

July 2015

Proposed Changes to Lease Accounting: Is That The Finish Line...or Is It A Mirage?

Highlights

- While not yet finalized, the positions of the FASB and IASB have been clarified.
- The Boards have agreed to disagree on lease classification:
 - The IASB will treat all leases the same (Type A).
 - The FASB will have two lease types (Type A and B).
- Regardless of lease type, all leases will be required to be capitalized on the balance sheet except for short-term leases (i.e., leases of 12 months or less).
- Existing leases will not be grandfathered.
- Joint deliberations are complete with only a few meetings remaining for each Board.
- The drafts of the standards, once approved by the Boards, will be provided to select external parties for a “fatal flaw” review.
- The Boards plan to issue the final standard by year end.
- The most likely effective date will be 2018 for public companies and 2019 for non-public companies.
- It is unknown whether the one year delay in the effective date of the Revenue Recognition Standard will impact the effective date of the Leases standard.

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), individually “Board” or collectively the “Boards,” continue to make progress on the proposed changes to lease accounting and, as the five-year anniversary of the “Leases” Original Exposure Draft (OED) approaches, there could now be an end in sight.

While there have been countless deliberations and re-deliberations on this topic since the

OED was issued in August 2010, the positions of each Board have now been clarified to a great extent. Surprisingly (tongue planted firmly in cheek), despite all the time and effort devoted to this topic, the Boards could not achieve a fully “converged” standard. However, even though they failed to agree on several key areas, they remain unified in the requirement that all leases be capitalized on the balance sheet except short-term leases (i.e., leases of 12 months or less). They also remain steadfast that existing leases will not be grandfathered.

The most significant area where convergence has not been reached by the Boards relates to lease classification. In this area, the Boards have now formally agreed to disagree. The IASB will treat all leases the same (Type A), while the FASB will have two classifications (Type A and Type B):

- Type A leases will generally be those considered capital or finance leases under current accounting guidelines and will have a front-end loaded expense pattern consisting of both amortization and interest expense. The related lease liability for Type A leases will be classified as Other Debt on the balance sheet.
- Type B leases will generally be those considered operating leases under current accounting guidelines and will be accounted for as rent expense on a straight-line basis over the term of the lease. The lease liability for Type B leases will not be considered debt; rather it will be classified in Other Liabilities on the balance sheet.

Again, it is important to note that both Type A and Type B leases will be capitalized (i.e., on balance sheet).

Status of the Proposed Changes

Joint deliberations by the Boards are complete with only a few individual Board meetings remaining. Each Board has instructed their staffs to prepare the initial drafts of the standards for the respective Board’s review.

The FASB has future meetings scheduled to address: 1) issues and questions arising from the staff during the drafting process; 2) the benefits and costs of the new Leases standard; and 3) the effective date of the new standard.

Once initial reviews by the Boards are complete, the drafts will be distributed to a select group of outside parties for an “external review” (aka “fatal flaw” review) to identify any errors. This review is **not** an opportunity for stakeholders to note their disagreement with the standards; rather, it is to ensure the standards, as written, are interpreted in accordance with the intent of the Boards.

It is our understanding that once the external review is complete, “pre-ballot drafts” will be provided to the Boards. Any comments or edits are then incorporated into the “ballot draft” versions that are circulated back to the Boards. Once voted upon and approved, “post ballot” drafts will be prepared, which will ultimately become the final standards, with the FASB and IASB each issuing their own standard.

Cost/Benefit Analysis

Sometime this summer, the FASB will meet to address the cost/benefit of this new standard. While it can be argued they should have performed this analysis much sooner than five years into the process, this action is likely a direct result of numerous stakeholder comments expressing concern over the burden the new standard will impose on companies. Many are speculating this step will be a meeting to allow the Boards to “check the box” that an analysis was performed. It is possible, though improbable, that political forces could come into play at this point and disrupt the process.

Timing for Issuing the New Standard

The Boards are targeting issuance of the final standards by year end. Given past deadlines that have come and gone, this is not a certainty; however, it does seem likely given recent

conversations with the FASB.

Effective Date

The Boards have yet to publicly state an effective date. It will likely be 2018 for public companies and 2019 for non-public companies. That being said, the Boards have recently extended the effective date for the new Revenue Recognition Standard (issued last year) from 2017 to 2018 for public companies and from 2018 to 2019 for non-public companies. It remains to be seen whether this will delay the new Leases standards, as the Boards may be hesitant to issue two major new standards with the same effective date as the burden on companies to simultaneously implement both standards may be too great.

It is important to note that for companies with comparative financial statements, the two years prior to the effective date will need to be restated to conform to the new standard. However, based on a recent FASB-only meeting, companies will be provided the opportunity to elect several “practical expedients” which, if elected, will: 1) result in no impact to a company’s income statement or cash flows for the comparative periods; and 2) provide for a fairly straight-forward calculation of the Right-of-Use Asset and corresponding liability to be recorded on a company’s balance sheet by using the minimum lease payments already provided in the notes to the company’s financial statements. This only applies to the FASB, while the IASB’s requirements will result in a more complex transition.

For further information, visit the websites of the [FASB](#) , [IASB](#) and the [CBRE Task Force](#).

For suggestions on what companies can do in advance of the standard being issued, please see the [recommendations previously put forth by the Task Force](#).

We will continue to keep you apprised on this important topic as we draw nearer to the finish line. Stay tuned!

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