

[Technology + Management Smarts]

Lease Accounting Changes [3 reasons why you shouldn't worry]

There has been much buzz lately about the potential new rules for lease accounting. It is true that the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are considering changes that would eliminate the off-balance sheet accounting of operating leases. But contrary to what you may have heard, at First American, we see no reason to worry.

For organizations that lease technology, the proposed changes will NOT have a material impact. Leasing remains a smart, strategic business decision.

1: Three years will likely pass before any changes take effect.

Any new accounting rules, once they have been decided, will not be implemented until 2015—at the earliest. Here is what industry experts say:

- + “Effective date? Not known, but not expected before 2015.” –KMPG (*Lease Accounting Technical Update, September 2011*)
- + “The final standard is expected to be effective in 2015.” –PricewaterhouseCoopers (*PwC Proposed Lease Accounting Changes Survey, 2011*)
- + “Neither [of the Boards] has yet decided on effective dates, but... both have indicated they would provide ample time for companies to apply the new requirements.” –Ernst & Young (*Lease accounting proposals: simplified, but not simple, August 2011*)
- + “This timeline makes it more likely that the effective date would be 2016, particularly given the current transition requirements...” –Deloitte & Touche (*Lease accounting developments and implications, August 2011*)

Why so long? IASB, FASB and the international accounting community are currently at odds over the specifics of the implementation of the new rules. The Boards issued their initial Exposure Drafts back in mid-2010, but an avalanche of public comments prompted the Boards to re-deliberate. They are expected to issue a new Exposure Draft during the first quarter of 2012, following which will be a 120-day comment period. This means the final new rules will not be **issued** until late in 2012, with an **effective** date of 2015 or even later.

These changes are clearly not happening in a hurry, and chances are good the changes will not impact the shorter-term leases you enter into today. A new 3-year computer lease will likely remain in the notes to financial statements.

2: Any balance sheet impacts will be minor for the majority of organizations that lease technology.

To be sure, organizations that lease big ticket assets – think aircraft, rail cars or power plants – may see a significant impact to their balance sheets as a result of the new lease accounting rules. But organizations looking to lease such items as IT hardware, medical equipment or office furniture will find these leases are simply not large enough to be of material concern should they eventually be included on the balance sheet.

Organizations take advantage of the many benefits of leasing for a variety of reasons—but off-balance sheet accounting is NOT typically the primary strategy for most of these leases.

[continued on page 2](#)

3: Leasing will continue to deliver powerful benefits.

The proposed changes deal with *financial accounting issues* only. The many sound business reasons for leasing equipment still exist – and will continue to exist, despite whatever changes might be decided.

Organizations that lease will continue to benefit from:

- + **Maximized Cash Flow:** Leasing involves consistent, fixed payments, allowing organizations to acquire equipment without large cash outlays.
- + **Low Fixed-Rate Financing:** Leasing provides a low-cost source of capital in addition to normal bank lines of credit.
- + **Benefit From Residuals:** Leasing companies invest in the residual value of the equipment on lease, resulting in an implied interest rate that is 0% or less.
- + **Strategic Asset Management:** Leasing improves access to cutting-edge technology, allowing organizations to seamlessly replace, upgrade or add to systems during the lease or at the end of the lease term.

Progressive leasing companies like First American Equipment Finance take the benefits of leasing even further—with confidential online asset management reporting and comprehensive project management for complex procurement initiatives.

The accounting rules for leasing will, undoubtedly, face some changes in the years to come. Will leasing still be a smart business decision? Absolutely. **Regardless of the changes to accounting rules, leasing will continue to be an intelligent, effective business strategy.**

What: Currently, operating leases are not recorded on the balance sheet; these leased assets are included in the notes, and the lease payments are treated as rent expense. Under the proposed changes, these leased assets will be included on the balance sheet and the lease obligations will be listed as liabilities.

Why: Post-Enron, financial regulations have focused on disclosure. Although balance sheets traditionally list assets owned outright (which leased assets are not), the prevailing concern within IASB and FASB is that the financial obligation of on-going, non-cancellable lease payments should in fact be treated as a liability.

Timeline:

August 2010	IASB and FASB issue Exposure Draft proposing changes to Operating Lease accounting rules.
Aug–Dec 2010	Initial comment period: 780 comment letters received.
April 2011	The Boards reissue Exposure Draft. Based on comments received, the Boards decide that existing leases will be grandfathered, and the analysis of lease renewals will be limited.
May 2011	The Boards unexpectedly reverse the decisions on grandfathering and renewal analysis, causing an avalanche of negative feedback that the proposed changes are overly complex and will be costly to implement.
July 2011	The Boards announce they will re-deliberate and re-expose the draft.
1 st Quarter 2012	New Exposure Draft expected to be issued.
1 st Qtr–2 nd Qtr 2012	Comment period, open to the public.
3 rd Quarter 2012	IASB and FASB re-deliberation of issues.
4 th Quarter 2012	Final new rule expected to be issued.
2015	Anticipated implementation/ transition year ➔

About Technology + Management Smarts

Technology + Management Smarts is a quarterly electronic publication developed for select customers of First American Equipment Finance. First American is an equipment lessor that excels at providing simple, innovative financing solutions for complex projects that combine products and services from multiple vendors and service providers into a single equipment lease. Headquartered in New York, with offices in Chicago, Los Angeles, and Naples, Florida, First American has satisfied customers in all 50 states. Visit us at www.faeef.com.