

In the U.S., public companies' operating leases carried off-balance sheet amount to more than $1 trillion in leasing obligations, according to a FASB staff study of 2014 securities filings, FASB Vice Chairman James Kroeker told Bloomberg BNA Feb. 25.

That lack of recognition will end in 2019 when the new standard—Accounting Standards Update 2016-02, ASC 842—that FASB issued Feb. 25 becomes effective for public companies.

KPMG LLP said that "the new standard ushers in a new era." Right-of-use assets and liabilities stemming from leases will be recorded generally for the first time.

Disclosures Enhanced

FASB also will require enhanced disclosures. Those feature qualitative and quantitative reporting in footnotes to the financial statements.

Current accounting by lessors generally won't change very much under the new FASB standard. Special accounting for leveraged leases will be phased out.

IASB and FASB: Accord, Then Divergence

The International Accounting Standards Board, which worked with FASB jointly on leases for some nine years, issued its own set of lease accounting rules in January (12 APPR 01, 1/15/16). While IASB and the U.S. board are fairly well aligned on the balance sheet recording of lease-related assets and liabilities, they differ markedly on income statement prescriptions—recognition of lease-related expense—and in cash flow reporting.

FASB doesn't depart much from current generally accepted accounting principles in the way leasing expense is reported, with minimal impacts. While IASB has a single model for all leases, the U.S. panel continues with its long-held two-lease classification model, labeled in the new rules "operating leases" and "finance leases."

Under the FASB model, operating leases undergo single-lease expensing on a straight-line basis.

Advice: Get Started Now

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They also advise that companies should get a definitive picture soon of exactly how many leases they have and what the renewal dates and other lease terms are. Such cataloging and tracking can be a challenge, articularly for companies that may have thousands of leases.

"The big issue for companies is getting the data into electronic formatting," Sean Torr, with Deloitte & Touche LLP's advisory services, told Bloomberg BNA Feb. 24. "This is a big enough deal for most companies that an early start is not going to hurt."

Reversing 40-Year-Old Rules

The standard, a decade in the making, reverses the course from 1976 rules that has resulted in what the staff of the Securities and Exchange Commission called one of the largest forms of off-balance sheet accounting.

The current prescriptions for leases have led to structuring of transactions to avoid recognition of what can be huge liabilities on the balance sheet, according to a 2005 SEC staff study of off-balance sheet arrangements.

> ***"The new guidance responds to requests from investors and other financial statement users for a more faithful representation of an organization's leasing activities."***
>
> ***FASB Chairman Russell Golden***

FASB Chairman Russell Golden cited the commission's study on the Feb. 25 release of the new ASU. "The new guidance responds to requests from investors and other financial statement users for a more faithful representation of an organization's leasing activities," Golden said in a prepared statement.

Impacts on Companies

The new FASB standard affects all companies and organizations that lease property, plant, or equipment—"that is, land and/or depreciable assets," FASB states in the ASU.

The new rules cover leases of more than 12 months. Unlike the IASB rules (IFRS 16), the FASB standard doesn't exempt so-called "small ticket" leases, such as those for office copiers or laptop computers.

Examples of leased assets covered by the FASB standard include airplanes, trucks, rail cars not in "car hire" contracts, cruise ships, and manufacturing and construction equipment, according to interviews, the Feb. 25 edition of "FASB in Focus," and a special FASB publication on the costs and benefits of the new rules.

Sheri Wyatt, a lease accounting specialist at PricewaterhouseCoopers LLP, suggested in a Feb. 11 interview that technology companies also are big users of leased equipment.

Retailers' leases of stores and banks' leasing of branches and other facilities in shopping centers and grocery stores also will be covered by the new FASB rules, according to FASB officials and an accounting specialist at the American Bankers Association.

For major retailers and airlines, the impacts are expected to be in the tens of billions of dollars, based on some experts' analysis of information gathered from the companies' footnote disclosures. "Some of the numbers are staggering," said Deloitte's Torr.

Based on recently disclosed numbers, the balance sheets of drugstore chain Walgreens Co. and United Airlines Inc. will be bumped up by about $21 billion and $13 billion, respectively, after the new rules become effective, according to analysis by William Bosco, an accounting consultant who has worked for the Equipment Leasing and Finance Association.

ELFA welcomes the new standard, according to a statement issued Feb. 25.

CVS Pharmacy Inc. would record an estimated $17 billion in newly capitalized operating leases, according to Bosco's study. McDonald's Corp. would report about $9 billion more in the same balance sheet areas to be labeled "operating lease assets" and "operating lease liabilities," Bosco predicted

Siegel Dissents

Marc Siegel was the lone dissenter in the seven-member FASB's vote to approve the detailed, 485-page lease accounting blueprint in the new ASU.

Siegel wrote in his formal dissent that he "firmly agrees with the recognition of lease assets and lease liabilities for all leases." However, he disagreed with his colleagues on the measurement of amounts of lessees' liabilities, as prescribed in the new ASU.

Siegel registered concern that users of financial statements "may be misled by the measurement and, therefore, will incur costs to make considerable, albeit very different, adjustments to unwind the accounting required" by the standard "to accommodate their analysis."

CFA Institute's Views

Sandy Peters, chief of financial accounting policy at the chartered financial analysts group CFA Institute, told Bloomberg BNA Feb. 25 that she agrees with Siegel's analysis on the liability-measurement issue.

However, on balance, the CFA Institute welcomes the improvements contained in the new FASB standard. "Our choice is not do anything or do this," Peters said.

Peters noted that the analysts group first advocated the on-balance sheet reporting of all leases in 1971—45 years ago.

"We view all change as incremental," Peters said. "We'd hope, over time," standard-setters would "consider ways to improve the measurement."

To contact the reporter on this story: Steve Burkholder in Norwalk, Conn., at sburkholder@bna.com

To contact the editor responsible for this story: Steven Marcy at smarcy@bna.com

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