

Companies: New Lease Rule Means Labor Pains

As standard-setters inch toward a new lease-accounting standard, corporations push back on the added work it could create.

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Standard-setters have more than comment 150 letters to sort through before they can finish crafting a new rule for how companies account for leases, a project that has been under way for three years.

Some companies — particularly those such as airlines, retailers, and railroad companies that will be most affected — are hoping the rule-makers will take their dear, sweet time. As it is, the Financial Accounting Standards Board estimates that at the earliest, a formal rule will be in place by mid-2011, 35 years after FAS 13, the current lease accounting rule, was created. The new rule will apply to all companies that lease plants, property, and equipment.

Not surprisingly, such companies are not overly enthusiastic about the preliminary leanings of FASB and the International Accounting Standards Board toward overhauling FAS 13. The rule update could, by some predictions, move hundreds of billions of dollars in assets and obligations onto their balance sheets. Many of them are hoping they can at least convince the standard-setters that the rule doesn't have to encompass *all* leases.

Under the current rule, companies distinguish between capital lease obligations, which appear on the balance sheet, and operating leases (or rental contracts), which do not. Based on FASB's and IASB's discussion paper on the topic, released earlier this year, the new rule will likely require companies to also capitalize assets that have traditionally fallen under the "operating lease" category, making them appear more highly leveraged.

In addition, warns Ken Bentsen, president of the Equipment Leasing and Financing Association, the proposed changes could lead to higher costs for both capital and accounting. "Rather than simplifying [FAS 13], it ends up creating an extremely complex formula, which will put a great burden, particularly on smaller, nonpublic companies, and

does not achieve what we believe is the ultimate goal of FASB and IASB, which is to improve financial reporting," he told CFO.com.

Bentsen's trade association notes in a recent comment letter (the deadline for comments was last Friday) that the proposed changes will impose on smaller companies a disproportionate burden to apply the new accounting to their leases "for immaterial but required adjustments." According to ELFA, more than 90% of leases involve assets worth less than \$5 million and have terms of two to five years.

The 109-page discussion paper at least starts with what seems like a new simplified concept for lease accounting: lessees must account for their right to use a leased item as an asset and their obligation to pay future rental installments for that item as a liability.

JCPenney claims it has been in that mindset all along. "Historically, we have managed our capital structure internally as if all real estate property leases were recognized on the balance sheet," wrote Dennis Miller, controller for the retailer, adding that lease obligations are considered long-term debt and have been disclosed in financial-statement footnotes.

Dissidents to FASB's changing of lease accounting rules have all along said that rating agencies and analysts have referenced such disclosures in footnotes and made adjustments in their modeling to account for a company's leased assets.

Still, as IASB chairman David Tweedie has noted, the current rules, for example, allow airlines' balance sheets to appear as if the companies don't have airplanes. One of the quibbles with the existing standard is its bright lines, which have legally allowed companies to restructure a leasing agreement so that it be considered an operating lease and not have its assets and liabilities fall onto the balance sheet. In 2005, the Securities and Exchange Commission staff estimated that publicly traded companies are in this way able to hide \$1.25 trillion in future cash obligations.

Critics of the rule-makers' discussion paper are hoping that they'll at least replace the deleted bright lines with some new ones, such as the exclusion of short-term leases. For instance, the Small Business Administration suggested companies should be able to expense rather than capitalize lease transactions of less than \$250,000, and others said

leases that last less than one year should be expensed. However, the discussion paper notes that such scenarios could give way to workarounds.

Other common issues raised by respondents to the discussion paper: they want the standard-setters to also tackle lease accounting by lessors. The rule-makers had deferred thinking about lessors as the project continued to be delayed.

In addition, some respondents pushed back against the suggestion that they should have to reassess each lease as "any new facts and circumstances" come to light. Exxon Mobil's controller, Patrick Mulva, said such reassessments — which would require a quarterly review — would be "excessively onerous" for his company, which has more than 5,000 "significant" operating leases and thousands of "low level" leases. Mulva called on the standard-setters to be more specific for when a reassessment would be required.

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