Integra International Audit & Accounting Alert

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Major Changes to Lease Accounting Standard Effective Next Year

Implementation can be tricky and requires planning

Taking even longer to resolve than they did with revenue accounting, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), with the issuance of their corresponding standards in early 2016, have both agreed to the overall concept of reporting leases on the balance sheet as assets with corresponding liabilities. However, the boards differ as to the model for accomplishing that goal.

The FASB retains a two model approach for lessees. Under this approach, finance leases, which current accounting considers capital or purchase leases, will have the right-of-use balance sheet asset amortized as an expense using a straight line basis. The balance sheet lease liability will produce a separately reported interest expense. Operating leases will have the periodic lease cost amortized as a single expense using a straight-line method. Leases meeting any one of five criteria will be considered finance leases. All other leases will be considered operating leases. The criteria generally provide that the lessee receives the bulk of the value of the asset over the lease term, considering the nature and expected life of the asset, purchase options, and present value of payments. However, the old rules-based measures are replaced with principles-based determinations, so that leases cannot be cleverly structured to avoid the standard.

The IASB approach will consider all leases the same, using a one model approach. The lease costs will all be reported in a similar fashion as finance leases, with both amortization and interest expenses reported on the income statement.

Lessor lease accounting under both boards will be similar to the current standards, which already use an approach that corresponds to the finance and operating models above. Also, leases with terms of a year or less will be exempt from the standard, and groups of leases with comparable characteristics can be reported collectively as a portfolio.

According to the standards, "a lease is defined as a contract, or part of a contract, that conveys to the customer the right to use an asset for a period of time in exchange for consideration…A lease exists when the customer controls the use of the identified asset throughout the period of use. This is when the customer has the right to: 1) obtain substantially all of the economic benefits from use of the identified asset throughout the period of use, and 2) direct the use of the identified asset throughout that period."

Since the lease standard goes into effect a year later than the revenue accounting standard, the reported slow pace of preparation is not surprising. A noted exception is Microsoft, which, in similar fashion to the revenue accounting standard, became an early adopter. However, a mid-year 2017 PwC/CBRE survey found that 23% of companies had not started to assess the impact of the changes required. While 52% were in the assessment phase, most of them were in the early stages and almost half of them were finding the effort to be greater than they had expected. Consequently, for companies that procrastinate, the time consuming difficulties likely to be encountered may prove to be a nasty surprise.

Integra has been drawing attention to the new lease accounting standard through various means, such as conference presentations, webinars and articles in professional publications. Integra International members, Swenson Advisors and Cresa, have been especially proactive in alerting clients and the financial community of the substantial and complex task that lies ahead for many companies. Using Swenson's and Cresa's proprietary AccountLease™ process, one of their clients appears to be the first SEC filer to submit a report with disclosures under the new standard.

In a November 21, 2017 Journal of Accountancy article, Swenson Advisors' Steve Austin, along with Cresa's Don Mitchell and Simon Terry-Lloyd, shared practical considerations gained from experience with the AccountLease™ process. At the top of the list were the importance of "a defined strategy and timeline," that "more time and effort will be required than most companies anticipate," and that "real-estate related leases are typically more complicated than equipment leases and may require real estate leasing expertise to implement and maintain." The article goes on to enumerate and expand on various factors that can prove complex and less obvious to the casual observer, and yet necessitate consideration.

On another helpful note, the FASB on November 29, 2017 announced that the proposed Accounting Standards Update (ASU), *Land Easement Practical Expedient for Transition to Topic 842,* will be finalized for issuance. Also, proposed ASU's will be drafted to provide a transitional expedient allowing that "effects of initially applying Topic 842 [be] recognized as a cumulative-effect adjustment to retained earnings in the period of adoption," and under certain circumstances "to not separate non-lease components from the related lease components and, instead, to account for those components as a single lease component."

Further details can be found at Practical considerations for lease accounting and FASB Makes Decisions on Leasing Standard Simplification

(https://www.journalofaccountancy.com/news/2017/nov/practical-considerations-lease-accounting-201717479.html) and
(http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176169479071)