Lease Accounting Standard Inches Forward

Despite disagreements about how to report leases, standard setters held firm Wednesday on putting all of them on the balance sheet.

- David M. Katz CFO magazine 3/20/14

Rather than going back to the future, the Financial Accounting Standards Board apparently moved closer to the completion of a final new standard governing lease accounting by stepping forward to the past.

At the conclusion of a meeting of FASB and the International Accounting Standards Board that stretched over the last two days, the boards "reached consistent conclusions on important areas of lease accounting," they said in a joint statement immediately following the meeting.

More fundamentally, the standard setters continued to agree on the need to require corporate lessees to report all lease transactions on their balance sheets rather than in the footnotes of their financial statements, as they do for certain kinds of leases currently. But the boards diverged sharply on whether there should be a distinction between different kinds of leases.

For its part, FASB members held to a position that differences in the economic underpinnings of leases must be reflected on corporate balance sheets. While varying the definitions in the boards' most recent lease-accounting proposal —reportedly the last one available for public comment — FASB feels that there should be two kinds of leases.

Under the boards' May 16, 2013, exposure draft (Topic 842), companies would separate their leases according to the type of asset they're leasing: Type A leases (equipment, including anything from aircraft to office copiers) or Type B leases (real estate, including land and buildings). The two types of leases would be accounted for on the balance sheet in different ways.

That marked a distinct change from current U.S. generally accepted accounting principles, which distinguish only between capital and operating leases. At the boards' meeting, FASB members agreed to return to the distinction under GAAP, though, rather than distinguish leases by the type of asset being leased.

As they would under the exposure draft, FASB members continue to want lessees to treat the liabilities on their Type A leases as "front loaded." Much in the way that they account for capital leases today, Type A lessees would assume they have already bought the asset, estimate its amortized costs over the length of the lease and allot the costs in line with the depreciation of the asset's value over time. Type A lessees would thus record more expense in the early years of the lease than they would later on.

Further, FASB continues to think that lessees should account for their Type B payments in roughly equal amounts over time. They would recognize the total lease cost on a straight-line basis over the lease term — like recording the same rent expense for office space each month, for instance.

As they've been prone to do, however, IASB members held to the dictum that simpler is better. All leases, they tentatively agreed among themselves at the meeting, should be treated as the purchase of the right of use (ROU) of an asset and accounted for as Type A. No distinction should be made for leases that are apparently rentals.

Another area of disagreement between the two boards appears to be how to account for leases of "small-ticket" items – office equipment like personal computers, for example, priced at, say, $100,000 or less. IASB appears to want to jettison such accounting altogether, while FASB would want to include it.

Nevertheless, the boards have reached apparent convergence on the issue of when to account for options to extend or to terminate a lease, agreeing that a lessee should reassess the lease term only if a significant event or "a significant change in circumstances that are within the control of the lessee" has happened. The boards will be meeting at various times over the next few months in an attempt to iron out their differences on a final lease-accounting standard.

5 thoughts on "Lease Accounting Standard Inches Forward"

1. Pingback: FASB and IASB Work on Resolving Lease Accounting Differences – Accounting TodayAccounting Business News UK | Accounting Business News UK
2. *Prof. Morris McInnes* says:

   03/20/14 at 6:15 pm

   I think this is one of the least-well considered initiatives of FASB in some time. What has prompted this? Investors and financial statement readers are well aware of off-balance sheet financing and the related footnotes; they don't need a complete revision of standards that have worked well enough – if the Enrons of the world are intent on deception they will find another way. We don't need a change that will wreck our time-series analyses following the companies in our investment portfolios. Only the analysts will profit from this, and attorneys as debt covenants are re-negotiated en-masse.
   Leave well enough alone!!

   Reply
3. Pingback: Weekly News Round Up: IRS Releases Data on Last year's Activities; CFOs Push for New Tech; and New COSO Paper
4.

Robert Meybohm, CPA says:

03/25/14 at 2:17 am

This proposal reminds me a bit of the thought process that was put forth to justify the change in accounting for rent expense a few years back. What could have best been explained and understood in a footnote got muddied up in some half baked new way to confuse everybody….I see the same thing happening here with leases….

Reply

5. 

   Bill Bosco says:

   03/28/14 at 3:45 pm

   The FASB is listening to the comment letters, outreach meetings and feedback while it appears the IASB is ignoring the feedback that does not agree with their position. Current GAAP for lease accounting is based on a risks and rewards analysis to arrive at the substance of a lease contract and that approach is aligned with the tax and commercial law view. Essentially there are 2 types of leases – capital leases (that transfer ownership) and operating leases (that only transfer a temporary right of use). The IASB now chooses to break that alignment asserting that all leases are the same because the lease payments are made over time. In my opinion they have not made a convincing and conceptually sound case for such a major change. The IASB's one lease model will eliminate essential information on operating leases that lenders and credit analysts have relied on to make decisions.